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MARKETS MANDARINS AND MATHEMATICIANS

by

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Abstract

This paper presents arguments against the intellectual imperialism of both the axiomatic, positivist Arrow-Debreu paradigm of the mathematicians as well as the libertarian a prioristic paradigm of the neo-Austrians about the relative role that markets and mandarins should play in fostering development. It also examines the arguments against the market of the "moral imperialists" as well as the assertion that supporting markets versus mandarins is "ideological". It emphasizes the importance for development policy of the neo-Austrian insights about the market process which are based on the recognition of the importance of incentives and irreducible uncertainty (as distinguished from risk) and ignorance. It concludes that (a) despite divergent visions the two "schools" lead to practical judgments similar to the relative efficacy of markets and mandarins in organizing the economy; (b) both traditions despite divergent attempts at explaining the market process would recognize the need for some collective action; and (c) that the denigration of "political economy" by mathematical economists is misconceived.
Markets, Mandarins and Mathematicians

by

Deepak Lal

I.

I would like to begin on a personal note, in part to expiate past sins of omission rather than commission, partly as this will also allow me to illustrate a major theme of this paper.

Though I began the study of economics in Oxford in 1960, to my shame the sole work of Peter Bauer's that I had read till fairly recently was his 1961 book on Indian Economic Policy and Development. Leafing through my copy to prepare this paper I found the margins covered with exclamation marks and "see Little". The latter reference is of course to Ian Little's review of Bauer's book in the Economic Journal, 1961. Its opening salvo gives a fair idea of its central thrust:

"One would like to discuss this book as the obvious outpouring of a political adolescent with an economic idee fixe. But it is meant for laymen who do not know India. They might be misled by the arguments of a professor whose chair has special reference to economic development and underdeveloped countries" (Little (1961) p. 835).

Not wishing to be misled and impressed by the intellectual authority of our leading mentor, Bauer's work was written off by my contemporaries as that of an economic illiterate and a political adolescent! But when I reread the book, Little's review, and his own subsequent survey of the current status of the economics of development (Little (1982)), it was apparent that Little
(1982) would no longer seem to subscribe to the views espoused in Little (1961). 1/

Clearly, Little (along with many of us) who found Bauer's views illiterate in the 1960's would now accept that particularly on issues concerning the role of markets in development, Bauer's 1961 book and other writings on the Third World, were prescient. Yet, professional development economists are still reluctant to give him his due. There is only one reference to Bauer - in a footnote (on p. 35) - in Little's 1982 book. 2/

Whilst Michael Lipton (1984) in his comments on Bauer's World Bank Pioneers lecture 3/, provides a very perceptive appreciation of his work, T.N. Srinivasan (1984) in his comments on the same lecture is clearly very uncomfortable being seen in Bauer's company. The reasons he gives for his discomfort are highly revealing. They suggest why the type of arguments deployed by Bauer in support of the market mechanism have not been found persuasive by many professional economists. 4/

Srinivasan writes:

"While I agree with Lord Bauer that a much greater reliance on markets is called for in many developing countries, I find in his writings more polemics and debating points than depth. A far deeper analysis of the role of markets and development can be found in the few pages of Kenneth Arrow's presidential address to the American Economic Association" (p. 59).

He then goes on to cite the well-known reasons within the Arrow-Debreu framework for market failure, and commends:

"current research (which) involves investigations into the role of alternative institutional and contractual arrangements that exist in the absence of a complete set of insurance and future markets ... A fuller understanding of their systemic role in concrete socio-political-economic contexts is essential in devising developmental policies. In the absence of such understanding, a discussion of the
place of markets, or, for that matter, central planning cannot go very much beyond assigning totemic value to either. Further, since governments, just as markets, can be and often are imperfect, and are subject to lobbying, interventions to correct market imperfections that are optimal in theory may turn out to be worse than no interventions at all (p. 55 emphasis added).

This last passage provides the reasons which make Srinivasan (and me) suspicious of the presumption for dirigisme commonly adduced within the Arrow-Debreu framework. This indirect, and as some would say (see Barry (1985)) 'limp justification' for the market, is based both on the logic of second best welfare economics (refined in the 60's) within the Arrow-Debreu tradition as well as from observations of the actual effects of government interventions in many developing countries (reviewed in Little (1982); Lal (1983)). Thus though Srinivasan would from his sophisticated Arrow-Debreu perspective reach many of the same practical conclusions as Bauer on most policy related issues concerning government intervention, he is deeply suspicious of Bauer's style of argument - "fulminating against government intervention" (p. 55) - because it is not couched in the Arrow-Debreu language. It is differences in rhetoric (in McCloskey (1983)'s sense) rather than divergent assessments of the need for government intervention in specific cases in developing countries which set them apart.

The dominance of the rhetoric of the mathematicians - particularly their protectionist demarcation of what is to count as rigorous theory - explains Bauer's failure to persuade mainstream professional economists in the 50's and 60's, when the mathematicians still hoped to provide mandarins with the tools to improve on markets. But even with Bauer's views on the relative efficacy of markets and mandarins, drawn from a different and older rhetorical (but by no means atheoretical) tradition in economics, being vindicated by the
development experience of the 70's and 80's there is still much discomfort amongst mainstream economists in accepting this cuckoo in their nest! This however, as McCloskey (1983) has cogently argued, is a sign of the impoverishment of the rhetoric of mainstream economics, based as it is on an epistemologically unsound positivist view of economics as a science. By contrast, the popularity of Bauer's work amongst laymen, - much to the fury of the technicians - is partly based on his appeal to an older classical tradition of political economy, whose modern day representatives can broadly be classified as neo-Austrian. 5/

The two Weltanschaungs lead to different visions of the market process and how its social efficacy is to be judged. These visions are not mutually exclusive though over-concentration on one at the expense of the other does lead to different degrees of support for the market. One person's ideology becomes another person's vision.

The resulting incivility of economic conversations, causes confusion in the lay public's mind of economists support for the market. Thus, in this paper, I want to argue against the intellectual imperialism of both the axiomatic, positivist, Arrow-Debreu paradigm of the mathematicians, as well as the 'libertarian' a 'prioristic paradigm of the neo-Austrians. For in ongoing debates on public policy the former directly (as we shall see) and the other indirectly (through the sort of religious resistance it evokes amongst unconverted positivists), provide intellectual or emotional support for mandarins and what I have elsewhere termed the Dirigiste Dogma (Lal (1983)). 6/ Finally, I shall also deal (albeit briefly) with the arguments advanced, by those I call the 'moral imperialists', against the market.
II.

Even though mathematicians can find an antidote within their chosen rhetoric for the prima facie dirigiste implications of the Arrow-Debreu framework, with considerations of bureaucratic failure offsetting those of market failure in any real world, and hence necessarily imperfect economy and polity, there are some who are still bewitched by the seeming plausibility of letting mandarins loose (albeit guided by technical experts) in an imperfect economy. They have lent indirect intellectual support to the natural dirigisme of mandarins and the modern day lay public in their addiction to what David Henderson (1985) has so aptly labelled "do-it-yourself economics".

As examples I would like to consider the writings of three ex-colleagues of Bauer at the London School of Economics, economic theorists of the highest distinction for whom I have the greatest respect - Professors Dasgupta, Hahn, and Sen. In their writings on 'the market' (Sen (1983); Hahn (1984); Dasgupta (1980)) all three follow the Arrow-Debreu vision of the market process, and assert that the justification for the market is provided by the two so-called Fundamental Theorems of Welfare economics that can be derived within this framework. I do not need to go into the stringent conditions (which being co-terminus with those for perfect competition require "complete markets" for all goods indexed by physical and locational characteristics, and by temporal states of nature) necessary for the existence of such an ideal state. However, all three of our distinguished theorists, explicitly or implicitly argue that the case for the market depends upon asserting that the conditions in any real world economy correspond to those required for perfect competition. It is child's play to show the implausibility of the reality of the completeness of markets, and thence of
perfect competition. "Hence, economies which significantly depart from perfect competition — that is in general, actual economies — would be candidates for the deployment of a visible hand" (Hahn (1984), p. 118). Considerations based on the ethically preferred distribution of endowments and incomes, as well as the existence of public goods and externalities are then adumbrated at length to create the impression that 'market failure' is ubiquitous (as it surely is) and that its correction requires massive government intervention (which is arguable). Only at the end and almost in passing is there any mention of the antidote to dirigisme to be derived within this framework. 2/ For as Hicks (1985) has rightly noted:

"When the economist has got his 'welfare' rules and has established (if he can) that, existing organisation does not satisfy them, he has still not finished his job. For he has no right to criticise the existing organisation simply on account of what, he has so far shown. For anything that is yet apparent it may be that there is no practicable organisation which will satisfy wants any 'better', which will approach the optimum any more nearly. In order to have a basis for criticism it has to be shown that there is a practicable alternative organisation which can be expected to do this" (p.6).

Dasgupta (1980) does attempt to do this. He rightly notes:

"The operational appeal of the Fundamental Theorem of Welfare Economics is of course minimal. The informational requirements for the state are awesome. It is required to know the preferences, endowments and the (personalised) production set of all individuals. These observations alone suggest that individual rights to certain private decisions may not only be a moral imperative, but may at once be a necessity prompted by the fact that the state possesses incomplete information". (p. 112).

He then summarizes the recent mathematical economics literature on 'incentive compatibility' and the problems this raises (as pointed out by Hayek and Mises at the start of the "planning debate" in the 1930's) 10/ for a command economy run by mandarins. In this framework the only feasible incentive-compatible resource allocation mechanism is not a command economy,
but one which achieves a full optimum by working through the price mechanism supplemented by optimal taxes-subsidies.\footnote{11}

But the implementation of 'optimal taxes' raises a whole host of questions about the character of the mandarins required for their design and administration. To achieve the desired outcomes, these mandarins would have to be 'economic eunuchs' (in Buchanan's apt phrase). Dasgupta to his great credit recognises this when he writes:

"It has been an abiding shortcoming of applied welfare economics that it has for the overwhelming part supposed a perfect government - one that faithfully goes about its tasks. But if one addresses oneself to the question of what incentives there must be to ensure that governments undertake their tasks faithfully one is, at a minimum faced with the principal-agent problem with all its attendant difficulties" (p.119).

Quite. In a footnote he cites Buchanan and Hayek's work as very important exceptions. But he does not follow this lead to examine the thinking on 'constitutional economics' that the Virginia 'public choice' school has pioneered and which is the next natural stage of the argument. Instead he discusses the complementary viewpoint of Hayek on social organization and his neo-Austrian justification for a market order. But ends up by dismissing Hayek's system of thought:

"Such an anti-rational view, disagreeable though it may be to many, is still not the most disturbing feature of Professor Hayek's philosophy. Ultimately, it seems to me, what is most disturbing is the degree of authoritarianism that he would appear he be willing to tolerate for the sake of his conception of progress". (Dasgupta (1980) p. 118).

A similarly jaundiced view of Hayek's defense of a spontaneous market order is taken by Sen. This is not the occasion to discuss these common misunderstandings of Hayek which as John Gray (1984) has recently shown are based on a lack of understanding of Hayek's epistemology. Instead I want to
argue that they illustrate the difficulty faced by even the most sophisticated mathematical economists in comprehending this alternative vision of markets.

III.

The neo-classical recognition of the importance of imperfect information and pervasive uncertainty in economic life has been accompanied by the realisation that general equilibrium theory with its Walrasian auctioneer only considers "situations in which the invisible hand has already accomplished its task" (Hahn (1984) p. 125). Echoing the Austrians, the market process is seen as a disequilibrium system moving towards the notional Walrasian equilibrium through a sequence of temporary equilibria. At each moment in time, economic agents are Bayesian econometricians updating their probabilistic forecasts of future prices on the basis of currently observed values of the relevant variables.

However, this is a vision of the market process as a mechanical system moving through an environment of Knightian risk. It takes no account of the irreducible Knightian uncertainty - or ignorance - in economic life, which is an essential ingredient of the Austrian view - and it should be said, Keynes. As Littlechild (1986) has observed: 12/ "The crucial feature of the neo-classical approach is that the form that the future can take is known in advance... The neo-classical agent lives in a world of Knightian risk". By contrast in the Austrian view as represented by Kirzner (1973):

"the agent maybe characterized as knowing some things and not knowing others. The problem is not uncertainty (or risk) but ignorance. Over time, however, the agent discovers things of which he or she was previously unaware. The Austrian model differs from the neo-classical model with point estimates in two respects.
First, the revision of forecasts is not merely an updating in the light of experience - it may take place autonomously, as when, for example, the agent discovers a hitherto unsuspected source of supply. Second, this new opportunity is not necessarily a better value for a known variable - it may be a completely new variable. For example, a consumer may discover honey for the first time. Risk (and uncertainty) are not the essence of the Austrian approach (a la Kirzner). Tomorrow is a vector of which the agent knows some components but not others; he or she knows there will be other components, but not what they will be; consequently, the agent cannot form a probability judgment as to the likelihood of their occurring" (Littlechild (1986) p. 29).

The entrepreneur who is at the centre of Kirzner's Austrian theory is the agent who moves the real "disequilibrium" world through arbitrage towards the notional competitive equilibrium. He is to be contrasted with the Schumpeterian entrepreneur who through his innovation and "animal spirits" is a destabiliser of a notional Walrasian equilibrium. There have been some attempts to model Schumpeterian innovations by mathematicians, but apart from one attempt by Littlechild and Owen (1980) there has been no attempt to provide a formal account of Kirzner's entrepreneur. This lack of formalism and its reluctance to rely on positivist methodology are considered to be shortcomings of the Austrian approach - for instance in B. Klein's (1975) review of Kirzner's (1973) book.

But even amongst Austrian converts, as Littlechild notes, there are critics who question Kirzner's assertion that the market process:

"tends to coordinate rather than discoordinate. Kirzner's view is that entrepreneurship consists in the discovery of opportunities thrown up by exogenous changes but not yet noticed by other market participants. In this sense, the entrepreneurial market process is one of continual discovery and increased coordination. Critics point out that this analysis downplays (or even ignores) the possibility of mistakes ... It is true that market participants are trying to forsee the future correctly, and that market forces will tend to eliminate the unsuccessful participants; but they cannot guarantee that every entrepreneurial action (or even most such actions) will increase coordination in the market" (Littlechild (1986) ps. 32-33) 19/
The essential difference between the neo-Austrian and neo-classical viewpoints concerning the proper role of government in an economy must therefore lie elsewhere. It seems to me to be analagous to the differences between those who hold to procedural - 'entitlement' - based-views (e.g. Nozick) as compared with consequentialist views (e.g. utilitarians) of justice. Thus Buchanan (1986) states:

"How does one improve a market? One does so by facilitating the exchange process, by reorganizing the rules of trade, contract or agreement. One does not 'improve' or 'reform' a market like exchange process by an arbitrary rearrangement of final outcomes" (p. 22).

As one who shares the pluralist vision of society of the great Oxford liberal philosophers Berlin and Hart, I have found recent discussions in ethics based on a desire to find some absolute ethical standard, to judge social orders conceived as a choice between 'rights' and 'utility' particularly uncongenial. Similarly, I find the desire to limit discussions of potential interventions to improve market efficiency, purely to the derivation of appropriate procedural rules through a constitutional specification of efficient property rights as being too narrow. An example will make this clear.

As is well known, the Coase theorem concerning externalities shows that voluntary exchanges within an appropriately defined and legally enforced system of property rights will be able to ensure allocative efficiency in the Paretian sense. But as Cootter (1982) noted, this depends upon assuming non-strategic behaviour on the part of agents, otherwise "in the absence of some externally imposed rule for dividing the purely distributional gains, there is no assurance that exchanges in rights will shift the economy towards the
Pareto efficiency frontier and maintain a position on the frontier once reached" (Buchanan (1986) p. 93).

Buchanan solves this dilemma (within the neo-Austrian framework) through his distinction between the ex ante and ex post aspects of choice. He insists that, as only the ex ante aspect of choice is relevant from a full-blooded subjectivist Austrian perspective, revealed preference is sufficient to ensure that voluntary exchanges within a Coaseian system of property rights will achieve efficiency, in the sense that resources will necessarily move into their most highly valued uses. On this pure subjectivist view no objectively measurable harms and benefits can be derived (even conceptually) from the ex post results of choice, and which could be used by an external observer to determine a unique Pareto-efficient outcome. Only the initial assignment of property rights can be questioned. Moreover, only the rules derived from a community wide consensus for the designation of these property rights, argues Buchanan, will be efficient.

Even if the logical validity of this full-blooded subjectivist-contractiorian view is granted, it still seems to me to make no allowance for the contingent factors of history. As a descriptive theory of the evolution of modern day states, it is obvious that apart from the US (and paradoxically modern day India) most modern states did not emerge from the deliberations of constituent assemblies. The log-rolling, vote-trading equilibria the theory depends upon are irrelevant for most Third World countries - which are not democracies. Whilst on purely practical grounds I find it well beyond the bounds of the "suspension of disbelief" that in the myriad countries of the world, the unanimous decisions of a constituent assembly continually
discussing matters of entitlements and property rights is a feasible method of dealing with the market 'failure' admitted to potentially arise from externalities and strategic behaviour even within the neo-Austrian perspective. As Buchanan (1979) himself notes:

"It seems to me that one of the dangers of the subjectivist approach and particularly in its pure Austrian variant, is the tendency to form a priesthood, with the converted talking only to those who are converts" and that "Milton Friedman objects to the Austrian - subjectivist approach largely on the grounds that it implies conversion rather than gradual conviction by the weight of logical argument and empirical tests" (p. 90). "An understanding and appreciation of the principle of spontaneous order or coordination may emerge from the very citadels of objectivism, and often does. After all, Adam Smith was no subjectivist. What I am implying is that, to the extent that subjectivism tends to concentrate attention on the interaction among persons and away from the 'economic problem', an understanding of the principle of order is facilitated rather than retarded. The post-Robbins maximiser must learn the principle of order in spite of rather than because of his analytical paradigm" (p. 84).

With this last statement I can agree. As such I remain an agnostic in these tussles between the alternative grand visions (objectivist-subjectivist) of markets and how they can be improved. As Deng Tsiao-Ping is reported to have said: "It does not matter whether a cat is black or white, the important thing is does it catch mice" 19/

IV

There is, however, one thorny issue which is raised by all three of our representative 'mathematicians' concerning the ethical justification of the market which can be illumined by the Austrian vision of the market as a process, and the constitutional perspective of the Virginia school. This is a large subject in its own right, and I cannot discuss this with any
thoroughness in this paper. (But see Sen (1985), Buchanan (1986), Gray (1984), and Brittain (1986)).

We begin by noting that ethical criticisms of the system of voluntary exchanges which constitute the market process can be considered to be misguided for a very simple reason. This process translates the initial endowments of agents into final outcomes. Ultimately as is recognized by traditional welfare economists (through the so-called "converse theorem" and the distinction between Pareto-efficiency and Pareto-optimality), by Marxist revolutionaries (with their notion of exploitation emphasizing the distribution of the ownership of the means of production - recently extended to include human capital (see Roemer (1983)), as well as by the Austrians and other procedural (rights-based) moral theorists (e.g. Nozick), it is the ethical justification of the initial distribution of endowments which is usually in question. The market process of voluntary exchange for transforming these endowments into market outcomes can hardly be called moral or immoral.

In this context it is particularly surprising that Sen (1983) should argue against the procedural theorists of justice that the existence of disasters such as famines is an argument against the market process, particularly when he himself states that he has "presented evidence to indicate that only famines - even very big ones - have taken place in the recent past with no overall decline of food availability, and millions have died because of being deprived of food in terms of market command, reflecting sharp failures of entitlement (Sen (1983), p. 12, emphasis added). But if it is a "failure of entitlements" which leads to the awful outcomes, why should the process of voluntary exchanges be blamed?
The real argument against the 'property-rights' based, 'converse theorem' of welfare economics is a different one, and depends as Sen (1983) (1985) recognizes on adopting the "imperfect information" insights of the neo-Austrians. As Sen (1985) argues: "If the information regarding individuals is inadequate for determining what the initial distribution should be, or if there is an absence of - or reluctance to use - a political mechanism that would actually redistribute resource-ownership and endowments appropriately, then the practical relevance of the converse theorem is severely limited" (p. 12). As a second best, it may only be feasible to achieve an ethically preferred distribution of endowments through interferences with market outcomes, with the gains in equity being set against any losses in efficiency that may result.

The argument against this view of the "moral imperialist" - if I may so label it - is that it depends upon assuming the existence of a universal moral code amongst all the peoples of the world which allows some observing economist to make these welfare judgments encompassing both the efficiency and equity components of economic welfare. But casual empiricism is enough to show that there is no such world society; nor is there a common view, shared by mankind, about the content of social justice.

Against Sen's assertion that egalitarianism is a universal value, as "indifference to the inequality of well-being requires some justification", one can only say that, as witnessed by the numerous societies both past and present the value of the equality of (I presume) "material well being" has rarely commanded wide public support as seen in the actual practices and behavior of the people constituting these societies. Amongst present societies I only have to mention Sen's and my
own country, India – which for millenia has had a hierarchical society based on the caste system, whose values as Dumont (1970) has emphasized, do not even recognize the notions of equality and inequality. In a hierarchical society all are encompassed within their proper stations by the hierarchy and questions of 'equality' in Sen's sense are meaningless. Lest it be thought that the Enlightenment ethics incorporated in the Indian constitution, and rhetorically espoused by its Westernised castes reflects a change in these more atavistic values one has only to peruse the marriage advertisements in the pages of various English language papers in India to see that caste considerations still seem to be paramount, even amongst this group, when it comes to vital things such as who to wed.

More seriously, even if there were a universal egalitarian distributitional ethic it is not obvious that, as Sen argues for the case of redistributing endowments, we could find a political process which could deliver the goods either for the ethically desired realignment of outcomes.

V.

This brings me to the fundamental insight of the "neo-Austrian" view which until very recently has been lacking in the neo-classical view of the market. It has been most fully developed by the 'public choice' theorists but it can also be arrived at by the neo-classical route (see Krueger (1974)) and the subsequent literature on 'rent seeking,' and directly unproductive activities, (Bhagwati (1982)). This view incorporates and revives various 'classical' insights as found for instance in the works of Adam Smith and Karl Marx.
Whilst problems concerning imperfect knowledge have undermined the implicit assumption of the omniscience of governments, the recent developments in what is called "the new political economy" have led to a questioning of the linked assumptions about the omnipotence and benevolence of governments which underlie that tradition of formulating public policy as if it were advice to a committee of Platonic Guardians. It is evident the latter view of the State, as well as many others (such as that of the idealized Communist State of the Marxists), ignores the fundamental question about the motives of the State; it fails to answer the question posed in the first sentence of a splendid new book by de Jasy (1985): "What would you do if you were the State?", as well as the more ancient question of "who will guard the guardians?"

A detailed typology of actual and possible government forms (in terms of the objectives they seek to subserve) is beyond my remit. But I have recently found it useful to think in terms of two polar types - the benevolent (Platonic Guardian) and the self-serving (predatory) State (see Lal (1984)). The objectives of the former are well known as they form the staple of every elementary economics textbook. The objectives of the latter are more murky but must by analogy with biological predator-prey models involve the self-serving extraction of the maximum continuing flow of resources (which includes intangibles such as power and prestige) for the members of the government and its associates. Predators will share an interest in the enlargement of the incomes of their prey (say through economic growth) in so far as this raises the potential flow of their own income. Unlike the benevolent State the welfare of their subjects - as conceived by economists - may only at best be a very minor direct component of a predatory State's objective function. More
important, however, is the likely opportunistic nature of its behavior, so that compared with the more principled benevolent State, its orderings over social states are likely to be fickle.

Of course most actual States will not fall into either of these extreme categories. But it will be useful for my clarificatory purpose to maintain this stark contrast. The Grand Tradition of Economics of Marshall, Keynes, Pigou, et al. has implicitly assumed that it was by and large working out the economics for a benevolent State. This in itself was not an unreal and absurd assumption. For, as Skidelsky's (1984) biography of Keynes shows - by its excellent description and dissection of the intellectual and social milieu of Edwardian and post Edwardian Britain - English economists of the day could reasonably assume that the governments they were advising were either benevolent - made up of people like themselves - or even more important, could be directly influenced to serve the commonweal as viewed by these self-proclaimed Platonic Guardians.

The resulting paternalism underlying this mandarin view - which is by no means stifled in the breasts of many economic advisers particularly to developing countries - is best summed up in Douglas Jay's immortal words, written in 1937:

"Housewives on the whole cannot be trusted to buy all the right things, where nutrition and health are concerned. This is really no more than an extension of the principle according to which the housewife herself would not trust a child of four to select the week's purchases. For in the case of nutrition and health, just as in the case of education, the gentleman in Whitehall really does know better what is good for people than the people know themselves" (quoted in Howarth (1985)).

But as the Platonism of the Guardians has slipped even in Britain, that whole splendid body of elegant, sophisticated and subtle theory which
leads from Ramsey, Samuelson, Meade, Little, Diamond-Mirrlees to Atkinson and Stiglitz, based on the assumptions of a benevolent State run by Platonic Guardians increasingly appears naive and unrealistic. I will cite only one example.

Thus, those of us who have been brought up to accept arguments justifying various forms of government action as a solution to the "assurance paradox" (see Sen (1967)) must find the recent savings behaviour in developing countries paradoxical. It has been argued (and incorporated in the project evaluation literature) that the social rate of discount must be lower than the private rate of time preference; on the grounds that society as an immortal collectivity would wish to save more than mortal individuals. The latter would thus sign a social compact to save more than they would atomistically. Governments as a result were charged by the Grand Tradition with the task of using the choice of public projects as an indirect means of raising national savings above the sub-optimal levels resulting from individual choices. Apart from the obvious "project illusion" on which this argument must be based (see Lal (1973) p. 123), it is not applicable if a predatory rather than a benevolent state is assumed as the executing agency of this social compact.

No vast empirical research is required to test the assumptions of this view. All we need point to is the amazing 'stylized fact' that (except for Sub-Saharan Africa since 1973) household savings in developing countries have consistently risen over the last two decades to levels which on Arthur Lewis' view in the Theory of Economic Growth should have led to self-sustaining growth in most of the Third World. 29/ At the same time one distinguishing feature - at least of the last decade - has been the prodigal behavior of the public sector nearly everywhere - in the First World as much
as the Third. Instead of supplementing national savings, most Third World governments have been depleting the household savings pool through budget deficits and the losses of public enterprises.

From the perspective which views most States as being closer to the 'predatory' end of the spectrum, this is hardly unexpected. Countries and societies may be immortal (though even that is dubious) but governments certainly are not. Concerned about their tenure, which is probablistically likely to be much shorter than the average individual's lifetime (and that of his offspring), the government's rate of time preference is likely to be much higher than that of private individuals. Hence the observed savings behavior.

VI

My purpose in the previous sections of this paper was first, to show how many seemingly divergent visions lead (in their fullness) to similar practical judgements on the relative efficacy of markets and mandarins in organizing our economic lives. Both the neo-classical and Austrian visions of the market use a notional equilibrium as the fulcrum of the order towards which the market economy moves. Despite their divergent attempts at explaining the market process, due to differing views of the environment (primarily concerned with the nature of uncertainty) facing economic agents, both traditions would recognize the need for some collective action. Thus from both perspectives the choice is not the stark one between markets or the State. Apart from anarchists I do not know of any economist who would want to do away with mandarins altogether. That is why the painting of all supporters of the market as adherents to a laissez-faire dogma (as Keynes recognized in The End of Laissez - Faire), is at best a debating point.
In this context it is surprising as I have noted elsewhere (Lal (1983), ps. 45-47) that Sen should argue that "the difficulty - in reading great significance into the performance of South Korea as a success story for the 'invisible hand' is the fact that the hands that reared South Korean growth were very visible indeed" (Sen (1983), p. 13). Elsewhere in the same article he makes clear that by the 'invisible hand' he means laissez-faire. Thus he writes "while the 'converse theorem' is a tribute to the market mechanism, it is not a tribute to the invisible hand, i.e. to the market unassisted by political intervention" (p.5). But who has ever argued that Korea's success is a demonstration of the validity of laissez-faire?

The important distinction in explaining the relative performance of different developing countries is not in terms of an active State versus a State which does nothing. Thus even Bauer who many consider to be a free market ideologue argues.

"Criticism of central planning or of the policies pursued in its name must not obscure the importance of the essential tasks of government. The adequate performance of these tasks is indeed helpful to the effective operation of the market, if not necessary for it. The tasks include the successful conduct of external affairs, notably the defense of the country, and also the preservation and encouragement of external communications contacts; the maintenance of public security; the effective administration of the monetary and fiscal system; the promotion of a suitable institutional framework for the activities of individuals; and the provision of basic health and education services and of basic communications" (Bauer (1984), p. 28).

The successful economies are not laissez-faire economies. Korea, and most of the other so-called NIC's in the Third World certainly have activist governments, nor have they fully succeeded in avoiding policy induced distortions in their economies but, in comparison with the less successful developing countries (such as India, Sri Lanka, Tanzania - to cite some
examples) they have concentrated the State's energies and resources relatively more on doing those things which only governments can do and less on those areas of economic life which are by and large best left to private agents.

The accumulating empirical evidence of the grossness of the distortions that mindless dirigisme has created in many developing countries should (as it has) convince even the most skeptical that purely as a practical matter, and irrespective of one's theoretical position, the pendulum has swung too far against the market in most of the Third World. In this sense, it is now a fair professional judgement that in many developing countries most of the more serious distortions are due not to the inherent imperfections of the market mechanism but to irrational government interventions, of which foreign trade controls, industrial licensing, price controls and various forms of inflationary financing of fiscal deficits are the most important. Thus, irrespective of theoretical beliefs and differing judgements about where the ideal line between the market and the State should be drawn, these practical arguments should suffice for economists as a group to unite in urging Third World governments to liberalize their economies. Without settling any more fundamental disputes, this nevertheless provides a practical agenda for reform. As Queen Elizabeth the First of England said in another religious context, as long as her subjects were willing to swear allegiance to her "she would not, ..... make windows in men's souls" (Elton (1955) p. 264).

It is for the above reasons that it is astonishing that some development economists consider it ideological to urge Third World countries to liberalize their economies. The dictionary defines 'ideology' as "thinking
or theorizing of an idealistic, abstract or impractical nature; fanciful speculation." I find it, amazing that those who recognize the grossness of policy induced distortions in most Third World economies would nevertheless resist the inevitable conclusions that pragmatism now dictates, on purely theoretical or emotional grounds, and label the advocates of liberalisation as ideological. This is surely a case of the pot calling the kettle black.

Nor, as far as I can judge, do most moral critics of markets advocate their extinction. Thus Sen (1985) discussing 'the moral standing of the market,' concludes:

"The argument that is much harder to dismiss is one that claims little for the market mechanism except superiority over other practical alternatives. Indeed it is not unfair to ask a critic of the market mechanism what precise system he would put forward instead, how well does it work, and how does it compare? When all the qualifications have been put in, the market mechanism certainly has some instrumental moral relevance, related to its handling of information and incentives." (Sen (1985) p. 18-19).

The latter are neo-Austrian insights and the second point I have sought to make is that, it is not because of the 'internal logic' of the neo-classical research program, or because of any great falsification of its predictions that these insights from an alternative vision have been incorporated into mainstream economics. Nor is it because there has been a neo-Austrian, neo-liberal scientific revolution in economics. For as Hicks (1975) has noted, unlike the natural sciences there are no real scientific revolutions in economics, in the sense of a more powerful or general theory superseding others. Most revolutions in economic thought are more in the nature of "a change of attention." Economic theories underpinning beliefs about how the world could, should or does work, which at particular times are fairly appropriate are subsequently rejected or neglected because in the
course of time they have become inappropriate in the light of changing circumstances. But this does not mean that the older theories disappear or are superseded as in the natural sciences.

It is for this reason that despite the recent shift of attention we must not imperialistically limit our conversations (the rhetoric of economics in McKlosky's terms) to members of one sect or creed. Those lonely figures Hayek and Bauer, in their different ways have kept alive an alternative way of looking at the world which would not have been possible if Hahn's recent positivist prescriptions for the proper conduct of economics had been universally implemented. There is a role for 'preachers.' But equally we must not let visionaries (on either side) blind us in our practical thinking about the commonsensical and obvious so that the best becomes the enemy of the good.

VII.

Hahn (1985) makes a distinction between "economics" and "political economy":

"The political economist seeks to understand economic events and arrangements in the framework of a comprehensive social theory, or at least as part of a social totality...The economist, by contrast, sets out to study the 'economic' in isolation from the 'social' not by ignoring the latter but by taking it as given." He then goes on to admit "there is substance to the complaint that economists have too sparse a description of the constraints under which agents act in society, and too narrow a view of the motives of actions." He concludes: "But if forced, I will choose economics and that for two reasons: first, one can understand what it has to say and second, that it attempts to say only those things which have a chance of being understood. That limits what it can claim to know or do. There are many economists who pretend otherwise. To account for them is a task for political economy" (p. 1399).
Elsewhere (Hahn (1984)) he makes clear that for him economics is co-terminus with current mathematical economics and I suppose econometrics. This forms part of his positivist methodological stance (see Coddington (1975), McKloskey (1983) for critiques). However, as illustrated by the neglect of certain neo-Austrian insights of market processes (and as emphasized by Keynes one of Hahn's apparent heroes) this failure to comprehend anything not put in symbols must certainly impoverish the mind.

However, when Hahn (1984) comes to discuss rational expectations the austere pose of the scientific applied mathematician sticking to his last begins to slip. He is 'scandalized' by "monetarism" and the new macroeconomics (p.13). He finds the strategic interaction between the 'policy maker' and the 'public' which is the basic insight of this new macroeconomics as a "not very deep observation" (p. 123). And most extraordinary of all he believes that "on the basis of this specious nonsense Keynes has been pronounced dead and Mrs. Thatcher advised" (p. 125).

I am not concerned with assessing the relative merits of Keynesianism and the 'new classical' macroeconomics. What is interesting is that (a) Hahn's wrath is expended against a mathematical theory which he (erroneously) believes is the reason why so many no longer find Keynesian panaceas persuasive; (b) he rails against the descriptive content of the rational expectations theory, whilst at the same time judging the equally unrealistic general equilibrium theory as a beautiful theoretical construct!; (c) he commends Keynesian policies even though as he admits there is no logically tight 'Keynesian' model available, nor one whose empirical validity has been established in any scientific manner; thus his belief in the validity of Keynesian panaceas could hardly be justified by his austere positivist
standards; (d) as an organizer of the famous letter of 364 British academics who predicted dire consequences for Mrs. Thatcher's policies he has not followed his own advice that:

"Economists who seek to influence people in power soon come to resemble their patrons. Moreover, they come to feel an urgent need to defend what they proposed through thick and thin. Add this to political beliefs and one is well on the way to explaining some of the zealatory. My own position is that economists are at their most useful when they give an account of the alternative scenarios which the present state of our knowledge allows" (p.8).

Clearly in organising the letter to The Times like most other economists, Hahn too was engaged in persuasion.

The reasons why Keyensianism no longer persuades many economists is not due to any rational expectations mathematical model, but because first, of the gradual recognition that many Keynesian prescriptions relied on the questionable assumption that ignorant private agents react passively to the macroeconomic policies devised by well-informed and well-meaning public agents. Increasingly, the authorities were seen to be engaged in a strategic game with private agents, who were at least as well informed as themselves, and who had incentives to undertake countervailing actions to undermine the intended outcomes of public policies; secondly, that (as the 'public choice' theorists argue) in democratic welfare states self-interested politicians with a necessarily short time horizon will have a natural tendency to be inflationists; thirdly, the problems of stagflation and increasing unemployment need to be tackled at their source through removing the institutional rigidities which are their prime cause.

These insights are increasingly denied the mathematical economists with their self-imposed blinkers against, what Hahn terms, 'political economy.' But if, as I have argued, most economists are ultimately writing
essays in persuasion, the advice proffered by Hahn on the proper nature and scope of economics will make most economists mere applied mathematicians — dullards who few would want to engage in any conversation! This is not an argument against the use of mathematical methods in economics, or rigorous analysis (which need not necessarily be couched in mathematics) but rather to suggest that to make the subject matter of economics co-terminus with a particular type of applied mathematics, as Hahn seeks to do is to impoverish the subject by narrowing our minds. I would instead endorse Keynes' judgement:

"... the master-economist must possess a true combination of gifts ... He must be mathematician, historian, statesman, philosopher — in some degree. He must understand symbols and speak in words. He must contemplate the particular in terms of the general, and touch abstract and concrete in the same flight of thought. He must study the present in the light of the past for the purposes of the future. No part of man's nature or his institutions must lie entirely outside his regard. He must be purposeful and disinterested in a simultaneous mood; as aloof and incorruptible as an artist, yet sometimes as near the earth as a politician". [J.M. Keynes: Essays in Biography, p. 141].

With the increasing recognition by economists that the State is not a disembodied, omniscient, omnipotent, and benevolent entity, but made up of self-interested persons like ourselves, it becomes necessary to think hard and clearly of the ways in which we can make these our agents serve our ends. The "new political economy" — which Hahn eschews — whilst still in its infancy, holds some promise of answering this question; it is an area of research — both empirical and analytical — which is likely to have the greatest pay off. It can be as rigorous as most of economic theory. Thus, the third point I wish to make in this paper is that, contrary to Hahn, we all need to be "political economists" in the classical sense. Peter Bauer is par excellence a political economist. 41/
But finally in writing our essays in persuasion one has to judge one's audience. Peter Bauer's correct arguments were seen as those of a dissenter in the 50's and 60's partly because they were not couched in the positivist terms that carried conviction in the existing climate of opinion. It is the accumulation of empirical evidence as well as the developments of the theoretical antidote to the 'market failure' based Dirigiste Dogma within the mainstream of 'positivist' analysis which has led to the changed perceptions of development policies, namely the importance of markets and incentives - and of the limits of government intervention and central planning. I wrote a popular book (Lal (1983)) summing up these developments which to my astonishment seems to have been found persuasive by many people. But amongst those who didn't like it was the reviewer in the Policy Report of the Institute that has sponsored this conference. The criticisms are from a neo-Austrian perspective - which is fair enough. But this was to misjudge the purpose of my essay in persuasion. If as I have argued in this paper, neo-classical economics properly interpreted, as well as neo-Austrian economics, reinforce the case for markets, then given the positivist temper of the times, friends of the market would be well advised not to reject even the limp hand proffered by "second best welfare economics".

For as recent, polls of economists have shown, there is relatively greater agreement amongst them on the importance of the market than amongst the lay public and the mandarins who as David Henderson (1985) documents are natural "do-it-yourself" economists. For economists interested in public policy it is more important to convince these mandarins and their principals of the recognised (though some would say limited) virtues of the market than to enter into scholastic debates seeking to convert one group of...
economists to one's own theoretical vision on the ideal balance between markets and mandarins. In this task of public education, through the lucidity of his thought, the clarity of his prose and his unflinching vision, few have been more persuasive than Peter Bauer, and I am pleased to be able on this occasion to pay him his due. But in understanding the paradox of his unjustified past neglect it is also important to note that, though ultimate glory may await those who stand against their time, to be influential, the pamphlets we write must to some extent be in tune with the times.
Footnotes

1/ One example should suffice - by quoting Little (1982) against Little (1961):

"Economics arguments are, it seems to me, used in a one-sided manner as persuasive devices" writes Little (1961)

"First, he (Bauer) says that a bad harvest and a rise in import prices cannot cause a substantial deterioration in the balance of payments, on the insignificant grounds that they also reduce incomes: while on the export side he argues that overvaluation of the rupee discourages exports, implicitly discounting the possibility of inelasticity of demand with the remarkable statement that 'the volume of Indian exports bears no relation to the total world demand for the products' (p. 64). No wonder he can imply that there never need be any connection between development and balance of payments difficulties" (Little (1961) p. 837).

In this critique Little is clearly basing himself on the two-gap model of which he recognised himself to be a pioneer (see Little (1982) p. 148 and the references to Little (1960)). After summarising the implausible conditions on which this view is based, Little (1982) concludes: "Given time to make adjustments, I doubt whether any country has ever been in such a position" (p. 148). As regards Bauer's illiteracy in not recognizing the inelasticity of the demand for Indian exports, Little (1982) states "that incentives work is shorthand for saying that export demand and domestic supply are both elastic" (p. 139).

2/ As one of the many economists in England who became 'exclusively development economists' after World War II. My purpose in exhuming this past is not to castigate Little in any way, as these changing views, unsurprisingly parallel my own. I bring these matters up in part as a "mea culpa".

3/ Lipton (1984) rightly notes: "Lord Bauer is a classical economist. Enterprise, trade, enlargement of markets: these are the engines of development. Bauer makes no neo-classical claim that all businessmen act like profit-maximisers, or would maximise welfare if they did. For Bauer, it is the move from subsistence to ever larger markets that counts" (p. 45).

4/ I of course discount the hysteria of those numerous dirigiste 'development economists' who have over the years made Bauer into their bete noire. As Alan Walters rightly notes in his comments on my paper, the primary opposition to Bauer's views in the 50's and 60's in the U.K. came from the "socialist" anti-market followers of Joan Robinson at Cambridge and Thomas Balogh at Oxford. They were non-mathematicians. I do not discuss their views in this paper, in part as I have done so elsewhere (see Lal (1983)),
and partly as I am more concerned in explaining why the mainstream of the profession - which cannot be put into any narrow ideological category, but which was (and is) by and large led by the mathematicians - finds Bauer's views so uncongenial.

5/ The term neo-Austrian refers not to a particular type of capital theory, but to the general Weltanschung of Austrian economics, beginning with von Mises through Hayek, Haberler and some members of the 'Chicago' and 'public choice' schools.

6/ I fully accept Alan Walters point (in his comments) that mandarins do not need economists to convert them to dirigisme. As Henderson (1985) has pithily documented they are natural dirigistes. What concerns me in this paper is the indirect or direct support economists may have provided to their irrational dirigisme.

7/ As Dorfman-Samuelson-Solow (1958) put it: "The main propositions of welfare economics are usually stated in terms of a long string of equivalences among marginal rates of substitution in consumption and marginal rates of transformation in production. More recently it has become common to sum up all these in one brief and easily understood theorem which contains everything of significance and provides the backbone of modern welfare economics. This fundamental theorem states: Every competitive equilibrium is a Pareto-optimum; and every Pareto-optimum is a competitive equilibrium" (p. 409-10). In its more refined version, in order to distinguish between the infinite number of Pareto 'optima' that can be competitive equilibria starting from different initial endowments of the agents, and the optimal allocation amongst these which must depend upon an ethical evaluation of the alternative distribution of these endowments or the outcomes as summarised in some 'social welfare function', it is usual nowadays to distinguish between Pareto-efficient equilibria, which correspond to the 'Pareto-optimum' in the above quotation and the full Pareto optimum which is that ethically preferred amongst the infinity of potential Pareto-efficient outcomes within this framework.

8/ Thus Hahn (1984) after summarising the Fundamental Theorems states: "They have led many to claim that the invisible hand is not only smart but also beneficial" (p.115, emphasis added). They have led many? who? There is not a single citation.

9/ Thus Hahn after spending nearly 8 pages (ps. 112-120) on developing the well-known themes of 'market failure', makes this central point as a mere qualification to what has gone before:

"Nor is such failure sufficient ground[s] (sic) for intervention, since it remains to be demonstrated that 'government failure' is less damaging than market failure. Hence although there may be a prima facie ground for intervention when the invisible hand fails, and no such grounds when it does not, there is some arguing and thinking to be done
before a case for intervention has been clinched" (p. 120).
But in the rest of the paper there is none of the future
'arguing' required to justify government intervention, which
essentially concerns the nature and behaviour of 'governments'
or 'state'.

10 See Hayek (1935).

11/ As Dasgupta puts it: "The full optimum can still be implemented in a
manner that is compatible with incentives; but decentralisation is a
necessity imposed by the question of incentives now — not solely a moral
requirement" (Dasgupta (1980) p. 114.

12/ Also see Lal (1982), (1985) about the importance of recognizing the
importance of the distinction between knightian risk and uncertainty which
mathematicians and economists had tended to ignore on the grounds that
genuine uncertainty cannot be modelled. But see the important paper by
Heiner (1983) which argues that the predictable behaviour which economists
are concerned with, can only exist, as behavioural rules for an
environment that is irreducibly uncertain. "Observed regularities of
behaviour can be fruitfully understood as 'behavioural rules' that arise
because of uncertainty in distinguishing preferred from less-preferred
behaviour .... it is in the limits of maximising that we will find the
origin of predictable behaviour" (p. 561).

13/ Much the same point is made by Hahn (1984), p. 127. "Opportunities for
mutually advantageous trade must be recognised and hence signalled... trade
opportunities are supposed to be signalled by prices which are
public and anonymous — they do not depend upon the persons engaged in the
trade .... In such a world, it is false to propose that, because there
are unexploited gains from trade, it will always be rational to signal
this by price changes. The manner in which potential traders can
communicate is of basic significance. One should have thought that, in an
age where the prisoner's dilemma ...... is known far and wide, this point
harshly needed making".

14/ Buchanan (1986) p. 51, would I think be in the same camp. Nor do I think
Sen's recent attempts to marry the two views in his so-called
'capabilities' approach (see Sen (1985)) is successful. But this is a
large subject which I cannot discuss in this paper.

15/ See Buchanan (1969).

16/ Thus Buchanan (1986) states: "If the only source of valuation of assets or
resource claims is the revealed choice behaviour of parties to potential
exchanges, there is no means through which an external observer can
determine whether or not trade, as observed, stops short of some idealized
norms. If a person A is observed to refuse an offer of $x for asset T,
then person A must be presumed to place a value on T in excess of $x.
That asset, in A's usage, must be yielding a value or benefit more than
Sx. The fact that, some portion of the imputed subjective value of T, to
the current owner, A, may be based on his estimates as to the real

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preferences (valuations) of B, the potential purchaser, is totally irrelevant ... 'Efficiency' in resource use, given the institutional setting, is ensured so long as A and B remain free to make the exchange or to refuse to make it..." But he goes on to note that with the Coase theorem "so interpreted, the theory becomes a tautology .... In this construction how can inefficiency possibly emerge? [He argues, however,] that agreement is the only ultimate test for efficiency, but that the test need not be confined in application to the allocative results or outcomes generated under exploiting existing or defined institutional-structural rules... Agreement on a change in the rules within which exchanges are allowed to take place would be a signal that patterns of outcomes reached or predicted under the previously existing set of rules are less preferred or valued than the patterns expected to be and generated under the rule as changed. Hence, the new rule is deemed more efficient than the old." (ps. 94-5).

17/ It should be noted that the 'unanimity rule' does not require unanimity of values or views, as in the vote trading equilibrium that Buchanan and Tulloch (1962) envisage, log-rolling could still lead to unanimous decisions. The main argument against the procedure is that it ignores the "consequentialism" which many find appealing (see Sen (1970) ps. 24-26).

18/ There is also de Jassy's criticism that these contractrian theories remain instrumentalist and like other theories of the benign state "carry the tacit assumption that the satisfaction or happiness of the state is for some reason and in some manner attained through the happiness of its subjects. No good reason is offered for this, nor a plausible manner in which it could take place" (p. 65). As regards, the faith of the 'constitutionalists' that Leviathan can be chained to the mast through constitutional rules, de Jassy is surely right that: "with its key always within reach, a chastity belt, will at best occasion delay before nature takes its course" (p. 187).

19/ This position can of course slide into a form of utilitarianism which is open to de Jasy's (1965) charge: "Judging things on their merits with an open mind fatefuly attracts open minds" (p. 88)! But as I argue later, we do not need to commit ourselves to any particular set of theoretical or ethical beliefs to form a practical judgment about the current need for economic liberalisation in the Third World.

20/ Such as Nozick who have agreed that, once an initially just distribution of endowments has been created - a tall order as we shall see below - there is no moral justification for altering the outcomes resulting from 'capitalist acts amongst consenting adults' (Nozick, p. 173)).

21/ It should be noted that the Indian famine code introduced by the British in the late 19th century explicitly recognised that famines were due to a loss of entitlements, and instructed district authorities to transfer purchasing power to the 'poor' once a state of famine was declared in the district.
22/ See Berlin (1978) for the various counter arguments to this argument for egalitarianism which is ultimately based (as he shows) on some form of natural 'symmetry' argument which requires 'sufficient reason' to be upset, but which is deeply ambiguous. Also see de Jasy (1985) ps. 170-81.

23/ I am aware of the inadmissability of moral arguments based on the 'naturalistic fallacy' (deriving an 'ought' from an 'is') but as much of current moral theory seems to depend upon an appeal to common moral intuitions it is important to note the lack of universalisability of these intuitions across cultures.

24/ Also see Lal (1986d).

25/ When the moral imperialists go on about how no sensible person would dispute the force of egalitarianism I am reminded about the story in the Flanders and Swan musical At the Drop of a Hat, in which the son of a cannibal returns home and says he won't eat people as "Eating people is wrong." This leads to much derision and the poor boy is driven into madness screaming "Eating people is wrong" to the laughter of the rest of the tribe!

26/ On this see my review of Roemer, Lal (1986).

27/ The following is based on Lal (1986a).

28/ It should be said that if the mandarins do have relevant knowledge not generally available to the public they should diffuse it to the populace.

29/ See Lal and Wolf (1986) for empirical substantiation of these assertions.

30/ There are some criticisms of the notional 'equilibrium' concept as for instance those of Lord Kaldor (1972) which are unsustainable. Hahn (1974) in a splendid paper which imaginatively weaves together aspects of the neo-classical and Austrian views of the equilibrium of a market process, rightly castigates these views, which claim that because perfect competition does not and could not exist in the real world (for the critics primarily because of the ubiquitousness of increasing returns - which as the recent work on 'contestable markets' within the 'equilibrium' framework shows (see Baumol et al.) is the least likely cause of traditional 'market failure') they hope to have shown that any efficiency claims for the market are spurious. But, as both modern neo-classicists as well as the neo-Austrians emphasize, the actual disequilibrium economies we observe cannot thereby be castigated as being inefficient, and any or every government intervention then be justified solely on these grounds to serve the particular observers' personal definition of efficiency or equity.

31/ Similarly as Michael Lipton has rightly pointed out to me it is equally as much a debating point "to paint all advocates of the design of central policy in order to affect prices and endowments as being 'against the market', 'mandarins' or believers in a benevolent and neutral State"
(Lipton, private correspondence.) I have noted in (1983a) precisely this point.

32/ On a comparison of Indian and Korean industrial development see Lal (1986b). On the relative lack of success of Sri Lanka during its dirigiste phase see Lal and Rajapatirana (1986); Bhalla (1986) and the exchange between Sen and Bhalla in Bardhan and Srinivasan (1986). On Tanzania see Coulson (1982) and Collier et al. (1986) who argue that its dirigisme has led to an imploding economy!

33/ Which has put them well within their potential production possibilities set, so that the removal of these distortions which leads to a movement towards the frontier (assuming all goods are normal) would imply an improvement in terms of any ethical welfare function.


35/ That is remove the grossest of those policy induced distortions in the working of the price mechanism which cannot be justified on even dubious second best grounds to subserve efficiency or equity.

36/ There also seems to be an assumption that the new political economy is not rigorous. But this is false. As the work of Krueger, Becker, Findlay and Wellisz, Bhagwati and Srinivasan attests, standard theoretical tools and modes of arguments are being employed in developing the 'new political economy'.

37/ See Keynes' review of Tinbergen's work in the Economic Journal and the subsequent exchange of letters with Harrod, all reprinted in Keynes' Collected Works, Vol. XIV.

38/ For a much more persuasive account of why Keynesian fiscalism and loose money are not sensible policies to deal with stagflation, see Haberler's contribution in Lal and Wolf (1986). Haberler shares Hahn's jaundiced view of rational expectations, but he equally recognizes the limitations of Keynesian policies in the stagflationary conjuncture. He rightly stresses the importance of the 'classical' prescriptions - sound money, tight fiscal policy, and a reduction of rigidities particularly in the labor market to deal with these problems. I should add that, though I have argued against the views of mathematicians which have lent support to mandarins rather than markets, I by no means wish to suggest that, the mathematicians have had much (or any) influence on mandarins or public policy. Alan Walters is therefore right in his comments in saying that apart (in this sense) from some minor aiding and abetting of mandarins, mathematicians must be absolved of responsibility for the dirigisme of the post World War I period.

39/ Which in the U.K. began not with Mrs. Thatcher but her predecessor the Labour prime minister, Mr. Callaghan.
Thus I agree very much with McCloskey that, "economic intellectuals should not discriminate against propositions on the basis of race, creed, or epistemological origin. There are some subjective, soft, vague propositions that are more persuasive than some objective, hard, precise propositions.... The cure would not throw away the illuminating regression, the crucial experiment, the unexpected implication unexpectedly falsified." (p. 511, 515).

Thus whatever view one might take about Peter Bauer's castigation of foreign aid, it is important to recognise that his observations that foreign aid induces (a) the formation of an anti-Western coalition of Third World states and (b) the alteration in the behaviour of recipient governments which become 'aid-addicts', can be derived from an application of simple economic principles to the behaviour of political agents. They are insights of 'political economy'.


See Brittain (1973); Kearl et al (1979).
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