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Article — Digitized Version

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Intereconomics

Suggested Citation: Kueng, Emil (1967) : The role of capital in economic development, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 02, Iss. 1, pp. 14-16, <https://doi.org/10.1007/BF02930332>

This Version is available at:

<https://hdl.handle.net/10419/137680>

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The Role of Capital in Economic Development

By Professor Dr Emil Kueng, St. Gallen

The under-developed countries in our time are basically facing exactly the same task as the advanced national economies had to face at the time of their first industrial revolution. And this is to pull themselves out of a state of continuous poverty of the masses and to raise productivity to such an extent that the rapid growth of population is being compensated or even more than that—with the result of a growing supply of consumer goods, and this per head of population, not only as a total. Almost everywhere this target is now being aimed at with the help of development plans, lasting several years, where the State plays the main part in planning as well as supplying the necessary finance.

If we compare this with the process of industrialisation during the 19th Century, it first of all strikes us how small at that time the task was vested in the State. In fact, that period stood out for restricting the functions of the State to a minimum. The conception of the State was that of a "watchman" who had nothing else to do but to safeguard peace and order, to protect the law and the country's borders, and, as time proceeded, also to take over certain tasks in the fields of education and vocational training. But there was no question of total economic planning: all questions of coordination were left to the "invisible hand" of the free market. The entrepreneur was the captain. He had full powers and freedom of action.

Why Is It Different Now?

If we ask ourselves why industrialisation in our time follows a completely different pattern despite the same starting points and aims, the impression forces itself immediately on our mind that this is due to the captains of industry. In Europe centuries passed by in which trades and small industries were developed and therefore men with initiative had the chance to train their talents as industrial leaders. Trade already had a strong position. And people who found the old Continent too narrow emigrated to the United States and other overseas countries where they found every chance to work as independent entrepreneurs.

There is hardly any doubt that this factor is of some considerable importance: until recently the less developed countries of today found themselves in a stage resulting from centuries long economic stagnation which paralysed free enterprise. If something new is to be created in such surroundings, it can mostly be achieved by the State only. In our context we do not intend to deal with this point more closely, but want to consider mainly the importance of capital. For in

this respect, too, some interesting differences are noticeable. They arise from the fact that firstly the power of the trade unions is now greater than before; that secondly social policy comes stronger into the foreground; and that thirdly the already prosperous national economies exercise a fateful influence. Before dealing with these points in detail, the case of Russian industrialisation should be considered briefly.

The Soviet Scheme

It may sound paradoxical, yet is a fact that, as far as the problem of capital goes, Russian industrialisation since 1917 has hardly differed from the former capitalist example. During the 19th Century the private industrialists financed the large investments out of their high profits, whilst in the Red, centrally controlled economy the bureaucrats have had the formation and direction of capital in their hands. In both cases, however, want was imposed on labour and consumers and forced saving demanded from them; in both cases comparatively high prices or low wages reduced the real income of the masses to a very modest level. Such "renunciation" of consumption made it possible to develop the production facilities be it through the profits of free enterprise or through the net proceeds retained by the State or the surpluses of tax revenue above current ordinary expenditure.

Regardless what today's humanitarian ideologists may think of this development, these inherent laws cannot be shaken either. Capital for additional production facilities and for raising productivity must in any case be made available and only to a very small extent can be expected to come from abroad. If we look at the internal sources of capital, it still stands that it can only become available from keeping mass consumption at a low level. Experience shows that squeezing out the rich is by itself far from sufficient to find capital internally—apart from the fact that in a market economy the levelling out of incomes would rather tend to undermine the propensity to invest. The prosperity we enjoy today is therefore in fact based on the restriction of consumption in the time of our forefathers.

The Trade Unions

It is obvious, however, that the pattern of the 19th Century and of the Russian five-year plans can hardly any longer be applied to a period and under conditions where the organisations of labour have already assumed a decisive right of co-determination. This obstacle impeded the freedom of the "Manchester" enter-

prises as little as the Soviet planners. For other national economies which are prepared for development it means, however, that they cannot easily keep wages at a low level, since many employees will or may accept jobs only against certain minimum conditions.

But this makes the unavoidable task of accumulating capital all the more difficult. This becomes evident if we assume that the wages policy of the trade unions is guided by the extent of industrial profits; that they therefore insist on higher wages whenever there is an ample rise in profits. If this policy is successful—and strong trade unions make it certain—profits cannot be as large as they would be otherwise. This also excludes that as much capital can be derived from own finance as is needed for investing in an expansion of production facilities. Equally, the recipients of dividends will be less able to put their savings at the disposal of the capital market. The result is a slowing down of development; and this means that the number of new jobs is declining and that of an abundance of people ready to work, many cannot find employment. This is certainly not the intention of the well meaning ideologists of development but is unavoidable. Beneficiaries are the trade union members who are employed for comparatively high wages; they need not tighten their belt and are probably little concerned if they benefit at the cost of their less fortunate colleagues.

The Social Policy

We mentioned social policy as the other modifying factor in comparison with the liberal system as well as the Russian development scheme. This means that even in the less developed regions the State can today no longer avoid the promulgation of factory laws, the regulation of working time and all kinds of social welfare measures.—It was different in the past: since hourly wages were low, workers were prepared to work up to sixteen hours a day and also to let their children work to supplement the family's earnings. Accidents and illnesses in work were partly ignored unless they affected the interests of the entrepreneur. Pension funds or old age provisions were unknown.

If in contrast the International Labour Office now tries to draw up inter-governmental conventions in all possible fields of wages and social policy and has them ratified by the various States, many governments in the backward regions cannot escape the pressure of public opinion to incorporate them in their national legislation. Employers have therefore to bear charges which are bound to increase their cost of labour and thus also the most important part of their production cost. This leads to a deterioration of the competitive strength in export markets, since this strength depends on the whole not on superior quality of their products but on low prices which again require cheap labour. The results are lower exports and lower proceeds from exports than could be secured without the social political regulations. And this again reduces the ability to employ additional labour and thus to increase national income.

All this shows that it is highly unwise—though humanly understandable—to embark on measures of a welfare state already in the early stages of industrialisation; for it can by no means be avoided to operate in these stages with low labour cost as a parameter of competitive action. Even a socialist economist like Gunnar Myrdal must fully recognise this point. Social policy, which here is not yet supported by high productivity, impedes the formation of capital and the growth in prosperity.

The Demonstration Effect

Finally, it should not be overlooked that the existence of prosperous national economies retards in some way a speedy economic growth in backward regions. This is due to the means of mass communication such as press, films and television which show the "luxury life" in western industrial countries to the people in those regions. Students who complete their studies in western countries experience the same. And the way in which "development experts", members of legations and special missions live has a similar effect; all this shows how high the living standard can be if one sells oneself to industry.

At the same time impatience is being roused and the fatalist attitude that prevailed for centuries disappears. Envy and resentment take the place of recognising superior efforts and achievements. The political effect is the attempt to reach a level of existence one has yearned for as speedily and with as little effort as possible. Planning is therefore directed mainly towards increasing the supply of consumer goods for the population and, as far as possible, getting round the confounded problem of investments.

If we were to assume that this action is successful and can raise prosperity per head of population: what would be the consequences? Under the conditions prevailing in most of the under-developed countries it will be shown in a fall in infant and child mortality without a fall in the birth rate. Less people will die of diseases and starvation, and there will be an explosive growth of the population. The supply of labour will increase without a corresponding rise in the number of vacancies. Owing to the insufficient accumulation of capital neither will there be an expansion of production facilities to the same extent as the supply of labour grows. The larger cake will soon have to be shared between more people who want to eat it, and in due course each of them will receive as little as before.

The Critical Starting Speed

The problem is similar to that of satellites which, when launched into the orbit, have to separate themselves from the gravity of the earth by exceeding a certain minimum speed. Unless they reach this speed they fall inevitably back to earth. In overcoming poverty in the less developed countries the question is, con-

trary to popular belief, not so much how to increase the supply of consumer goods to a certain minimum. Exactly the reverse applies: and this is whether and to what extent the standard of living can be kept low.

The rate of saving and the extent of capital formation are decisive. As Prof. W. W. Rostow explained in a series of articles on economic growth in the "Economist", the whole difference is whether, as until now, only five per cent of the national income or even less go into savings, or whether it will be possible to raise this percentage to ten or more. For our question it is of secondary importance whether savings are directed into production investments by State functionaries or by private enterprise; what matters is to achieve this expansion of production facilities.

Aid from Outside?

Attention will be directed to the possibility of attracting foreign capital. This will be all the more the case the more the economic policy of a potential debtor country conforms with market rules and the sounder its balance of payments is. We would point to the United States last century and to Canada at present. Nevertheless, every statistical evidence about the less developed countries reveals a gigantic demand for capital; in the light of these gigantic dimensions any capital influx from abroad is only a drop in the bucket.

As to private investments in particular, it should be pointed out that they are being discouraged not only by an economic policy which is hostile to creditors but also by the absence of an efficient "infra-structure".

The United States Reviews the International and Financial Economic Outlook

By Professor Dr Robert G. Wertheimer, Cambridge/Mass.

The 53rd National Foreign Trade Convention held in New York early in November provided an exciting climate and confrontation with issues and policies for 1967. Officials and experts from the business community and government presented their views and projections shaping up some of their principal propositions as follows.

The Balance of Payments and the Dollar

There exists general agreement that the level of world trade of \$ 400,000 million (imports and exports) should continue to grow at least at present rates of 8% annually, that the US Balance of Payments is sound and that the United States is not living above its means but that the deficit, though minor, can be eliminated. More important, the US will support all measures designed to expand world trade without discrimination and assist the International Monetary Fund. In terms of international solvency the US continues to reflect overwhelming strength with net assets of \$ 50,000 million.

The trade and service balance continues in surplus while the deficit items consist of private capital exports, foreign aid and the financing of military commitments carried for the entire Free World. Any one of these items remains enough flexible though to permit that all together may close the deficit gap. Particularly, an expansion of agricultural exports is expected to improve exports probably assisted by a success of the Kennedy Round. Americans being accustomed to think in terms of world-wide business, reject narrow nationalistic payments prescriptions and do not consider it an outrage that the world may have to live with an annual US deficit of \$ 1,000-2,000 million. For demonstration purposes, however, the ex-

perts agree that the gap can be closed completely at will though this may hurt the world and change the entire international climate in an unfavorable way. This author projects the US balance of Payments for 1967 as follows:

Item	exports	imports
	(in million of \$)	
Goods	30,800	26,300
Services, remittances and net investment income	12,300	10,200
net private capital exports		2,500
government foreign aid (minus repayments)		3,300
military spending (minus paid-for military exports)		2,400
Total	43,100	44,700

The actual deficit for 1966 is expected to amount to \$ 1,500 million. According to the Department of Commerce, a briefing on the deficit outlook and the extension of the voluntary capital export restraining program for 1967, is to be expected momentarily. However, due to the uncertainties of war and probable growth rates of the GNP for 1967—at 7%, for example, both imports and exports are expected to grow by 10%—any projection even though officially submitted, will carry a considerable margin of error. Hence, the estimates submitted ultimately might come as close to reality as can be expected at this early date.

Concerning the dollar, the US remains the world banker with foreign countries holding one-half of their reserves in high-yield earning dollars. The dollar itself is expected to continue to be sound and to remain the most wanted reserve currency. The price of gold—notwithstanding some European Alice in