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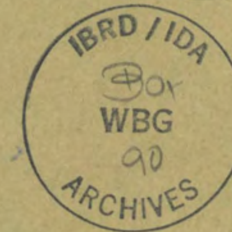

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MITRA

ECONOMIC GROWTH AND THE DOMESTIC RATE OF SAVINGS

Ashok Mitra[1/]

Research Conference

on

Obstacles To Economic Development In Underdeveloped Areas

University of Illinois, Monticello

May 18-20, 1962

1/ The views expressed in the paper are those of the author, and not necessarily those of the International Bank for Reconstruction and Development.

I.

The aspect of world economic growth I want to discuss is the recent pattern of growth of the rate of domestic savings in developing economies. It could be said that, given the proximity of Chicago, I am running into considerable geographical hazard by raising questions that would even remotely connect such elements as savings and capital formation with the phenomenon of economic growth. But I have a lurking hope that, while the Chicago School would continue to thunder--and rightly--against the misuse of capital, the crucial place which savings could fill in case such misuse is prevented would not be denied even by it. I have also been told that of late considerable vote-splitting has developed among the Cook County economists.

The United Nations World Economic Survey for 1960 contains a chapter on the savings trends in the underdeveloped countries. There is reason for great concern in the statistics assembled in this chapter. Data are presented on the movement of savings in a fairly representative cross-section of the developing countries--from Asia, Africa and Latin America--during the decade of the fifties. In a large number of cases, the rate of domestic savings has either declined or barely maintained the past level. If the countries have still moved forward, and in some instances registered rates of national income growth of the order of 4 to 5 per cent annually, such advances have been achieved mainly on account of substantial external aid or by dissaving of past reserves. Many of these countries, including, for instance, my own, have witnessed an increase in real national income of between one-third and one-half over the decade, and it is here that the situation is most puzzling. Used as we are to the notion that income

is the unique determinant of savings, we would have expected that this order of increase in real income would leave some impress on the domestic rate of savings. The statistics however tell a depressing story. In most of these countries real income has moved up almost continuously, but the stubbornness in the level of domestic savings has scarcely been disturbed. Even when we make some allowances for the deficiencies of statistics, the contrast between the two series cannot still be explained away.

In fact, for one or two countries, such as Burma, if the savings which emerged in the government sector are excluded, one could then discover a near-perfect inverse correlation between income growth and the rate of savings. Since, in sophisticated phraseology, this amounts to a marginal propensity to consume greater than unity, we would be able to treat ourselves to a number of bizarre inferences, if we could imagine that such a trend would continue indefinitely over time.

The policy implications are clear enough. One major assumption underlying the current external assistance programs is the concept of "tapering-off." If, through sustained external aid over a period of ten years or thereabouts, the level of real income could be pushed up in the under-developed countries, the vicious circle of poverty would be broken through. The economy would progress toward relative affluence and the rate of net domestic savings would start travelling from the 5 per cent level to the 15 per cent level. Once the latter point has been arrived at, foreign aid could be safely turned off. A large proportion of the literature on the economics of growth concerns itself with alternative time-paths of growth which a developing economy might adopt before it becomes wholly self-generating

What happens if massive external aid leaves no mark on the domestic rate of savings, even when it helps to raise the level of income? How far should foreign nations continue to extend assistance, even when by convential standards the countries ought to be able to fend for themselves. Admittedly, it is impossible to give economic answers to such questions. The decision would be by and large political. But the defensibility of foreign aid programs would no doubt diminish considerably if aid continues to be handed out to such countries as should have been off it if standards, accepted as objective only a while ago, were rigidly applied. For the recipient countries themselves too, the failure to raise domestic savings, even when real income increases significantly, would have far-reaching consequences. An economy which suffers from a chronic disequilibrium between domestic capital formation and domestic savings is susceptible to unpredictable pressures. It, so to say, lives in a fool's paradise. On the one hand, the population gets used to a certain standard of living which it has not earned. There is no relationship between the marginal accession of pleasure and the marginal input of effort. The resultant slack in attitudes and morality has a corrosive effect on all types of activities. Besides, the vulnerability of such an economy to international political influences is very great.

I propose to take up a few issues underlying this problem of lagging domestic savings in the underdeveloped economies. The problem is present whatever the institutional and political structure of a country. It does not really matter whether a poor economy is laying its hopes for development on extensive private initiative, or whether an integrated economic development

program, with the public sector in the fore, pinpoints the economic aspirations. Without an upsurge in domestic savings, development activities are bound to come a cropper. For both foreign patience and savings carried over from the past would wear out quickly if the current efforts are halting.

In what follows, I will try to go beyond the global figures and discuss the problem specifically in respect to three sectors of the economy: (a) agriculture, (b) the private sector outside agriculture, and (c) the government.

II.

It is remarkable that in practically all the countries which the U.N. Survey covers--the exceptions being Costa Rica, Jamaica and Rhodesia--household savings have declined over the decade of the fifties. Since the household sector is dominated by agriculture, it is the failure of the farm community to raise savings that calls for the greatest concern. Agricultural operations contribute about half, or even more, of total national output for most of the countries reviewed. The failure of agriculture to generate savings from within thus provides the key to the puzzle of stagnant savings. It is not that farm output has slipped or failed to maintain the pace of increase in national income generally, but the progress achieved in this sector has been largely due to the net transfer of funds from outside, mostly from the government. This process represents a reversal of the pattern of building capital stock which emerged in the countries that have now reached an advanced stage of development. Instead of the surplus

from agriculture presenting the wherewithal of growth for the rest of the economy, what is currently happening in the poorer countries is that the other sectors of the economy are subsidising agricultural growth.

Of course, one must disaggregate further within agriculture, identify specific functional groups and try to study their individual patterns of savings. One outstanding feature of agriculture in the underdeveloped countries is the skewness in the distribution of holdings. A predominantly large number of Asian and South American countries have a structure of land distribution of about the same degree of progressiveness as obtained in pre-World War I Hungary. A representative distribution would be, for example, of 25 per cent of the agricultural community to be without any land at all, and of another one-quarter possessing holdings of less than 2 or 3 acres at one extreme, and at the other, of a fortunate 10 per cent who might effectively possess as much as two-thirds or four-fifths of the total arable land. The differing nature of the pressure of population in these countries, one would have thought, should lead to some divergences in the way land is distributed. It is one of the surprises of real-world statistics that this is not the case.

One could suggest that for assessing the savings potential in agriculture and for judging the relative performances of the various groups, the landless labourers and the poorer peasants be excluded, and attention wholly concentrated on the upper strata of the land-owning community. It is true that it is this class which has demonstrated the least initiative in capital formation activities in recent years, whatever the country one chooses to discuss. It is also true that, especially in Latin

America, this particular income-group, instead of ploughing back their surplus into agriculture, has been largely responsible for surreptitiously transferring such funds abroad.

There are however a number of wider issues. Whatever might have happened since the end of the war regarding the pattern of relative shares in agriculture, there is no question that the absolute real income of the agricultural workers and poorer peasants has also risen somewhat. If the savings performance of all categories of the agricultural population--rich, middle and poor--have been disappointing, my suspicion is that this has been so on account of one peculiar type of psychological orientation which affects the entire agricultural community. The significant point regarding the statistics of agricultural output of most countries is that although the upward trend is clear, agriculture has not yet been able to extricate itself completely from the tyranny of the climatic cycle. The usual pattern still is one of a bunch of good harvests, a levelling off, and suddenly a drought accompanied by a sharp drop in output. The recovery would come only at the end of another two years or so. Such an agricultural cycle, when superimposed on the psychological more of the subsistence farmer, can lead to unpredictable forms of behavior. Since the farmer is accustomed to stagnant levels of earnings, a sudden spurt in income has an element of unreality to him. He suspects the increase to be in the nature of a windfall--an aberration--, and therefore as something which would be unable to repeat itself for any extended period. Empirical investigations would show that a high income, which is considered to be unstable, is generally spent away in a spree, and nothing is husbanded out of it. More often than not, such incomes are used for improvement of housing, maintenance, and repair,

for redemption of debts, advanced in the past by moneylenders who promptly re-lend the money to someone else for non-productive purposes, or simply for increased consumption. If these rising levels of income could be sustained uninterruptedly for a number of years, this pattern of behaviour could perhaps undergo a change, but on account of the fact that a bad harvest invariably intervenes and cuts off, even though temporarily, the ascending income trend, the farmer hardly gets the opportunity to stabilize his attitude with respect to the phenomenon of steady income growth.

Even if the farmer's earnings rise year in and year out, the rate of savings is unlikely to show much improvement till so long as he cannot be persuaded to accept the fact. Savings on the farm can therefore increase only when this "spree" effect of income growth has worked itself out. The period of this psychological gestation will of course vary with the circumstances, but it has been present in most of the developing countries to a greater or less extent. The instability in export earnings, for the Latin American countries in particular and, following the break of the post-Korean War boom, for all countries generally, has been one major contributing factor.

The other element which in my view has held back rural savings is the uncertainty which has followed the introduction of diverse types of land reform measures. Some of these measures are half-baked, some others are full of good intentions, but weak in action, while yet others are patently dishonest. In most countries land reforms have therefore been unable as yet either to transform the quality of agriculture, or to transfer property rights, to any substantial degree, to the poorer agricultural workers. They have nonetheless helped to cloud the atmosphere. The affluent peasants, I dare say, have not given up their efforts to prevent the implementation, or

at least to damp down the effects, of extensive reforms. But since they cannot be quite certain that the worst is not going to befall them, many amongst the richer farmers have preferred to "sit it out" rather than plow back into capital formation the fruits of increased agricultural productivity which has taken place in the post-war period, largely due to the government's activities for improving the infrastructure.

In other instances, farmers have been reluctant to extend their operations for fear of spoiling the market both of crops and of labour. Middle peasant proprietors, being particularly vulnerable to price fluctuations, are often unenamoured of possible price uncertainties in the wake of expanded output resulting from higher levels of capital formation. Similarly, the fact that both extensive and intensive cultivation call for progressively larger employment of outside labour, inhibits many peasants from experimenting with such measures as land improvements and irrigation. In an economy where monetization is proceeding apace, the farmer realizes that he is losing his hold on prices. What he can influence locally is the cost of buying labour, and he is reluctant to carry forward agricultural improvements beyond, or even up to the point, where the local wage structure might get unduly disturbed.

The two factors I have mentioned feed upon each other and influence the affluent farmer to greater consumption rather than to more capital formation: his mind is finally made up for him by the availability of opportunities for using up the increased income in the form of what he formerly would have considered as luxury expenditure. The usual forms which such types of dissipation have taken are, for example, a change-over to better

quality textiles if not to greater quantitative consumption, social ceremonies with a high service content, and, in many cases, even increased intake of food, which the initial rise in farm output makes possible. Some of the Indian statistics for the period of the first two Plans indicate that an increase in per capita income by 1 per cent has on the average raised per capita consumption of foodgrains by 0.9 per cent and of sugar by the astonishing magnitude of 2.3 per cent.

It is obvious, therefore, that while the existing inequalities in income distribution in agriculture have been of little help in improving the rate of savings on the farm, the possibility that such inequalities might be narrowed by State action in the future have further worsened the position.

III.

The rate of savings in the sectors outside agriculture has been scarcely better. In organised industry, trade and transport, appreciable capital formation has of course taken place in most of the countries. But the differential margin between own-account savings and capital formation has come, if not from the government, then from some foreign collaborators. Besides, one particular type of development has taken place which I consider to be extremely disquieting. The contribution of the tertiary sector to national income does not exceed 30 or 35 per cent of the total for most of the industrial countries. We have enough current data on this relationship, and if Mr. Colin Clark's figures are to be believed, such a ratio has actually prevailed in the countries of West Europe over their entire period of development. Whether there is some technological relationship between primary, secondary and tertiary production is of course a difficult question

to answer, but the fact that for so many countries the ratio between the income from services and that from material production has remained stable for so long should be considered. While this relationship may be disturbed for short stretches when capacity is being built up in any of these sectors, one could suspect that any deviation by the services sector above and beyond this proportion of one-third of the total for an indefinitely long period indicates the presence of an unnecessary bulge. This would reflect either of the following phenomena or a combination of both: (a) excess capacity in the tertiary sector which cannot be justified by the existing state of growth in industry and agriculture; (b) the prevalence of a scale of relative prices which overvalues the services.

Unfortunately, an emerging trend in many developing economies is precisely such spurt in the services. A computation from official economic data shows that in many of these countries, particularly those in Latin America, the contribution of the tertiary industries to national income has exceeded or at least approached a proportion equal to 50 per cent of the total. For example, in Chile it is nearly 55 per cent, in Jamaica 57 per cent; in Korea, 45 per cent. It is my contention that this type of disproportionate growth in the tertiary sector provides one major explanation for the poor performance in the domestic rate of savings.

I will first mention the particular type of environment which expansion of the services sector promotes. By and large, the enlargement of such service industries as cater to personal consumption leads to a state of affairs where relaxation is the rule. It therefore impinges directly on the social norm regarding national priorities. It spreads a message of opulence which

is misleading. The bunching of service industries--tourism, entertainments, and their concomitant, luxury construction--makes it appear that the relative valuation of consumption and savings in society has abruptly undergone a change.

A certain stream of consequences follow immediately. There is an element of sympathetic movement even in the consumption of services. One service industry begets another, and the effect of starting and enlarging one particular type of service is that the initial disturbance of the established social norm between savings and consumption works via a multiplier. There is after all no upper limit to the enjoyment of leisure. The construction of cinema houses, for example, leads on to the construction of gigantic sports stadia, amusement centers, sophisticated eating places, etc. Gradually what happens is a concentration of a set of service industries. The multiplier effects of one service industry in terms of diverting scarce resources are therefore very great.

This diversion of resources involves not only domestic goods and services which could be utilised for productive investments, but also precious foreign exchange. Clearly, a disproportionate expansion of the services sector, which in the current period distorts investment priorities, would affect the growth of savings with a certain time-lag. If some sections of the community discover that their own investment desires would not be fulfilled on account of the non-availability of investment goods, since the latter have been channeled for expanding the capacity in the tertiary sector, it is conceivable that in the subsequent period they would give up the idea of raising savings for productive capital formation. Instead, they would themselves try to make entry into the services sector, if not as producers, at

least as consumers. This is one way how the supply of the tertiary sector is able to create its own demand.

What I have said regarding the disincentive effects on savings of the expansion of services can in fact be generalized for a wide range of light consumer industries. Once we admit the proposition that under certain circumstances savings can be pressed down by (a) the non-availability of investment goods, and (b) the availability of wrong types of investment outlets, we have then to own up to the fearful implications of establishing certain categories of consumer industries in the developing economies. All of us are by now familiar with Professor Hirschman's famous linkages. Professor Hirschman himself has made a distinction between desirable and not-so-desirable types of investments on the basis of the linkage effects of such outlays. While his main preoccupation, I suspect, is to economize one particular scarce factor of production, namely, decision-making, it can be easily shown that these types of linkages are really all-pervasive and involve all scarce factors. If today we set up a TW transmission station, tomorrow we would encourage the import of television sets, and the day after tomorrow we would invite a buying spree of such sets. Similarly a soft-drink bottling plant, would, after a while, spread the desire for consumption of soft drinks among a population who could very well do without such drinks hitherto. Moreover, some chemicals and silica which would have normally entered some essential production would now be diverted for producing bottles for the soft drinks. This sort of creation of supply so as to induce demand to follow may have virtues in an economy where resources are plentiful and building up of capital assets is not the prime socio-economic priority. But

in economies where per capita income levels are less than $100, the rate of net domestic savings is below 10 per cent, and dependence on external capital is heavy, it is open to question how far the promotion of such types of consumption contributes to the common weal. These Hirschman-type linkages have been responsible for the wide splurge in consumption demand in many poor countries in the post-war period, and bear part of the responsibility for the slow rate of growth of savings.

This is of course, a very delicate area, and there can be an interminable debate on whether economic growth works out fastest if no attempt is made to regulate and control the magnitude and pattern of consumption, or whether it is best promoted by some form of over-all coordination which also decides on the broad order of priorities between consumption and investment. My contention would be that in a capital-short economy any overly encouragement of certain consumer industries which crop up, not because there is current demand, but because it is the intent of the entrepreneurs to create such demands, is going to be self-defeating. If consumer industries are promoted to such an extent that the aggregate rate of consumption not only keeps pace with, but threatens to exceed the rate of growth of national income, the rate of national savings would be the obvious victim, the growth rate of the national economy would slow down, and, in the long run, this would inevitably affect the rate of growth of consumption itself.

The crucial bearing which the pattern of allocation of resources between consumption- and investment-goods industries has on the domestic rate of savings can be judged from certain developments in the Indian economy during the first two Plan periods. In the Indian First Plan, which was in

operation during 1951 through 1956, national income in real terms went up by nearly 18 per cent. Most of this increase was concentrated in the last two years of the Plan, so that an enlargement in the capacity to save, one may say, became pronounced only around 1955. Because of the sudden rise in incomes, an abrupt increase in the propensity to consume occurred for important segments of the population also at about the same time. This can be equated to the "spree" effect of income growth as I have described it. While this effect immediately worked itself out, through, for instance, larger import of consumption goods, the desire to save and invest manifested itself much more slowly. There was also the fact that investment decisions take a certain minimum period to be planned and executed. However, by the time the will to raise the savings function assumed more concrete direction in 1957 and 1958 through an increased demand for importing investment goods, the "spree" effect had done a rather thorough work of pre-emption. Foreign exchange reserves had been eroded by heavy imports of consumption goods and the severe import control measures which were introduced at that time could only choke the desire to transform savings into investment.

That foreign trade did not offer any opportunity for the rising desire to save to be crystallized into actual accumulation becomes obvious from the figures of India's exports and imports. Merchandise exports have not exceeded the equivalent of 5 per cent of national income in any of the recent years. Imports, on the other hand, have consistently been near to 10 per cent of national income, and more than half of the imports are in the nature of "maintenance" imports, consisting of goods other than investment goods.

After a very brief upward movement, the rate of domestic savings in

the country started declining from 1956. Where people cannot accumulate because of the lack of capital goods, they will not save either. One can infer that, within the economy, the supply of investment goods of the types that was desired was not adequate, so that, in the absence of external availability, the rate of savings had to slide back to a lower level.

IV.

Let me now pass on to a review of the role of the government in influencing the rate of savings in the underdeveloped countries. The data included in the U.N. Survey do not indicate that the performance of the public sector in this respect has been strikingly different from that of the other sectors. Absolute capital formation in the government sector has of course multiplied in all the countries. But, again, the marginal element has been provided by external assistance, which each of the governments has received in generous proportions. True, the government's revenue receipts have increased considerably in most countries, but by and large the increases in government revenues have merely kept pace with the increases in national income. Moreover, such increases have not led to any expansion in the rate of government savings, for the volume of current outlays has gone up at a rate much higher than the rate of increase in the yield from tax and non-tax receipts.

There is little doubt that in most countries the government's attitude to the task of creating surplus in the economy has been altogether passive. Of course, given the narrow base of government activities, one cannot really expect, at this stage of development, any impressive yield from public enterprises (although it is possible that a bolder rates policy could have made some difference). Since the appropriate institutions are lacking, the

government's loan programs have proved disappointing, but this too was only to be expected. What one might still ask is whether the government ought not have tried to realise a larger proportion of national income in the form of taxes than the paltry 10 per cent which is about the average for the countries we are discussing.

In this context, I would like to single out especially those countries where an economic development program is in operation and where public capital formation sometimes constitutes as much as two-thirds of the total program. A very crude arithmetic example would illustrate how much the tax effort is lagging behind in these countries. If we assume a 3 per cent increase in per capita income annually as a minimum goal of development, and also assume that population is growing at the rate of 2 per cent per annum, an annual growth of 5 per cent would then be the target for national income. If the capital-output ratio is taken as 3 : 1, this would then call for capital formation annually at the rate of 15 per cent of national income. If two-thirds of aggregate investments are concentrated in the public sector, and the "mix" of projects is about the same for the two sectors, the government must then invest annually 10 per cent of national income on its own. But since each modern government has to spend at least 7 to 8 per cent of national income on administration and other public services such as education, health, housing, etc., on current account, a tax program which would transfer to the public exchequer something between 15 and 20 per cent of national income would appear as a minimum need. This target is still a very far cry for most of the developing economies, including the ones which claim to be socialistically inclined.

A closer analysis of the figures indicates that in many countries total tax yield is pulled back principally because of the reluctance of the government to raise the impost on agriculture. The overriding reason is of course

political, for the ruling elements generally come from landed interests. Unless the process is reversed, and these groups are persuaded to tax themselves somewhat more severely, it is entirely likely that diminishing returns would set in even in the receipts from taxes levied on non-agricultural groups. There is a limit beyond which it would be impossible to impose further taxes on the population outside agriculture, if at the same time no parallel measures are taken to coax the farm population to pay higher rates of taxes. Let me also turn the argument round and suggest that any marginal increase in taxes on agriculture would have a multiplier effect on the total tax yield, since this would make it politically more feasible to stiffen the burden on non-agriculture.

I am aware that there is one group of economists in whose view raising the rate of savings and taxation is not a crucial issue. Domestic resources, they claim, are no substitute for foreign exchange. Since, according to them, capital formation in developing economies is mostly impeded on account of the non-availability of plant and equipment, merely gathering more tax revenue would not help; as long as the export possibilities of domestically produced goods and services cannot be enlarged, it would not be possible to exchange domestic resources against foreign goods and services. They would therefore like to play down the emphasis on raising tax rates and suggest the continuation of liberal foreign aid until this so-called structural defect in the foreign trade pattern is corrected.

This point of view can be contested on several grounds. Firstly, I would maintain that in many cases taxation _per se_ can have an additive effect on private savings, even where there is no direct gain to the public exchequer. Insofar as certain types of consumption expenditure are of the indivisible variety, taxation which discourages contemplated expenditure might

be responsible for a volume of savings much larger than the magnitude of the tax. If an individual were intent on buying an automobile which would have cost him $2,000, a marginal levy of $500 on his income might prove decisive to persuade the individual to save the entire amount of $2,000. One can point out several such instances where a stricter regime of taxation could promote savings all around.

Secondly, there is a wide range of commodities, especially agricultural crops, where some form of domestic excise could discourage internal consumption, thus releasing additional supply for the export market. There is little use in putting forward a blanket apologia that the demand for domestically produced goods is inelastic in the world market. By picking and choosing, almost all countries should be able to locate a range of commodities which could be taxed in mild measure so as to induce the producers to look out for external markets. In the context of my own country, I have in mind the case of several commodities where some marginal improvements in trade are quite within the bounds of possibility.

Finally, of course, one can refer to many categories of investments, where the foreign exchange component is negligible. The extra availability of funds, which additional taxation would make possible, could easily enable the government to put through such investments, provided the will is there, and organization is adequate.

V.

Let me sum up what I consider to be the major implications for policy making of the foregoing discussion. Clearly, the concept of a falling marginal

propensity to consume with rising income levels loses much of its validity if transported from the individual to the national plane, and a Giffen phenomenon makes its presence felt when poor countries suddenly experience a jump in output and income. Sad though it might seem, there is no automaticity in the relationship between national income growth and the rate of savings. The solution offered by the "big push" theoreticians, namely, a concentrated injection of external assistence to pull up domestic savings from the 5 per cent to the 15 per cent level, has to be worked for and would not emerge as smoothly in the real world as it does in growth-model equations. The target of a higher domestic rate of savings has to be carefully planned and actively pursued and implemented.

A great deal of responsibility here devolves on the political leadership of the countries. It is easy to scoff at such old-fashioned virtues as abstinence, unostentatiousness, plain living, and all that. But, in the ultimate analysis, a poor nation has to fall back on these virtues if it wants to raise its living standards in course of one generation or so. There is a cost involved in economic development, and the cost is still the Marshallian waiting, a restraint in consumption in the current period so that capital stock could be built up without delay. Despite voices to the contrary, I do not think that any acute value judgments are involved here. For the choice is not between a further lowering of current consumption standards and rapid income growth, but between a relatively modest growth in consumption or hardly any growth at all beyond a certain point of time, when foreign munificence comes to a stop.

In most of the countries we are discussing, the national leadership commands great respect among the masses. What they do or do not do acquires the impress of social sanction. It can hardly be disputed that a heavy burden

of the guilt for the upsurge of consumption standards which has taken place in many of the poorer economies during the last ten or fifteen years has to be borne by the leader class. If the leaders set the pace for luxury consumption by raising their own standards of living--as they have done in recent years--, the demonstration effect on the rest of the community becomes very great, and isolated moral preachings about the wonders that restrained consumption would do for the country and the people in the long run fall on deaf ears.

There is also no question that the State has to play a more active part for realising additional savings. We may have our private doubts regarding the ethics of the government's regulation of economic affairs, but, in the context of developing economies, the role of the State as a catalytic agent for releasing the processes of growth cannot be wished away. Even if examples are set by the leader class, and the morality of savings is preached from all the available pulpits, some positive pressures would still be called for if the people are to be persuaded to save.

Since most of the economies we are discussing have started sliding away from subsistence, a more positive exercise of the government's monetary instruments--such as either an accross-the-board or more selective increase in interest rates--might yield encouraging results. Besides, as we have seen, a larger and deeper tax effort is imperative. Apart from the considerations I have mentioned, a carefully mounted tax program may be just the thing to provoke an expansionary moment up in agriculture. I have discussed at some length the reluctance of the affluent peasant to extend his production horizon. One way to correct this inhibition could conceivably be to push up the farmer's cost function by burdening him with heavier taxation at the margin. If, on his own volition, he would not expand his activities,

the solution might lie in raising the real cost of his not so doing. Let me also repeat that it is only by strengthening the tax effort in agriculture that the government would be able to obtain the political sanction for further raising taxation for the rest of the economy.

There is yet another thing which the governments could do to improve the volume of savings and capital formation on the farm. The uncertainties associated with the prevailing fashion of constipated land reforms must come to an end. Governments should be urged to formulate and announce in advance what their program is for, for example, the next ten years, so that the farmer knows how to pitch his expectations. I realise the political difficulties involved in such once-over reform schemes, but sometimes even a declaration of intent, without formal commitment, can go a long way in removing the state of uncertainty.

Outside agriculture, I would urge a heavy reliance on the tax mechanism to influence the allocation of resources between non-essential services and near-luxury industries on the one hand, and industries with higher socio-economic priorities for development on the other. In such cases, taxation would not perhaps raise the total volume of investible resources in the community in the immediate period, but, by preventing the expansion of industries with a high linkage effect on consumption, would influence favourably the marginal propensity to consume of tomorrow's income.

Finally, I would like to concentrate on some aspects of the problem which have international implications. Although raising the domestic rate of savings is primarily a national responsibility, let me state humbly that foreign nations cannot completely wash off their responsibilities either.

We are fond of pointing out the tremendous advantages which have accrued to the developing countries today because of the availability of advanced Western technology, which has saved them huge expenditures on scientific experiments and research. There is little doubt that this advantage stemming from their late start has reduced many of the stresses and strains from the process of capital formation and has therefore correspondingly eased the task of development. But there is also a tremendous cost involved in being late with economic growth. Perfect mobility of knowledge implies not only mobility of improved technological processes, but at the same time mobility of ideas about improved consumption standards; it is a double-edged sword. It would almost seem that what the poorer countries gain in the roundabout of non-payment for technological efficiency is lost in the swing of the spreading desire to emulate the consumption standards of the advanced countries.

There is by now a fairly general awareness of the problem, and I need not dwell on it. But there is another facet of transmission of knowledge on which I would like to offer a few comments. In the field of ideas, nothing can be more dangerous than wrong analogies. By reason of a combination of historical accidents, the United States could attain a level of net domestic savings amounting to 11 or 12 per cent of national income at the very beginning of the process of growth. This meant that this nation could achieve and maintain an average rate of growth of almost 3.5 per cent per annum for a continuous period of more than one hundred years. The role of the government--and of taxation--in fostering these savings was in the initial stages only marginal. Since the rate of population growth was low, and, in fact,

the country was suffering from a chronic shortage of skilled labour, this rate of over-all national growth proved adequate. Besides, one can be reasonably certain that the per capita income level in the United States in the late eighteenth century was in real terms substantially higher than what it is today in, for example, India or Pakistan.

In fact, in most of the poor countries I have been discussing, the rate of domestic savings is currently much lower than 11 per cent, the rate of population growth is frighteningly high, the land-man ratio exceedingly unfavourable, and they are starting from a very low per capita income base. In addition, there is the economic lure of rich consumption standards in the Western countries and the political lure of what the so-called proletariat has been able to achieve in the Communist nations. The task of economic development is, as it is, extremely difficult in these circumstances, but it is made enormously more so if at the same time these countries have to cope with orthodox ideas regarding taxation, the role of the government, and the allocation of resources between investment-goods and consumption-goods industries. For it is not merely a matter of what is said but also one of what is done pursuant to such notions.

Let me stress particularly the point about allocation of resources, including foreign exchange. Friendly foreign countries can greatly influence the pattern of domestic savings by a careful selection of the sectors or industries which they want to encourage by providing capital and equipment. Foreign aid by itself, even when it adds to current capital formation, may be of little or no assistence in raising the internal rate of savings if the bulk of this aid is persistently allocated to the consumption sector. Unless the

pattern of allocation of foreign aid is planned in a manner which would minimise the linkage affects on consumption. I am afraid that much of this aid would be perpetuating itself, rather than creating conditions which would enable its gradual withdrawal in the long run.

How underdeveloped countries allocate their investment funds is thus an important question even for people in richer lands, for this would affect their own allocation of funds. Whether a poor country succeeds in raising its rates of taxation is similarly full of relevance for others, for maybe that would allow the latter to lower their own tax rates. After all, we live in a world of inextricable interdependencies.