CONDITIONS FOR ECONOMIC GROWTH

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"**People** must **come to accept private enterprise not as a necessary evil, but as an affirmative good.**"

—Eugene Black

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How can India progress most rapidly from relatively very low average standards of living to standards comparable with those achieved in, say, Western Europe and United States?

The question can be usefully put in another form. Why is it that, in spite of an ancient cultural background and in spite of powerful world forces which (it will be argued) are tending to spread to underdeveloped areas the modern technologies of industry and agriculture, with the accompanying outputs, high wages and good living conditions, the great mass of the Indian people are somehow being prevented from enjoying what the world has been offering her?

This reference to what the world has been "offering" does not relate to that assistance which, springing from altruism and enlightened self-intestest, takes the form of "foreign aid" to friendly nations. Gifts of that kind, we shall argue, are of negligible importance in relation to what foreign profit-seekers for whom no altruistic intention can be claimed, would be able to achieve for the poverty-stricken Indian masses if policies in India were *rationally* aiming at the rapid material advancement of the common people.

The speed of growth in material well-being on the part of any under-developed region depends ultimately upon the thrift of its people. For thrift is simply the net accumulation of capital.

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By "capital", we usually mean income-earning assets; but as used here the term is intended to include also what we to-day call "human capital". Capital in this form is accumulated through the improvement of the powers of the people, especially by means of education and technical training, which increase their ability to use physical assets effectively.

Because of the enormous importance of thrift, if the aim in India is to catch up, as quickly as possible, with the standards achieved in, say, the United States, their leaders ought to make one of their top priorities the creation of great respect for thrift. This they can do most effectively by gradually discarding *discriminatory* taxation[1]; and that will mean avoiding one of the worst mistakes of the western powers during the present century. It is neither to the advantage of India as a whole nor of its poor if the provident are taxed for the benefit of the thriftless, the industrious for the benefit of the lazy, the enterprising for the benefit of the complaisant or the plodder, or the competent for the benefit of the incompetent.

A case can, admittedly, be made out for death duties to limit the size of inheritances[2]. But, under economic democracy, this case rests on an important proviso. The sums acquired by inheritance taxes (or by any "progressive" element in taxation) must be constitutionally protected from squandering by the politicians. If the community's progress — through provision for the future — is not to be braked, the proceeds of death duties (or of the "progressive" element in taxation) must be *maintained intact and devofed to the production of income-yielding assets,* whether in the form of loans to private businesses, investment in equities *via* a collectively-owned investment corporation[3], or devotion to State enterprises*.

1. It is conventional to describe taxation which discriminates against the higher incomes as "progressive taxation."

2. This case may be based on the feeling that it is unjust to allow a person to enjoy the advantage of an inheritedincome in the achievement of which he can have played no part. But the wife and children of a rich man must necessarily benefit from his wealth during hislife-time. Is there, then, any compelling ethical reason why these benefits should end at his death? Or the case for death duties can be defended on the grounds that, ***properly administered,*** they may promote a larger measure of equality of opportunity.

Among the "assets" into which the proceeds of death duties or the "progressive" element in taxation *may* be legitimately invested are the people themselves. In so far as capital raised by discriminatory taxation is devoted to general and technical education which actually *does* play a part in raising the real earning powers of the peoples, the capital transferred may well be maintained intact. But a large proportion of expenditure on education will necessarily be in the nature of replacement. The developed powers of a person ultimately decline as he ages, and die with him. Hence some part of expenditure on education and training must, properly speaking, be regarded as in the nature of consumption and ideally be met out of *proportional* taxation (i.e., taxation which takes the same proportion from all incomes down to the point at which it does not pay to collect).

But increased expenditure from taxation on education may require concurrent or prior provision of additional physical assets from savings if that investment is to be fertile. And the skills of men not only need tools if they are to be productive. They require an appropriate development of communications (roads, railways, ports, etc). and trading institutions.

It is equally true that the accumulation of equiment may be wasteful unless accompanied by complementary investment in human capital.

In a stimulating recent contribution on this topic, Dr. H. D. Gideonse writes:

"If we ignore the fact that labour as a productive force derives its value from the investment of capital in the form of in-service training and formal education, it is impossible to understand comparisons of economic growth in the U.S.A. and in the U.S.S.R., or to develop an intelligent understanding of

3. The earnings of any such corporation should naturally be used to reduce the load of the proportional taxation required to pay for the services of the State.

4. Amenities like parks as well as "free" public utilities such as roads, bridges and sewers, may fallunder this heading.

5. As distinct from expenditures on "education" aimed at conditioning people's minds, so that they are amenable to control in the interests of the politically powerful.

our experience with the Marshall Plan in Western Europe when it is contrasted with the disappointing result of our billions of foreign aid in Asia or Latin America. In Western Europe the 'aid' produced increases in productivity that were more than proportional. In Korea or Indonesia there was no measurable enduring response in productivity. . . . . .

"In the European case, our 'dollars' literally 'primed the pump' — a human pump consisting of trained and educated manpower with moral or customary attitudes that were compatible with development. In the Asian or Latin American cases the absence of the corresponding — or preceding — investment in the human factor doomed the venture from the beginning.. The experience of Japan, which has shown an increase in productivity that is more than proportional to the flow of private capital assistance which it has received, is additional confirmation of the hypothesis that the rate of human investment is the crucial factor. . . .

"In the under-developed countries educational policy is more easily recognized as a apart of overall economic policy. The difficulty here is the emotional resistance to the acceptance of a rank-order of priorities that is compatible with a reasoned strategy of economic development. In the egalitarian passion for Literacy which was encouraged by some of the less fortunate activities of UNESCO, programmes for national literacy — the first six years for everyone — were sometimes encouraged at the expense of all other educational and economic development. Literacy at the sixth-year level is a not a reliable foundation for step-by-step articulation of a programme that supplies essential human skills as they are needed in the acceleration of economic development"[6].

To discern the potentialities of growth in a country like India, it is essential to appreciate that it is to the advantage of the *developed* countries that the economic progress of the *under-developed* countries shall be fostered. If there were no restraints imposed by the governments of the more advanced areas, the resources needed for the rapid economic expansion of the backward regions would flow into them far more rapidly than is happening at present. But most of the governments of the western

6. H. D. Gideonse, *College* and *University*, Summer, 1963, pp. 424-7.

world are committed to policies known as "central economic planning"; and among the aims which the "planners" nearly always pursue is that of retaining resources at home, or, as it is usually phrased, "preventing the outflow of capital". Now this discouragement of investment abroad is not to the material advantage of the people of any country which resorts to it; for resources (i.e., capital) are only sent to other countries when their prospective yield (i.e., their forecast contribution to the well-being of the nation) is higher abroad than at home. But the greater harm caused by restraint on the free international movement of capital is to the areas which, like India, are thirsting for capital. The economic and industrial progress of such countries has, indeed, been much slower than it would have been if the private owners of capital in Western Europe and United States had been allowed greater freedom to seek profits, without restraint, in those areas of the world judged to be most productive.

Why do we know that the under-developed regions could attract so much of the savings (that is, the accumulating resources) of the western world under unrestrained private enterprise? The answer is that *setting under-utilised resources to work is nearly always the most fruitful form of investment.* When there are no restrictions imposed by governments, investors will find it profitable to supply both equipment and co-operating capital; and this will enable the world's markets not only to provide more remunerative employments for the masses of the poorer countries, but to create an incentive for training the backward peoples in more productive and higher paid occupations. It is not *altruism* which will have this result. The development of virgin resources (by which is meant undeveloped or under-developed factors of production) simply happens to provide the most remunerative of investment outlets.

Moreover, there are other factors which are tending to spread secondary industrial activities over regions in which they do not as yet exist, or are as yet only beginning to emerge. The more advanced industrial countries do not themselves possess sufficient resources (labour, skill, equipment and "gifts of nature") to supply the world with machinery, machine tools generally and other products for the manufacture of which they have *"acquired* advantages" (or special natural advantages) ***and*** at the same time to manufacture secondary industrial products cheaply enough to export. During the last few decades a new division of labour has been brought into being by these circumstances, and it is currently creating a strong propensity to industrial progress in countries where there are as yet no local secondary industries.

Unfortunately, this propensity has nowhere been allowed free scope. On the contrary, it has been resisted almost everywhere. For instance, under world freedom of trade a country in India's position (like many other economically under-developed countries) would probably have experienced incomparably more rapid industrial progress than it has in fact enjoyed. For had pure profit-seeking been permitted or encouraged, both by the governments of relatively wealthy countries with capital seeking outlets, and by the governments of the poorer countries wishing to raise their Living standards, there would have been relatively little need for "aid" from other governments. Indeed, the advantage which the Indian people would have won from the new employment offered by private foreign investments would have been almost unbelievably greater than any benefits received from foreign governmental resources, or from World Bank loans.

Under existing circumstances, of course, foreign aid is not without material importance. But if international freedom for investment had existed, and the free market system had existed internally, the significance of "aid" would have rested firstly in the gesture of goodwill which it has expressed, and secondly in the possibility of its being utilised *educatively*, the sums advanced being maintained intact as "capital" (in which, of course, we must include "human capital"). Thus, if the immediate aim had been to provide Indian businessmen *with loans* to develop their enterprises, or directly with risk-capital (through some form of investment corporation), the fruits would have been cumulative and the whole population would have shared in the results.

If there is one country in the world for which this could have been confidently predicted, it is India, which has a well established commercial class and an ancient trading tradition. In the writer's judgement, the aspect of industrial progress which is most important during the formative stage of any industrial revolution is the marketing — the buying and selling — aspect. Business (including industry) consists largely of continuously predicting changes in consumer demand for particular products and changes in the availability of means of production, together with action in response to such predictions. The response takes the form of business planning and budgeting. Through rational foresight of this kind, diverse capital resources are committed to specific uses for varying periods. The costs of particular "inputs" are incurred in anticipation of prospective prices of the corresponding "outputs". In a more enlightened world, "foreign aid" would have been primarily devoted to training business men in the art of managing this process simply by financing *private* business. That this has not been done has been due, firstly, to the governments responsible for "aid" not having understood the issues I have just been discussing; and secondly to the political aims which have motivated it.

Because the Western governments have wanted to discourage the countries assisted from becoming "communist", they have financed foreign governments rather than peoples. But governments are, after all, merely small groups of private persons ; and they are all too apt to squander foreign aid, as well as their own people's savings, in striving to maintain themselves in office. This does not imply that, given the existing political situation in the world, this political aim of the donors of aid has not been legitimate', or that it has not had some of its intended effects. But direct aid to private Indian profit-seekers would have meant far more to the impoverished masses in India. It would have raised the employment opportunities at their disposal, released incentives for the improvement of their powers, and silenced the cynical allegation that the supposed generosity of foreign aid has merely been bribery of governments.

It has already been suggested, however, that capital advanced in the form of gifts from friendly governments could never have been nearly as fruitful as capital advanced in the form of purely private investment under normal business incentives*

7. The urgency of the situation created by an apparent threat from the militaristic, totalitarian imperialisms of Russia and China, bent upon world domination, seems to have made it expedient for peace-loving and freedom-loving powers, like the United States and the western powers generally, to seek the favour of the governments of the backward areas rather than directly to assist the inarticulate and untutored people of those areas.

It is now further suggested that the development potentialities of India would soon become a magnet to that part of the world's savings which is not being withheld by restraint on the export of capital, *firstly* if the Indian Government declared itself to be committed to economic democracy (i.e. private enteprise in business), and *secondly* if constitutional guarantees were somehow created to ensure that private foreign capital investments would be safe from confiscation by future governments (whether through nationalisation, taxation or other subterfuges). In the writer's judgement, fear of spoliatation *via* the State is currently creating the most formidable *internal & imposed* barrier to a rapid transition to industrial modernity and the high living standards associated with it, not only in India, but in most other under-developed communities.

But what of the fear that, the progress of these regions having been financed by aliens, we should ultimately find foreign ownership — with foreign control — of the greater part of the industrial assets of the countries financed? The answer is that a progressive economy would soon have its own savings to invest. Substantial investment from overseas is necessary in order to set going what has been recently called the process of "self-sustaining growth"; but subsequently, according to the extent to which thrift can be stimulated, a country such as India will be able to provide for itself a gradually rising proportion of the capital needed for its continued expansion.

During the transition to self-sustaining growth, direction from abroad represents the reasonable resolve of overseas investors, who are hastening the transition, to ensure the conservation and efficient use of their hard-won savings. Moreover as we have seen, "foreign control" may provide expertness in risk-taking, management and technical competence. Indeed, its presence may be expected to exercise a powerful educative effect. Whilst college courses in management can communicate recorded experience of business forecasting, budgeting and administration, and provide formal training in the relevant technical skills, real expertness in the decision-making of commerce and industry can be learnt only in action. What sentimentalists, or politicians appealing to sheer prejudice, may describe as "foreign domination" of industry can be the channel through which the most valuable capital of all can be transferred (from, say, American, British and German managements to Indian

managements), namely, proficiency in prediction and the direction of business effort. There is not the slightest doubt in the writer's mind that Indians have *innate* talent for the development of managerial ingenuity[8]. Their best opportunity of developing that talent may well be *via* co-operation with managements responsible to foreign investors. An attempt to learn it independently, through bitter experience (with some help from books and lectures), can certainly succeed; but will it not command success much more slowly?

One of the chief obstacles to the speedier modernisation of the industrial and commercial system of India is believed by some authorities to have been the absence there of an influence, sometimes called "the Christian ethic", which prevailed during the revolutionary growth in industrial output and trade in the western world during the eighteenth and nineteenth centuries.[9] There are sociologists who hold that this phenomenon was ultimately attributable to attitudes toward thrift, interest, profits and amibition which grew out of the Protestant reformation — particularly among the Puritans. The moral approach of Protestants and Puritans towards trade and thrift has been somewhat misrepresented by certain historians and sociologists[10]. But it is true that the religious convictions of the Protestants tended to justify the normally altruistic virtue of thrift[11], and did not frown on the incentive to excel and win respect — the personal ambition which promotes self-improvement and diligence.

8. Indians in the Republic of South Africa have succeeded remarkably in the trading field, against the obstacles of governmental-imposed discriminations and powerful prejudice.

9. The industrial and commercial revolutions effected under *laissez-faire* capitalism brought not only rapidly improving health and living standards (better food, clothing and shelter) but greater scope for leisure, the elimination of the child labour which had characterised the pie-capitalistic age, and greater economic equality. These proud achivements were secured in spite of restraints from misconceived legislation and labour unions seeking sectional benefits. See Hayek (Ed), *Capitalism and the Historians.*

10. The historians and sociologists in question are, on the whole those who have been actively allied to the political parties of the Left. A dispassionate and scholarly treatment of the issue is H. M. Robertson's *Aspects of the Rise of Economic Individualism.*

11. Thrift is normally altruistic because the saver wishes to protect himself from becoming a burden on others in old age, or in the event of some unforeseen misfortune, and to provide for those near and dear to him — his family and successors. It is politicians appealing to mass envy and cupidity who have tended to represent thrift as mere greed or acquisitiveness.

Nevertheless, in the present writer's view, doctrinal teachings tend more often to support and propagate the morals of any era than inspire those morals; and the religious traditions of countries like India (however different from those of the West) need form no *lasting* obstacle to the development of a system which rewrads persons whose providence, initiative and wisdom succeed in raising the material standards and broadening the economic life of the people.

Profit reward (in so far as it is truly profit[12]) is always small in relation to the social benefit for which it is the recompense. And rigorously envisaged, "profit" is merely a realised yield in excess of the rate of interest upon the value of replaced or accumulated assets, just as "loss" is a realised yield which falls short of the interest return. In seeking to avoid losses (and this is the same thing as seeking profits) to the investors on whose behalf they act, business managements are responding to production objectives set by the people as consumers; for consumers have the power to buy or refuse to buy any product offered. The form of replacement of inventories consumed and equipment worn out (or otherwise depreciated) or of their net accumulation is determined, under the free market system, by society's democratically expressed preferences.

The rate of material progress of any under-developed area is likely to be closely related to the degree of economic democracy achieved. By "economic democracy" is meant *the vesting in the people, in their consumer role, of ultimate power to command and control the productive process.* Through the consumers' expression of their wishes in the market (in buying or refraining from buying), the possessors of skills and the owners of physical resources are disciplined, not by a few strong and privileged persons or groups (as under "central economic planning") but by the whole community. And the consumers' discipline is then exercised with the greatest direct force upon the business managers who most commonly — in the modern world of free enterprise — administer limited liability corporations. The

12. If the free market is overruled through collusive action to fix prices or wage-rates (or to limit particular outputs), the remuneration (in dividends or wages) of certain sections of the community may be raised. But the increase of dividends, or wages achieved for the benefit of such privileged sections is enjoyed at the expense of other recipients of wages and dividends. The share of "profits" in aggregate income is not increased thereby.

managers act as intermediaries, entering into contracts with investors (as risk-takers) on the one hand and the suppliers of effort or skill ("labour") on the other.

The profits with which consumers remunerate wise prediction and action in business accrue, almost universally, to shareholders — those investors who are prepared to bear the risks of the managers making wise or unwise, lucky or unlucky decisions on their behalf. Investors contract to accept such risks when they acquire what are known as "equities" or "ordinary shares". There are social advantages in this sort of arrangement. *The suppliers of capital* cannot themselves have the detailed market and technical knowledge to make the necessary decisions with success, yet it is appropriate that they should bear the risk, thereby earning risk-remuneration (profit) as well as interest; for individual managers can seldom possess sufficient capital to justify their shouldering the essential risk-bearing function. Moreover, it is difficult, although by no means impossible, for "labour" — *the suppliers of effort and skill* — to bear the risk by paying interest to the providers of capital and sharing profits, in addition to wages, as their remuneration[13].

It is important to perceive the democratic nature of the authority which business managers — ultimately subject to consumers' will — must wield on behalf of the risk-takers to whom they are legally responsible; for backward communities may be expected to advance in proportion to the extent to which the reasons for the responsibilities of the managers — in commanding and directing the productive process — are understood and respected. The orders of "employers", as it is usual to describe the managements of companies[14], are democratic because, as we have seen, those orders are, properly observed, the interpreted dictates of the whole people in their consumer role.

Economic democracy is most likely to be achieved under political democracy. By political democracy is meant a society in which the rulers are elected, but accorded strictly defined, limited rights to make and administer laws. In every *true* de-

13. Or sharing losses as a deduction from wages.

14. The term "employers," as usually used, is extremely misleading. The true "employers" are the consumers. Corporations, administered by managers, are the employees most directly subject to the discipline of the market.

mocracy, it is not only possible to change rulers without force, but to subject them to enforce enforceable "rules for making rules". In a perfectly democratic society, a rigid constitution would strictly restrain the powers of the small groups of private persons who form successive governments. Thus, if political democracy has really been won, majorities will have no right to enrich themselves (through the governments which they have elected) at the expense of minorities,[15] or to discriminate in other ways, for instance on grounds of race, colour, creed, caste or social class.

There is, in fact, no such *perfectly* democratic governmental system in existence anywhere. But independently enforced constitutions, like that of the United States, provide examples of the machinery through which true democracy would be obtainable if societies ever did wish to free themselves from State tutelage and vest sovereignty in the people. British democracy evolved on a foundation of strong traditions or "conventions" which limited the powers of the legislature and the executive. But political philosophers have now perceived that the constitutional effectiveness of those "conventions" has been quite inadequate against the forces of acquisitiveness and envy.

The virtues of democracy are, indeed, derived less from the franchise (the right of citizens to qualify, by educational achievement or other proof of competency, for the responsible duty of choosing legislators) than from independently enforced constitutional entrenchments which limit governmental power by invalidating discriminatory laws. Such constitutional entrenchments do not stand in the way of the assumption by the State of any truly co-ordinative functions. The difference between liberal[16] and totalitarian planning by the State is that, in

15. When political power happens to be the monopoly of a minority the right of the minority to discriminate against the majority is, of course equally indefensible.

16. The term "liberal" is here used in its old, traditional meaning. But by reason of the many virtues which liberalism (in the sense of economic democracy, as I have described it) has manifestly brought the world, the totalitarians have found it expedient to appropriate the term. To such an extent has this tactic succeeded that, in the U.S.A. today, the word "liberal" has almost come to mean a mildly totalitarian-minded reformer. The so-called "liberals" hope to preserve the benefits which true liberalism has won whilst allowing the State the right to suppress the freedom of consumer preference and entrepreneurial judgement which has been the source of these benefits.

the former, *firstly*, the democratic rights of the people as consumers (expressed through the market) are regarded as sacrosanct; and *secondly*, that no power to discriminate is conferred. But under totalitarian planning (as is found under what Mises has termed "omnipotent government"), not only is the market expression of consumers' preference overruled but the government (a small group of private people, we must always remember), through its officials, claims the right to discriminate in favour of one industry against another, or one district against another, one firm or person against another, and one class, caste, or race against another.

Most countries of which the industrial development is only just beginning assume that tariff protection of young industries is essential for their emergence or survival. There is an element of validity in this assumption; for foreign suppliers of goods which compete with domestic industries that are in process of establishing themselves may try to kill the infant industry at birth by price-cutting in that region alone. But legitimate protection in this case should do no more than prevent the price of the local product from being forced below, say, nine-tenths of the previously ruling price. This is because the justification for establishing any local industry is that, by reason of cheaper labour — or other relatively under-developed resources — it is possible to produce the protected commodity substantially cheaper than the foreigner can, given his high costs of transport, insurance, interest and marketing. If you can establish a new industry at home only by raising the price which your people have to pay for its product, by doing so you will be holding back your country's development, not fostering it.

What misleads so many people is the fact that it is often possible to create prosperity for any industry, considered in isolation, by means of a tariff which excludes or restrains competing imports. But in each case all other, non-competing industries are burdened; for when people have to pay more for one commodity they have less income left with which to demand other commodities.

Even in developed countries, the overwhelming majority of industrialists believe that the emergence of industrial activity, as well as its survival, depends upon protective tariffs. But the arguments by means of which, in the 18th century, Adam Smith exposed the fallacies in such ideas have never been refuted. No economist denies that import tariffs can benefit the people of a country if they enable them to exploit some monopolistic power which they happen to possess (either as sellers or as buyers). The use of such powers can *certainly improve what we* call the "*term of* trade" of a country; but this simply means obtaining a given volume of imports with a smaller volume of exports; and as no tariff protection programme has ever been designed to increase the volume of imports in relation to the volume of exports, the theoretically conceivable gain (through the exploitation of foreign suppliers or purchasers) is hardly likely to be realised in practice.[17]

An illustration from the United States may be helpful. Over the last four decades, the southern states have been enjoying a phenomenal industrial progress. Now if these states had happened to possess sovereign independence, they would almost certainly have been forced to protect their "infant industries" against competition from the highly developed industries in the North. Under protection, because the forces tending to spread industry are extremely powerful, the southern states would still have developed some industries; indeed, they would have been very proud of them; and they would have been convinced that they were the result of tariff protection. But because the American Constitution has denied these states unqualified political freedom, by forbidding the erection of import tariffs, their industries have grown and have diversified at a rate which has sledom, if ever, been surpassed anywhere.[18]

The case of South Africa, which has also experienced remarkable industrial progress over the last four decades, provides another illustration. In spite of protective tariffs which have slowed down the development tempo, rapidly increasing utilisation of Coloured[19], Indian and African labour in factory employments has engendered an industrial boom.[20] Yet the writer has for many years told his students that every time he sees a factory in South Africa, he seems to see next to it a "ghost factory", that is, a factory which would have been there had not industrial growth been burdened by tariff protection.

It is sometimes argued that industry can be stimulated at the expense of agriculture. But although industrial protection undoubtedly does impose a burden on farming activity, in the long run it does not imply a redistribution of national income in favour of those engaged in industry and against those engaged in farming. It reduces all incomes, more or less in the same proportion.

Not only is it impossible to stimulate industry by any transfer of income from farmers to industrial investors, but a vigorous development of factory production nearly always requires a parallel development of agriculture. There is a certain complementarity in economic progress under which the growth of output in one sector creates demand for the growing output of another sector. It seems that what is wanted in India is a process which has been called "the industrialisation of agriculture" (i.e., its gradual mechanisation,), accompanied by concurrent investment in modern methods of factory production.

But the technological improvement of agriculture is *likely* to mean that many small farmers will find that they can earn more as skilled farm workers than as small farm owners. One can well understand the feelings of those who would resist the sociological changes which such a revolution in agricultural methods and land tenure would cause. But if the Indian community are to be better fed (as well as better clothed, better housed, and better supplied with secondary industrial products), large-scale farms must supersede smallholders. On the other hand, Indians as a whole may wish to give a high priority to the preservation of peasant farming. If so, they

17. The theoretical case for the use of import and export tariffs and trade restrictions to improve the terms of trade of under-developed countries is, however, strengthened when similar controls are imposed by the governments of developed countries, or when cartels tolerated by those countries are in a position to reduce the prices of their purchases below the free market value. Defensive restraints succeed when they force the removal of restraints in markets served.

18. In order to slow down the rapid advance of the Negro South, in response to the wishes of the politically powerful labour union movement, it was necessary to enact minimum wage legislation to prevent the Negroes from under-cutting their initial inferiority in respect of background and industrial skill. But even so, the enforced free trade permitted the Southern states to advance at a remarkable pace.

19. The term "Coloured" in South Africa refers to half-castes.

20. See the present writer's **Economics** of *the Colour Bar,* (Institute of Economic Affairs, London, 1964).

must be prepared to sacrifice the possibility of a rapid development tempo in both agriculture and industry.

Although wise leadership by the State is essential for the progress of under-developed areas to economic maturity, there is always the danger that spectacular, grandiose schemes will be given priority ; for governments are, we know, tempted to choose projects for which they can claim early credit and prestige. Whereas private investors have obvious motives for avoiding any squandering of their capital, and equally strong motives for careful prediction and risk-taking, the people who form governments are actuated by quite different motives. They do not personally bear the losses nor reap the rewards, as do private investors. That is partly the reason why certain critics believe that the large sums invested in the Indian steel industry have not represented the most productive use to which the savings of the Indian people could have been put, at the present stage of their economic development.[21] There is a certain time sequence in successfully programmed growth — a sequence normally secured through the simple operation of the loss-avoidance, profit-seeking incentives.

It is futile, for instance, to direct the people's savings into heavy industry before the secondary industrial activities it can serve are emerging, the transport and communications system (roads, railways, harbours etc.) is being developed, marketing machinery is evolving, and the appropriate education and training of labour is proceeding.[22]

There is another way in which India may foster its industrial development, and that is by avoiding the blunders of the " developed countries " in the matter of labour's remuneration.

21. These remarks are not inspired by any dogmatic, doctrinaire objection to State enterprise. For instance, in South Africa, the establishment in 1928, by State initiative, of ISCOR, a great steel corporation, appears to have been the result of wise foresight and sound planning. It has proved most successful and an important step in the country's industrialisation.

22. The need for large-scale cultivation and mechanisation in agriculture to accompany industrialisation, the need for the provision of physical assets to accompany increased investment in education, and the need for the development of communications and trading institutions to accompany both—all three needs illustrate the importance of an appropriate time sequence, with priorities carefully determined in the light of prospective yields.

In the western world, the course of politics has encouraged State action, or permitted private coercive action, continuously to reduce the flow of wages and other income. To understand this problem we must never forget that wages are paid by the consumers of the product, and neither by the owners of the businesses which employ labour nor by the managements of those businesses. Every increase in wage-rates which is enforced by privately-exercised coercive power (as through strikes) or by the State (in order to get the support of particular groups of voters) leads to the community having to pay more for the product. There are some exceptions to this principle but they are of negligible importance. The effect of such price increases is always " regressive," by which we mean that they tend to burden the poorer consumer relatively more than the well-to-do. Hence, in a society which wishes as rapidly as possible to raise its standards of living, and especially those of its poorest classes, wage-rates should be determined by free market forces. The flow of income and wages will then be maximised and its distribution rendered as equitable as possible.

The functions of labour unions should, in an equalitarian and economically democratic society, be confined (a) to preventing the " exploitation " of their members by firms which might rely upon ignorance about what the labour market is offering, or (b) to breaking down agreements to remunerate any group of workers by wage-rates which are less than the true free market value of the labour. In case (a) labour unions could search out better paid opportunities for members whom they felt were being under-paid through their unawareness of these opportunities ; and in case (b), they could bring Court actions for the dissolution of combinations designed to force wage-rates below their competitive level. But the right to strike means the right to use coerceive power for private aims ; and when the countries of the western world tolerate private coercion (whether in the form of strikes, boycotts or otherwise) they are submitting to a regime of right is might. Their ability to use and develop their physical resources and the powers of their people for the common good is obviously reduced thereby.

The great economic advantage which communist countries have in comparison with those of the West is that they do not permit strikes. This virtue of the totalitarian communities has naturally to be set against (i) their marked inferiority in the realm of management, (ii) the extraordinary clumsiness of their market machinery, and (*iii*) the absence of freedom of thought' and expression under their system. But the peoples of the free world could have outstripped the communists in **every** direction if they had followed the Russian example in just this one respect, namely, denying the right of private coercion. If, say, the United States had, in this way, protected their working classes from the labour union activities which have all along been growing stronger, and forcing the flow of wages and income well below what it could otherwise have been (as well as destroying the *security* of distributive justice), not only would the prosperity and material standards of Americans have been even more impressive than at present, but those benefits would have been shared much more justly with the Negroes in all parts of the country.

Some of the most serious weaknesses of the western powers' contemporary economic policies are to be found in the sphere of money, and unfortunately these weaknesses have been copied by the governments of under-developed countries. Inflation, either in the sense of the depreciation of a nation's currency unit in terms of currencies in general, or in the sense of its depreciation in terms of purchasing power, is proof of monetary inefficiency; for (to simplify the issue for expositional purposes), the purchasing power of the money unit is wholly a matter of discretion, determined chiefly by the relation between the volume of bank deposits plus currency in circulation (which volume can easily be controlled by treasuries and central banks) on the one hand and the flow of output on the other hand.

It is true that, if the performance of the State's role in the economic system is defective—prices and wage-rates coming to be fixed beyond the reach of the people's income, or out of harmony with their expectations so that unemployment emerges—inflation can serve as a crude way of bringing the economy into better co-ordination. But it has a debilitating effect, through penalising those who have been innocent of the pricing activities which have disco-ordinated the economy and encouraging those who have been responsible. Governments do not "fight inflation," as they universally claim. They engineer it, however reluctantly, because it is often the politically

easiest way out of their difficulties. And inflation will continue until electorates become sufficiently well-informed to throw out governments which resort to the debasement of their money.

Admittedly, the political difficulties of non-inflationary policies are real, and it would be too much to expect that an under-developed country should refuse to follow the depreciation of, say, the American dollar, which is to-day the tacitly accepted monetary standard of the world. Nevertheless, a community such as India ought to realise that a continuously rising cost of living is a phenomenon which strong, wise and truly democratic governments could prevent; and they should reject the currently fashionable argument that "moderate inflation" is a tolerable method of boosting a flagging economy. That argument becomes plausible only when governments are failing in their duty to protect society from collusively or politically motivated sectionalist actions which are disco-ordinating the economic system.

Not least of the evils for which inflationary policy must bear the blame is that, in attempts to prevent costs from increasing ahead of and in anticipation of price increases, resort to a proliferation of "controls" becomes unavoidable. The people's right to protect their interests through the free market is withdrawn, and a socially neutral market is replaced by the arbitrary decisions of officials. "Controllers" allocate foreign exchange, import permits and licences; and they dictate prices, rents and outputs. Now when officials thus acquire the power to create or destroy private fortunes, an inevitable inducement to bribery with a consequent weakening of business morale must follow. The fear or fact of public corruption can, indeed, provoke a malignant debilitation of the business incentives which can build up a healthy, expanding economy.

Mention has been postponed of one matter of overriding importance which, the author feels, may already be sufficiently understood by Indian leaders. The most successful achievements of economic policy can remain unrecognised if expanding real income is balanced, or more than balanced, by population growth. To win more satisfactory living standards demands not merely the accumulation of income-producing assets and the better utilisation of those assets: it requires that the number of mouths to feed and the number of bodies to clothe and house must decline, remain stationary, or increase less than proportionally to growing outputs. It is necessary to make this rather obvious point for the sake of completeness of exposition.

To sum up, the achivement in India of a rapid development tempo will, in the author's opinion, depend upon the success with which (i) thrift can be encouraged by a taxation system which does not discriminate against the provident; (ii) the foreign capital needed can be attracted by the creation of faith that nationalisation or confiscatory taxation will be avoided and by official acknowledgement of the reasonableness of foreign control of foreign capital accepted; *(iii)* enterprise generally can be fostered by explicit official recognition of profit as the reward for wise and responsible direction of productive activity; (iv) a climate of economic justice can be created through constitutional entrenchments whereby legislation or private agreements which discriminate on grounds of race, caste or income will be unconstitutional and void; (v) the temptation to distort the form of development by tariff or quota restraints on imports can be overcome; (vi) the mechanisation of agriculture can be hastened, so that the economies of large-scale cultivation can be won side by side with industrialisation ; (vii) the political incentive to invest public capital in spectacular, grandiose schemes can be resisted and an appropriate time sequence in development permitted; (viii) the determination of prices, wage-rates and outputs by private coercion (as through strikes or boycotts) can be forbidden; *(ix)* inflationary policy can be renounced, a major incentive to corruption (which accompanies the repressed form of inflation) being thereby eliminated; and *(x)* unbridled population growth can be prevented.

"Free Enterprise was born with man and shall survive as long as man survives."

— A. D. Shroff

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