CHAPTER IV Methods by which to Explore, Appraise and Stimulate Private Investment

IV 1 *The Search for Sound Projects*

A large portion of government investment projects relates to activities of a general character, such as transportation, power or education, needed in almost all sectors of economic life and only partly dependent on the specific products of the country. Private projects are to a much greater extent directed towards the production of specific goods; and it is of primary importance to the economy as a whole that they be directed toward the correct products. Often not very much is known about the comparative cost advantages of a country; private firms can hardly do more than make cost estimates for a few products in which they are interested.

As already observed, we are here faced with the most difficult problem of development policy: the search for sound projects. Government agencies will not, as a rule, be able to solve this problem by themselves. They may, by their general policy, as we observed in Chapter I, stimulate and give some guidance to the private investor. That general policy will be discussed in this chapter.

In the search for sound projects an attempt may be made to study the country's possibilities in a more systematic way, by making a general survey of national resources: a description of the qualities of the soil in the various regions of the country, of the mineral de-

posits and of the skills of the population. On the basis of such a survey rough estimates of the costs of production for the most promising goods may be attempted; and these provisional estimates may be the basis for more accurate computations by private firms. It would seem appropriate for government agencies or university institutes to make the survey and the rough cost estimates. But usually decisions must be taken in the absence of such a survey.

IV 2 *Role to be Played by Market and Cost Analysis: the Choice of Industries*

The more refined estimates on which private investment projects have to be based should not rest only on the technological data which they usually take as their starting point. They should also pay attention to the economic ties with the outer world. Especially if large projects are under consideration, their influence on the economic situation and hence on some of the economic "data" for the project should not be overlooked.

As already discussed in Sections II 3 and III 4, the general development program of the country might be the starting point. If such a program does not exist, some sort of a substitute for it might be taken. This implies, among other things, that investors should have in mind the normal expansion of demand, as well as the probable course of prices, wages, etc. Even if the private investor need not bother too much about such questions, they should be the government's concern. The function of this analysis of the economic background of the projects is to ascertain that they fit more or less into the general development.

On the other hand, there may sometimes be reasons to revise the general development plan on the basis of data from a specific project. This may be so particularly if the cost level of a certain product appears to be out of line, either favorably or unfavorably, with what was originally expected. It may be that the cost estimates disclose

unexpected possibilities—mostly as a consequence of mineral deposits or of better transportation facilities than were originally anticipated—or it may be that unexpected difficulties arise. In matters of cost analysis particularly, the private investment project is able to supply the more relevant information, whereas in matters of market analysis the general program may be the safer background. This illustrates the way in which market and cost analysis have to cooperate, not only in order to arrive at a more precise general program, but also to arrive at better individual projects.

The question which industries—in the broadest sense of this word—a country should select for its development may now be answered somewhat more explicitly. It is impossible to be very specific here; the question only makes sense if the context of a particular country is given. Even then there are no fool-proof recipes available. From the preceding discussion it will be clear that the following elements have a role to play in this choice.

First, the special agricultural and mineral products suitable to the soil and the climate must be determined.

Secondly, the products favored by the transportation facilities of the country have to be considered. Water transportation will often facilitate, for example, the supply of relatively heavy raw materials produced not too far away. Both categories of these products should be viewed broadly: the study should cover not only to what extent the raw materials or semi-finished products, but also the final products, can be advantageously produced in the country.

Thirdly, attention should be given to the development of home demand as a consequence of rising incomes. Of course, not necessarily all home demand will best be satisfied by home production, but the latter generally has transportation advantages as compared with imported products. This applies to goods with high transportation costs in particular, and still more to services that have to be rendered on the spot. A systematic investigation as to the probable development of this demand may therefore be helpful.

Finally, in countries with considerable unemployment, a preference should be given to labor-intensive industries, as has already been explained. This point will be considered more closely in the next section.

IV 3 *Choice of Technology*

A matter of peculiar importance is the choice of technology. To a large extent this choice will be determined by physical conditions in the broadest sense: the character of the soil or of the raw materials, the nature of transportation facilities, etc. Often there will hardly be a real choice.

Nevertheless, there are a number of industries in which a variety of technical methods are available. And there is one aspect of this choice that is of basic importance to the economy of the country: the aspect of capital intensity. Most underdeveloped countries are countries of extreme scarcity of capital. The position of capital is completely different from what it is in developed countries; and it is the necessary corollary of the position of labor, i.e., of human beings. The desperate situation of large parts of the population may be said to be due to lack of capital. Even a small waste of capital may bar the possibility of improving the situation of superfluous labor. The utmost care in choosing technologies is therefore needed; everything should be done to restrict capital requirements for a given type of production.

There are reasons to suspect that the correct choice is not always made. One reason is the tendency to copy technologies from developed countries: many technicians consider "advanced technologies" as something desirable by itself. They base this preference in part, perhaps, on higher technical perfection of the product to be obtained. Since their responsibilities are very limited, they often fail to see the social consequences of their choice: less employment than would otherwise have been possible. So it may be advisable for countries

short of capital not to use one-man street cars or not to mechanize road construction or road maintenance.

Another related reason is that decisions are taken on an incorrect basis of calculation. Even those who understand that it is not necessarily the most advanced technology, but the cheapest, which should be selected, make mistakes in their computations as to what is the cheapest method. Obviously the cost of labor should be compared with the cost of capital; "cost" to be interpreted as "cost to the nation." Here the problems discussed earlier arise again. Market wages will as a rule be higher than accounting wages; and interest rates charged by international institutions may be lower than the accounting rate discussed in Section III 6. Both deviations tend to slant the calculations in the same direction, in favor of too capital-intensive technologies. A careful and thorough re-appraisal of a number of projects would seem in order. Where private projects are involved it is clear that private investors can base their decisions only on the calculations relevant to their own interests. Here the government may induce them to do "the right thing" by a system of subventions (cf. Section IV 4).

A final point to be mentioned refers to the choice of the *number of shifts*. It goes without saying that working in one shift only means that equipment will be idle for two-thirds of the time. Although social considerations admittedly are involved, working with two, and sometimes three, shifts has many advantages.

IV 4 *Methods of Stimulating Private Investment*
A *Protection, Subventions, Tax Provisions*

For several reasons, discussed above, it seems appropriate, in large sectors of the economy, to rely on private production and investment. It may happen, however, and it does happen, that private activity falls short of the most desirable level or is applied in wrong directions. Development policy therefore should include an elab-

orate system of stimuli and deterrents intended to provide some guidance to private activity. In this and the subsequent sections some of the methods of stimulating investment will be discussed and illustrated.

The most important measures are, of course, to be found in the field of financial policy, where often considerable stimuli can be created. The oldest device is the one of *protecting* against foreign competition the industries which it is desired to develop. The appropriateness of this method has been discussed at length for a long time. The free-trade doctrine asserts that under certain conditions free trade, i.e., the absence of protection, leads to a maximum of world production. On the basis of this argument, and assuming that the particular conditions are met, protection should be rejected.

The conditions are not, however, necessarily always fulfilled. One of the conditions is that the resulting income distribution is accepted as the most desirable one. This also implies accepting the income distribution as among countries as the most desirable one. To the extent that this may be doubted, it is possible to influence that income distribution by the imposition of tariffs. These may affect the terms of trade between countries in such a way as to favor the country applying them by lowering its demand for import products, the country may depress their prices and hence obtain them on better terms. This of course applies only to countries or groups of countries able to exercise a considerable influence on their own import markets. The tariff to be aimed at is referred to in literature as the "optimum tariff."

Another condition on which the free-trade doctrine is based is that productivity is independent of the volume of production and of any opportunity to obtain training and acquire skill. The doubts as to this assumption have led to the acceptance of the so-called *"infant industry argument"* for protection: import duties would be acceptable for an initial period during which a country would gain experience in running a certain industry.

Theoretically an objection against these exceptions could still be

made: there appear to be other measures which can do the same job even better than protection. Income distribution among countries might be improved by direct transfers instead of by the indirect and complicated way of tariffs. Such transfers would leave world production at its maximum and hence the world at large better off. Similarly, infant industries might be helped by overhead subsidies rather than import duties. Subsidies on overhead costs do not affect marginal costs and therefore do not distort the price structure and consumer choice, as import duties—if applied unevenly—do. Theoretically, therefore, the best policy still would be free trade, provided that income transfers take place and subsidies are accepted.

For practical purposes, i.e., for purposes which it is difficult to integrate into theory, some recurrences to protection may still be appropriate. On the one hand, the possibility of international income transfers is not a reality, to any large extent, in the present political atmosphere; and on the other hand import duties are sometimes much more easy to administer than subsidies. In certain circumstances even quantitative restrictions may have to be applied as the instrument of protection, as for instance if foreign competitors try to eliminate their infant colleagues by dumping.

Import duties based on the infant industry argument should be *temporary* only. A five-year period is often said to be appropriate, and has been accepted in several international agreements. Governments should determine firmly not to depart from this maxim. After World War II the Netherlands government applied the device of protection to some 20 to 25 new industrial products, most of them metal products. Protection was strictly limited to items that had not been produced in the Netherlands before; the period of protection was three years. In addition it was decided that the maximum percentage of total imports that could be protected in this way would be 2.5 per cent. At present the device is hardly in use because of subsequent international agreements. Two products are still protected and generally speaking the results have been satisfactory. (Cf., however, Section IV 9.)

As already said, *subsidies* may, however, be the better course to follow, certainly if the number of plants involved is small. The well-known arguments in favor of subsidy rather than protection are (i) that subsidy is a more open technique: everybody can observe it; (ii) that there is a safeguard against its being unnecessarily continued: it has to be discussed each year; and (iii) that it need not distort the price structure. The latter argument holds true only if the subsidy takes the form of a lump sum. It is of some importance to the industry concerned itself; with this method of aid the price of the product can be lower than in the case of a "protected" product and demand therefore will be higher. One particular type of subsidy applied for the "distressed areas" in the Netherlands has been a 25 per cent subsidy on building costs, with a specified maximum.

An important and general argument in favor of certain forms of subsidy can be derived from the difference between market prices and accounting prices of certain factors of production, notably labor. In a country with significant structural unemployment, such a subsidy should be equal to the difference between market wage rate and accounting rate, i.e., it may even be of the order of magnitude of market wage rates themselves. Its effect should be to induce employers to revise their profit calculations and to bring them in line with the national interest. The result may be an important saving on capital. Thus it may be that cottage industries would become more attractive than large-scale plants, e.g., in cotton textiles.

Many may doubt the practical possibility of such a far-reaching measure. One of the doubts would be based on budgetary considerations. In fact this measure, if applied to all enterprises, would charge the government budget with enormous amounts that would have to be financed out of taxes. It may be that certain government investments would thus become impossible. To the extent that this applies it should be taken account of as a disadvantage, to be set off against the advantages. Tax revenue, however, would probably rise, since in most industries profits or sales, or both, would

rise considerably. On the other hand, the tendency to tax evasion would correspondingly increase. Another point of doubt has to do with the administrative complications. To the extent that enterprises pay taxes, one might conceive of an allowance proportional to wages paid; this would not be particularly difficult to administer.

If an unemployment dole exists and is paid out of public funds, a subsidy equal to the dole would not cause budgetary difficulties. If the subsidy is less than the dole, it has two advantageous results: it stimulates the absorption of unemployed workers and at the same time reduces public expenditure. This measure was applied with considerable success in the Netherlands, during the great depression, for certain types of investment projects, namely, improvements on farms. An extensive account has been published showing that the measure worked to the advantage both of farmers and of public finance.

Subsidies on the employment of unskilled workers may also be made in the form of an *exemption from, or reduction in, social charges,* if such charges exist. There appear therefore to be several possible ways in which this type of subsidy may be applied and in view of the importance to be attached to any reduction of unemployment the choice of a particular method should be given the most careful consideration.

The budgetary consequences might again be lessened if, as a logical counterpart of the subsidy, an *extra charge* were introduced for the *supply of capital.* Loans to be made by the government to either lower authorities, or government enterprises, or even private enterprises, might be made at a rate higher than the moderate rates at which the government itself borrows, on the principle that the accounting price of capital justifies such a differential.

Tax provisions are the third measure in the financial field that may stimulate investment activity. A general and simple form might be a reduction of company taxes. Such a reduction would leave more profits in the hands of entrepreneurs and hence encourage further investment. But the efficiency of this type of tax measure may be

doubted. The reduction would apply to everybody and in many cases would stimulate consumption rather than investment.

A more direct link between tax reduction and investment may, however, be introduced: the reduction may be made dependent on proof that certain investments have been made. It may take the form of exempting from taxation certain additional depreciation allowances on new investments. Measures of this kind were adopted in many countries after World War II.

Care should be taken not to create tax privileges for some industries not extended to others. Apart from the outright abuse they may lead to, it is economically wrong to distort the price and cost structure by deliberately selecting industries for tax reductions while leaving others unaffected. This does not rule out, however, tax measures in fact applicable to some industries only, if the basis of such an exception is a general principle. It is conceivable e.g., that subsidies in the form of tax reductions might be given based on the degree of labor intensity (cf. Section IV 3) of an industry.

IV 5. B *Programming, Information, Encouragement and Demonstration*

Apart from financial support in some way or another, there are other ways to stimulate private investment. These are directed toward facilitating investment, in particular by activities which a central agency can perform more effectively than can individual industrialists.

In view of the great importance of correct information on a number of outside factors, one of the fields where this greater effectiveness can certainly be attained is the field of *information*: information on markets, on official measures, technical information and social information. A distinction may be made between some more sophisticated types of information mixed with scientific research, and simpler information.

The former type may be exemplified by the use to be derived, by private business, from government programming of economic development. Correct forecasts on a firm's expansion possibilities are not easy and, if done well, are rather expensive. The most difficult part for the firm expert is the general aspect of the forecast, which depends on the country's general development, since this in turn depends on a number of factors of government policy. In any case, it would be a tremendous waste of energy if each firm, or even each industry, were to try to make such forecasts. The arguments in favor of some international co-ordination in this type of research apply even more strongly to co-ordination on a national scale (cf. Section III 5). It has been the experience in the Netherlands that there is a growing interest, in managerial circles, in the long-term development programs made up by the Director General of Industrialization and the Central Planning Bureau. In the Netherlands, the producers of equipment for electricity plants did not know what total volume of investment by electricity plants was to be expected in the ten years ahead. Industry and firm economists are making use of the figures in order to have a background for their own more refined demand estimates.

These demand estimates and a number of other analyses—e.g., on organization or on specified cost items—are to an increasing degree also being entrusted to specialized private institutes. In the Netherlands, the Netherlands Economic Institute, affiliated with the Netherlands School of Economics at Rotterdam, specialized in demand analysis for private firms and in the last ten years such analyses have been made for 34 goods or services, distributed as follows:

Food	15
Other raw materials, non-durable consumer goods	3
Raw materials for durable goods	5
Finished investment goods	2
Fuel	3
Services	6

For several of these goods a considerable number of national markets has been analyzed.

The second category of information includes commercial facts and all sorts of administrative regulations. Examples are foreign trade figures of particular countries, split up into a great number of components and arranged in comparative tables relevant to the problem in view; particulars on firms trading in different kinds of materials, machines, etc.: details on import duties and tax regulations in a large number of countries; and so on. This type of information may be supplied by public as well as private agencies. In the Netherlands, and probably elsewhere as well, the Ministry of Economic Affairs has an Economic Intelligence Service which supplies a large amount of such information. In addition, each of the eleven provinces, as well as certain municipalities, have so-called "economic-technological institutes" which supply data of a mixed economic and technological character to enterprises planning to expand their business in a certain region. Together with the Director General of Industrialization and the Central Institute for Industrialization, they work out regional development plans for depressed areas. Further details about this activity are set forth in the next section.

In addition to information, these services have also provided advice on matters of organization, co-operation and marketing. The idea of the "export combination" of a certain number of medium-sized enterprises, of the "combined show" at industrial fairs, of common research on design, packaging and markets and of collective export credit insurance have all been launched by the Information Service of the Ministry of Economic Affairs. This type of *encouragement* of a certain action may also take the form of discussions, on the initiative of a government agency, with representatives of certain branches of activity, regarding unused opportunities. Suppose there is an opportunity to establish a hotel in a region attractive to tourism and the initiative is not forthcoming; it may then be encouraged by such conversations. The Director General of Industrialization in the Netherlands frequently suggested the pos-

sible production of certain parts previously imported and several of his initiatives were successful.

A final element to be mentioned in this class of measures is the erection of *demonstration* plants. In the field of agriculture this is a well-known practice, generally believed to have been successful. New tools, seeds, fertilizers and methods are demonstrated to the farmers or experiment farms or in demonstration farms. The idea has been applied in manufacturing industry as well, e.g., in Venezuela.

IV 6. c *Financing Facilities: National and Foreign*

Investment has traditionally been financed only partly from the entrepreneur's own resources, so that credit facilities have always been an important factor. It is well-known that these facilities are organized differently in different countries; in some countries special investment banks have long existed, whereas in other countries they are a new phenomenon. Almost everywhere there is a problem of providing facilities to smaller enterprises, often solved in a semi-public or co-operative way. Although it is therefore not possible to generalize, it may be said that there is usually in some way or another a financing "problem." Solutions may be sought both in the national and in the international field.

In the national field then, the creation of institutes specializing in medium- and long-term credit for medium- and small-scale enterprises will be useful, if they do not already exist. As a rule they will have to specialize in terms of a particular type of activity; farm credit, credit for handicraft, retail trade and manufacturing industry may be organized separately. Often some government support will be necessary, in the form either of guarantees or of participation in the capital resources. To the fullest extent possible, however, the institutions should be concerned with furthering the supply of savings to these particular channels.

In certain individual cases, especially where large amounts of capital are involved, the usual methods of financing may be impossible. Here government participation may be important. Government participation may range from 100 per cent to a minority interest. There is no reason to consider only the extremes of complete government ownership and completely private ownership. Intermediary forms are even sometimes to be preferred: they may combine the strong points of private and public interest. Much depends on the persons involved and the form of management. Freedom in day-to-day management decisions is very important. On the other hand, the supply of additional capital should not be made an easy matter because of the government affiliation.

Government participation has proved to be successful in the creation of a center of heavy industry in the Netherlands. It was not for doctrinaire reasons that after World War II the central government supplied the capital needed for the erection of a rolling-mill. A certain minimum of steel supply, not exceeding 50 per cent of total consumption, was deemed a necessity for the country's development. The country was willing to import the other 50 per cent from its neighbor countries Belgium and Germany, traditional suppliers of steel. It was deemed preferable that the steel mill be financed privately. Private concerns willing to supply the capital could not, however, be found. It was not a socialist minister who proposed that, in the circumstances, the investment should be made by the state and it was a parliament with less than 30 per cent of socialist members which approved the proposal. The corporation is run very well and has no difficulty maintaining itself in the European Coal and Steel Community.

Another type of government participation in investment may be seen in the same country in the field of agriculture. The new areas reclaimed in what was first the Zuiderzee are government property, and have even been run by government agencies for a short time, because of severe and unknown risks to be expected for the first years. After that period most of the lots are rented to tenants. A small

group of farms is, however, operated by state farmers. There is only a slight difference in the operating results of these state farms and comparable private farms.

In view of the scarcity of capital in underdeveloped countries, national resources for financing are limited. Investment of foreign capital is another possibility, which has the additional advantage of sometimes introducing new methods of production.

For understandable reasons there has been much reluctance in some of the underdeveloped countries to admit foreign enterprises, and frequently such enterprises are regarded with suspicion: in the colonial era they often were the symbols of political influence. But this is no longer the case, in many countries, and the situation should be reexamined on both sides. The best thing to be done in the interest of both the underdeveloped areas and the private enterprises concerned seems to be a clear separation of political and economic considerations. Investment of foreign capital from the investor's side, should be treated as a purely economic matter, not influenced by any desire for political activity. Accordingly, economic policies with respect to such investments should be based, by the receiving countries, on their economic significance. Some conditions may be enumerated which seem to be fundamental to a smooth operation of foreign enterprises in underdeveloped countries.

A first set of conditions is that the country's policies with regard to all factors of production should be consistent and clear-cut. The entrepreneur cannot make calculations unless there is a reasonable degree of certainty and of continuity in social legislation, safety requirements, import duties and other trade regulations, taxes and the basic facilities such as the supply of power, transportation and communications. One point of particular interest is the policy with respect to the transfer of dividends to the lending country. In this connection the importance of avoiding violent changes in exchange rates should be stressed.

If more certainty and continuity can gradually be attained in all these matters, an increase in competition will also follow and profits

will become more moderate than they are under circumstances of high risks.

Another condition of great importance is that there be a reasonable degree of labor peace. It is remarkable how much the existence of labor peace in the Netherlands after the Second World War has contributed toward attracting foreign enterprises to that country. Labor peace was largely due to the regulations concerning labor conflicts which made government mediation conditional upon terminating the strike or lockout. Such a regulation, in its turn, could work only because the government had the trade union's confidence.

Apart from the conditions just mentioned, the availability of reliable and quick information and a smooth procedure in negotiating are important. Simple though these things may seem, they require exactitude and a co-operative attitude on the part of all concerned.

IV 7. D *Minor Facilities*

Programming information and credit facilities are only preparatory steps and will have to be followed by the execution of the plans that may emerge. Even if the latter is thought of as essentially a private activity, some help in what might be called minor facilities may be of critical importance. This help would consist of activities to facilitate relationship with the outside world, activities which usually cannot depend on private initiative alone. One example is transportation connections. To set up a plant at a particular site may require the presence of water, road or railway connections. The establishment or improvement of such facilities would be in order. Power and water supplies are of great importance, and they are in part a responsibility of public enterprises. Suitable sites must be made available and they may be prepared by local authorities. Sometimes even the buildings themselves may be turned over to the industrialists. A labor exchange, schools and medical facilities are additional examples of these facilities. It is of quite some importance

that a smooth and efficient apparatus be available to overcome the difficulties in these fields. Although each aspect may perhaps be said to be "minor," they are not unimportant as a group. It has in fact been considered the greatest advantage of the developed countries in contrast to the underdeveloped ones that such facilities are, as a rule, already available. This, however is true of the old industrial centers in such countries only and not necessarily to the developing regions. Experience gained in the planned stimulation of private activity in such areas may therefore be of some use to underdeveloped countries as well. As an example the region of South-East Drenthe, in the Netherlands, could be cited. This region, with a rather dense population, formerly made its livelihood from peat digging. With the exhaustion of peat deposits, as well as because of increased competition from coal, the region became a depressed one. The Netherlands government, in co-operation with the province of Drenthe and the municipality of Emmen, worked out a program for development. One of the most important incidents in the course of the endeavors was the decision of A.K.U., the large rayon corporation of the Netherlands, to erect a new plant at Emmen. This decision was undoubtedly influenced to a large extent by the "minor facilities" offered. Certain well-defined additional costs of the investment due to the separation of the plant from the corporation's center (Arnhem) were borne by the government. Road and railway connections were improved and new schools and a hotel were built in Emmen.

The picture would not be complete without mention of a happy coincidence. In the neighborhood of Emmen, in the village of Schoonebeek, mineral oil deposits were discovered during World War II. Their exploitation was postponed until the war was over. At present some 30 per cent of the oil consumption of the Netherlands is produced in that region. These two projects together largely account for the successful recovery of the region.

IV 8 *Public* vs. *Private Activity*

Only when the various measures described in the previous sections do not serve to induce private investors to enter a field generally considered most appropriate for private activity should a different course be envisaged. Such situations may present themselves for various reasons. One such reason may be the absence of sufficient entrepreneurial skill in the population. This is not a hopeful situation, since the development of such skill is a time-consuming process. It has been developed in the older industrialized countries by a process of gradual growth. Industrialists have grown out of handicraft and trade firms, accumulating their skill and knowledge through generations. As is true of every process, this can probably be accelerated. Apprenticeship in older firms inside or outside the country is one way in which this type of training may be organized. Important work for some of the non-profit corporations in the educational field, international and other, seems indicated. As is now generally recognized, the solution to the problem of skills is not primarily a question of university teaching, but rather one of secondary education and free vocational training.

As long as private activity is not, for whatever reason, forthcoming to a sufficient extent, the question arises whether public activity should take its place. This raises a further question often considered fundamental: where should the line between private and public activity be drawn?

It seems useful here not to put things too much in black and white— or should one say black and red? Even in the Soviet Union there is a private sector of peasants, small traders and handicraftsmen, whereas, on the other hand, in the United States, where the belief in private initiative is particularly strong, the public sector is none the less considerable. In most western countries the public sector was much smaller a century ago than it is at present. In nineteenth century Britain the government spent less than 10 per cent of national income; at present, government expenditures ex-

ceed 20 per cent in many western economies. The question of the best line of demarcation between the two may perhaps be called the most controversial issue of today's discussion and thinking: it may be said to be the economic side of the clash of doctrines between the communist and the non-communist world.

As might be expected, there is, on both sides of the Iron Curtain, much dogmatic thinking about this issue. The central arguments in favor of public activity in the economic field are that private ownership of capital goods implies the existence of unjustified high incomes to people who do not work and leads to uncoordinated production with consequent crises and unemployment. The central arguments in favor of private activity are that a direct personal interest in the results of production stimulates productivity and avoids the dangers of bureaucracy and abuse of power. Of course a host of further arguments is employed on both sides, but we may confine ourselves to the central ones. The discussion in its essence goes back to the nineteenth century economic discussion between socialists and non-socialists. It has seemed to stagnate since it has been drawn into the ethical sphere, mainly as a consequence of the development of dictatorial governments. The discussion of this form of government raises so many questions on the fundamental issues of life and culture that socio-economic questions have been neglected in the argumentation.

On both sides many of the arguments are therefore antiquated. No account has been taken of recent improvements in both the public sector and in private enterprise, or in mainly state-run economies and mainly privately-run economies. An up-to-date discussion has to be much more refined. And it is of some real importance, since clearly a country living according to some dogmatic belief will in the end be at a disadvantage compared with a country which tries to find the optimum pattern of organization.

Modern experience as well as economic analysis has shown that certain activities can best be undertaken by public authorities, whereas others can best be left to the private sector. Even if it is

admitted that a certain centralization is needed in order to avoid crises and waste, important tasks can be left to individuals or private organizations because of higher *internal efficiency*. And even if, on the other side, it is argued that free enterprise automatically leads to a maximum national product, it should not be forgotten that certain general conditions have to be fulfilled before a private economy can operate—here one could speak of *external efficiency,* the efficiency of the relations between productive units—and that it is state activity which has to bring into existence and maintain this framework. These considerations and experience derived from action in particular circumstances have led to the almost general acceptance of certain tasks for the public sector; these are, however, not invariable and depend on a number of characteristic factors. Apart from the well-established task of assuring internal security and performing certain basic juridical functions, the government has, in the economic field, certain tasks briefly referred to in Chapter I:

(i) to create and maintain *healthy monetary conditions;*
(ii) to regulate the degree of activity so as to *avoid mass unemployment;*
(iii) to *correct extreme inequalities* in income distribution; and
(iv) to *supplement private activity* in certain basic fields where for one reason or another that activity falls short of meeting legitimate requirements.

On top of these administrative, supervisory and supplementary tasks there is scope for some *direct participation* of the public sector in production. This is true of sectors so fundamental to the country's existence that direct control is needed, sectors safeguarding the country's security such as a system of flood control and military defense works. It is a question of some subjective judgment whether the country's water and power supply and even parts of its transportation and communications system should not also be included: some countries have answered this question in the affirmative, others have not. Often the development towards government own-

ership in transportation and public utilities has been a consequence of the imposition of low rates considered to be in the general interest. These low rates have made it difficult to attract private capital and so led to government investments in these facilities.

The argument in favor of some direct government control may also be derived from technical conditions. In sectors showing high fixed costs and economies of scale, free competition will lead to very unstable and often unremunerative prices and there is therefore a tendency for it to be replaced by a monopoly. It is well known that tendencies towards monopolistic combinations in the heavy industries and in railway transportation have their origin in this state of affairs. A private monopoly, however, does not seem attractive for sectors which are fundamental to economic life, and government control of monopolies has been shown not to be an easy matter. Public management may be simpler. Some countries have also considered steel manufacture as belonging to this group. The argument of threatening monopolies might be helpful in splitting up the transportation sector into two sectors, one to which this argument applies and another to which it does not; in the latter category would fall merchandise transportation by motor truck or by inland shipping. Here private management might be preferable, although with certain provisions as to prices.

More important to efficiency than the question of ownership, however, is the question of the *freedom of management*. Where management of public enterprises has freedom in every-day details and administrative control is confined to some broad lines, the internal efficiency of the enterprises appears to be comparable to that of private enterprise with the same quality of management. Some indication of the validity of this comparison is perhaps shown by the Netherlands' experience in the field of coal and steel. As was earlier observed, for half a century Dutch coal mining has been divided about equally between private and state mines. Whatever may be said about the efficiency of the two types, the state mines are not less efficient than the private ones. The Dutch steel industry is prac-

tically public property, but it has not the slightest difficulty in competing, in the European Coal and Steel Community, with private steel manufacturers in Germany, Belgium or France.

Interesting experience has also been gained in the field of agriculture. In the newly reclaimed Zuiderzee "polders," a number of farms are state-owned and run by "state farmers." From a comparison of the results of these farms and of comparable private farms in the same area, the tentative conclusion may be drawn that either the state farms are at a slight disadvantage or there is no difference between the two.[1]

One final remark on the subject: the choice need not be a black-or-white choice between wholly public or wholly private ownership. Mixed ownership may sometimes afford a means of combining private efficiency with a desirable direct public control. The device of government guarantees has likewise often proved to be a very useful instrument.

IV 9 *Lessons To Be Learned from Failures*

Not all methods, measures or projects constituting the development policy of a country will in the end prove successful. Economic life is beset with uncertainties and challenges which man has not been able to meet in a completely satisfactory way. Economic history is a history of struggle and of failures as well as successes. But failures are not completely negative since they may teach us what not to do. Some of the lessons to be learned from failures in Dutch development policy may be briefly mentioned here.

As far as *programming* is concerned, the experience so far has been that there is a tendency for statisticians engaged in this type of work

[1] The qualification in this statement is due to a technical uncertainty about the nature of one of the cost categories. I am indebted to Dr. A. W. G. Koppejan of the Netherlands Central Planning Bureau for the analysis on which my tentative conclusion is based.

to underestimate the changes that actually take place. Qualitatively this is connected with the continuous occurrence of new factors, mostly technical, but also political or psychological. Quantitatively it may be illustrated by the fact that the average ratio of changes predicted to actual changes was 70 per cent for the Netherlands (and as low as 55 per cent for Scandinavian programs) as far as annual official programming is concerned. Statistical research is continuously being developed and although it would be unreasonable to require a complete coincidence of prediction and reality, some improvement seems possible. Collection of more and better statistics will be the main source of improvement.

Failures in *policy* are often due to the well-known difficulties of lack of understanding of economic problems on the part of politicians, or to pressure exerted by vested interests. It cannot be said that these factors have been particularly strong in the Netherlands in the last ten years and not much can be learned in this respect. The most that can be said would seem to be that there is a certain lack of coherence between the various ministries, due to the responsibility of each minister separately to parliament and due partially also to some skepticism with regard to programming. It may be, however, that this skepticism helped to keep the proper balance between programming and improvisation!

In the particular field of *industrialization* there seem to be a few cases of new enterprises that were not really successful. Their common characteristic is that, although sufficient and even considerable technical skill was available, commercial abilities were insufficient. This phrase, of course, is a catch-all for many different abilities and it is not easy to indicate them all very clearly. Often it is a question of insufficient knowledge about the precise qualities of a product which the market wants or, sometimes, lack of flexibility necessary to follow the changes in demands. Of course there are also failures for which the firms involved can hardly be blamed; bad luck does occur from time to time. One form of bad luck is the attempts sometimes made by foreign competitors to kill the new enterprise by

all means of cut-throat competition, especially dumping. In such cases government support may be called for, e.g., by the temporary application of import restrictions.

Not only practical life, but also scientific research, shows many failures; one may learn from them also. The process of scientific development is a continuous succession of new hypotheses or theories being formulated, being refuted upon closer analysis or confrontation with the facts and being amended into a new version. The science of economies is no exception to this rule. It may be said to be in a period of rapid development and the fields of programming and policy design share in this development. It may be hoped that better and more accurate methods will become available in due course. Much will depend on the collection of more and better data bearing particularly on the cost side of production. Whenever possible, attempts should be made to widen knowledge in this field particularly. It should not be forgotten, however, that the role to be played by scientific knowledge and insight in the field of development policy will for a long time to come be only a modest one. The relevant facts of life are too many and too varied to make it possible to reach decisions without a strong intuitive feeling for human relations.