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Socio-cultural Aspects of Supply-side Economics for Developing Countries

by Hermann Sautter, Frankfurt*

The switch from demand management to “supply-side economics” advocated in some industrial countries is also colouring development policy. The measures perceived to be right for the industrial nations are being urged on the developing countries and they are also to serve as new criteria for the granting of development aid. More of the available aid is to go to those countries that embrace the market economy and declare themselves ready to abide by the prescriptions of supply-side economics. However, as Prof. Sautter points out, it is highly doubtful whether the socio-cultural conditions for a successful supply-oriented policy are present in developing countries or can be significantly improved by implementing the usual supply-side proposals.

The proponents of a supply-oriented policy have left no doubt that the success of the measures they propose – the activation of market forces through “deregulation” of the economy, the stimulation of individual effort and private capital formation by reducing rates of taxation and dismantling state welfare programmes, a monetary and fiscal policy directed towards stability and the strengthening of private enterprise – depends crucially on cultural influences. For example, the more deeply the idea of achievement is rooted in a society’s set of values, the more effectively can the demanded “deregulation” of the economy stimulate competition for economic achievement.¹ The more optimistically individuals look to the future and the more responsibly they provide for the next generation, the more likely it becomes that the supposedly necessary encouragement of private capital formation will succeed. Clearly, these requirements for successful supply-side economics lie outside the area under the direct influence of economic policy. The advocates of supply-side programmes recognise this when they speak of the need for a “neo-conservative revolution” to revive the old virtues of hard work, work discipline, responsibility for one’s own family and creative enterprise. In this same sense there is also talk of a “spiritual and moral renewal”, without which a new economic policy programme would lack the necessary social roots.

The importance of the socio-cultural environment for the success of supply-side policies raises the question as to how far the necessary conditions for application of

such a policy are also present in developing countries or how they can be improved. Can developing countries be made to understand that the pursuit of individual success supposedly activated by supply-oriented policies has a harmonising, prosperity-increasing effect within a market economy and can confidence in market forces be strengthened thereby? Can individual effort be stimulated by reducing tax rates and state welfare benefits? To what extent are the socio-cultural preconditions met for the emergence of “a dynamic class of entrepreneurs” in the sense used by Schumpeter? These are the questions that will be examined in the following article.

Emphasis on the socio-cultural aspects of supply-side economics does not imply that the economic policies put forward under such a programme are unimportant. It is often precisely to the governments of developing countries that the call for a monetary and fiscal policy directed towards stability and for the removal of distortions in goods and factor price relations should be addressed with particular urgency. Demands of this kind are by no means new just as, for instance, the so-called “Laffer curve” has brought no fresh revelation (except perhaps that an astute public relations strategy is useful when advising on policy). However, in the discussion of the pros and cons of individual economic policy demands it can easily be overlooked that according to supply-side politicians the

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¹ Cf. Otmar Issing: Erfolgsbedingungen einer angebotsorientierten Wirtschaftspolitik, in: Horst Siebert (ed.): Perspektiven der deutschen Wirtschaftspolitik, Stuttgart 1983, pp. 179-190.

success of such policies depends to a large extent on underlying social conditions. There is therefore ample justification in focussing attention on these conditions.

Confidence in the Advantages of the Market

Confidence in market forces will increase if people can be made to realise that the result will not be a merciless free-for-all but a harmonious balancing of individual interests and a general increase in prosperity. Adam Smith himself left no doubts that the markets could have this balancing and propitious effect only in quite specific circumstances. Even today the thinking of Adam Smith is still of fundamental importance for economic liberalism. As supply-side policies aim primarily to re-establish liberal principles, it is only natural that their motto is "Back to Adam Smith!"² It is therefore worthwhile recalling the conditions which, according to Adam Smith, ensure that free market competition not only promises each individual the greatest possible freedom to pursue his own advantage but also brings these individual interests into harmonious balance and harnesses them to the goal of promoting general prosperity.

Some of the important conditions of this kind must be fulfilled by the state. According to Adam Smith the state has a duty to provide protection from external enemies, to ensure "good laws" and, moreover, to be satisfied with low taxation. These requirements tend towards a restriction of state responsibilities. Viewed from the historic front-line position in which Smith found himself, this is understandable. However, it should not be overlooked that for Smith it went without question that the state also had to perform certain positive regulatory functions. Ensuring "goods laws" entails, among other things, guaranteeing the equality of all citizens before the law and protecting private property. Adam Smith is also quite clear that competition would actually have to be protected against private restrictions. However, he takes a very sceptical view of the effectiveness of an anti-cartel policy. His utterance in this regard is well known: "People of the same trade seldom meet together even for merriment and diversion, but the conversation ends in a conspiracy against the public, or on some contrivance to raise prices".³

We would not do justice to Adam Smith' thinking if we interpreted his work on "The Wealth of Nations" without reference to his major treatise of moral philosophy, namely "The Theory of Moral Sentiments".⁴ The thoughts expressed here form the background to the image of man that he took as the basis for his writings on political economy.⁵ This is the image of the prudent man, the contemplative, moderate, responsible man who is far removed from the unscrupulous egoist that many of Smith's successors thought they could see idealised in his main work. In Smith's eyes, the most important human virtue is the "sympathy of the unbiased observer", in other words the ability to put oneself in the position of one's fellow men irrespective of one's own interests. There is nothing to indicate that Smith intended this virtue to be interpreted as being confined to the family circle. He is, however, sceptical whether this central virtue can resist the temptations of the market. If the "sympathy of the unbiased observer" is lacking, and hence if there are no moral restraints on egoism, even respect of the rules of competition laid down by the state cannot be guaranteed. Smith's remark on the natural inclination to restrict competition demonstrates this with all the realism one could want.

The fact that Adam Smith does not resign himself to the situation but takes a robustly optimistic view of the advantages of the market owes little to his confidence in the state's ability to regulate competition. We know that he held a rather low opinion of the integrity of state officials. He trusted more in the beneficial effect of the "invisible hand". In later theory it was claimed that this could be seen as the almost natural effect of "perfect competition" in the establishment of overall equilibrium. This does not do justice to Smith's thinking; besides, the "Nirwana approach" of the neo-classical model world is most unsuitable as justification of the practical advantages of the market.⁶ For Smith the "invisible hand" is an innocuous code-word easily understood by the economics-reading public to designate divine providence in the sense of the Stoa and early Enlightenment.⁷ It is difficult for us to accept this idea today, but we should not deny to Smith a belief that we no longer possess. At any event, one thing becomes clear: if one does not believe in the "invisible hand" in the sense used by Smith, the state and the self-restraint

² As in Irving Kristol: *Ideology and Supply-side Economics*. Commentary, April 1981, reprinted in: *Economic Impact*, No. 35, 1981/3, pp. 30-35, here p. 32.

³ Adam Smith: *Inquiry into the Nature and Causes of the Wealth of Nations*, 1776, Book I, Chapter X, Part. 2.

⁴ Adam Smith: *The Theory of Moral Sentiments*, 1759.

⁵ As demonstrated by, inter alia, A. L. MacFie: *The Individual in Society*, London 1967; see in particular pp. 59-81.

⁶ See in this connection Erich Streißler: *Kritik des neoklassischen Gleichgewichtsansatzes als Rechtfertigung marktwirtschaftlicher Ordnungen*, in: Erich Streißler, Christian Watrin (eds.): *Zur Theorie marktwirtschaftlicher Ordnungen*, Tübingen 1980, pp. 30-69.

⁷ A. L. MacFie, op. cit., pp. 106 ff. Alexander Rüstow also speaks of a "neo-stoicism" in: *Das Versagen des Wirtschaftsliberalismus*, 2nd edition, Düsseldorf 1950.

of egoistic inclinations must be given correspondingly greater responsibility for maintaining fair competition.

As we have seen, "Back to Adam Smith!" is the motto of supply-side policies. If we take this call seriously, we realise that the harmonious effect of market competition ensuring freedom and promoting prosperity can certainly not be taken for granted. It can only occur if quite specific legal, political and moral conditions prevail. If they do not, it will be difficult to strengthen confidence in the beneficial effect of market forces and to allay the suspicion that the call for "more reliance on the market" is an invitation for a pitiless free-for-all battle.

Lack of a Legal, Political and Moral Basis

Let us now come back to the question as to the extent to which confidence in market forces can be strengthened in developing countries. Clearly, this can be done only if the legal, political and moral basis for the effectiveness of market forces is successfully improved.⁸ Equality before the law must be guaranteed, private property must be protected, where possible distortions to competition through the emergence of private market power must be prevented and state measures to this end must receive active support from market participants.

Simply enumerating these tasks makes it plain that for many developing countries they would entail nothing less than a kind of "cultural revolution". In view of the

many privileges that exist, it is often impossible to speak of equality before the law. The corruptibility of the public administration often permits serious restraints of competition, impedes the effective protection of private property and makes it impossible to internalize external costs. In many cases morally motivated self-restraint in the pursuit of personal gain is also lacking. The developing countries present numerous examples of such conditions. In many respects, Columbia is an extreme case, but the characteristics that are evident here in a particularly blatant form can also be observed on a lesser scale in many other countries. It is therefore instructive to examine briefly the situation in Columbia.

The state monopoly on power, which is essential for the maintenance of competition governed by the rule of law, appears to be in serious jeopardy from organised crime.⁹ A pervasive Mafia controls parts of the police force, influences the military and the civil administration and has recently been so bold as to offer assistance to the regular police in the campaign against (left-wing) terrorism. The kind of legal transactions that can be performed depend to no small degree on the power of the criminal organisations. For example, an orderly real estate market does not appear to operate; to advertise the sale of a piece of land is clearly seen as an invitation to extortion. In many parts of the country private property is "safeguarded" not so much by the state institutions as by the Mafia, to whom large sums of "protection money" have to be paid. A monetary policy for the economy as a whole is scarcely possible, because the inflow of foreign exchange via the illegal cocaine trade is uncontrollable. Crop decisions by

⁸ Ronald C l a p h a m stresses the political and legal requirements for a functional market economy in developing countries but mentions their ethical basis only in passing. He is therefore in agreement with most writings on the theory of free market systems. Cf. Ronald C l a p h a m : Marktwirtschaft in Entwicklungsländern, Freiburg 1973.

⁹ With reference to the passage that follows cf. Martin G e s t e r : Kokain allein genügt den Schmugglern nicht, in: Frankfurter Allgemeine Zeitung, 17. 3. 82; Geld gefährlicher als Guerilla, loc. cit., 3. 3. 83.

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many small farmers depend on the directives of the drug dealers and their skill in outwitting the customs authorities of large industrial countries.

If the safeguards for legal certainty, the protection of private property and competition and a moral awareness of the limits to legitimate market transactions are as lacking as in this case, then the call to place greater trust in the "forces of the market" has a cynical ring. Important political and socio-cultural conditions for orderly competition in accordance with free market principles and for a supply-oriented policy are simply not fulfilled.

The protection of private property, above all, is one of the conditions for market competition to resolve conflicts (the "socially pacificatory" effect) and to promote prosperity. In view of the high share of agriculture in the national product of many developing countries, the protection of real property assumes great importance. How little protection of this kind is granted may be judged from the example of Brazil. The lack of a binding land register and the corruptibility of the state administration mean that legal conditions are absolutely chaotic in many parts of the country. Not infrequently small farmers are driven from their land on the basis of dubious deeds of title and thus forced to settle in the slums of the cities, where they find casual work. The small farmers are no match for the large landowners and companies, who are able to get their own way, quite often through their ability to harness state power.

Some of the ideas of the *ordo-liberal* school should be recalled in this connection. It has always pointed to the close relation between economic, political and social order. For example, according to Wilhelm Röpke¹⁰ and Alexander Rüstow¹¹ a free market order is possible over the long run only if the ownership of property is widely spread so that a large number of people enjoy relatively high economic independence. Many ideas of this kind have been treated with amusement as being "socio-romantic". That may seem understandable if one has the legally and politically ordered circumstances of the industrial countries in mind. If one looks at the situation in many developing countries, however, one can ignore the opinion of the *Ordo-liberals* only at the expense of the free market order. The unscrupulousness with which independent farmers are uprooted and proletarianised in these countries cannot be reconciled with a functional organisation of free markets, at least not according to *ordo-liberal* thinking.

The methods often used to exploit the natural resources of developing countries without regard for elementary rules of competition must also be termed

"unscrupulous". If private-sector competition is to provide for the common weal of a country, it must bear the external cost of production. Hence, in exploiting tropical forest it must be ensured that measures are taken to maintain the fertility of the soil. For this reason Indonesia requires the timber companies operating in the country to fell only trees of a specified minimum diameter, to limit damage to the forest floor when removing tree-trunks and to reafforest felled areas. Conditions of this kind often remain a dead letter.¹² Vast areas are stripped bare without regard to the limits set in the felling permit, the trees are removed by machines that destroy smaller plants and break up the humus layer and the promised reafforestation does not materialise. Opinions may differ as to where the greater failing lies in this case: in the corruptibility of officials, the lack of facilities to delineate property rights clearly or the lack of self-restraint by private firms in the pursuit of short-term profit. Wherever the fault lies, the result is an allocation of resources that offends against elementary optimum conditions of welfare economics under the banner of "market economics".

The question we asked was how the developing countries' confidence in a free market order could be strengthened. In most countries it is not enough to demand the withdrawal of the state from economic affairs. That might further undermine confidence in market forces, particularly where the concept of supply-side economics is misinterpreted as a call to abandon efforts to establish a legal framework for competition and to delineate property rights clearly. If confidence in market forces is to be strengthened, thus meeting one of the socio-cultural requirements for the success of supply-side policies, many institutional, legal and political reforms are just as necessary as a strengthening of the ethical basis of competition. It would therefore be disastrous if the granting of development aid were to be made contingent upon "deregulation" by the governments of potential recipient countries in the form of a *laissez-faire* programme.¹³ What should be demanded is not "less state interference" but more precisely directed and more conscious state action to protect the function of the

¹⁰ Cf. Wilhelm Röpke: *Jenseits von Angebot und Nachfrage*, Erlenbach-Zürich-Stuttgart 1958, 4th edition 1966; and: *Civitas Humana*, Erlenbach-Zürich 1944, 3rd edition 1949.

¹¹ Alexander Rüstow: *Das Versagen des Wirtschaftsliberalismus*, op. cit., and *Ortsbestimmung der Gegenwart*, (3 parts), Erlenbach-Zürich 1950, 1952, 1957.

¹² See in this connection Karla Krause, Helmut Heinzlmeir: *Der Zyklus der Zeit und die Spur der Multis*, in: *Frankfurter Allgemeine Zeitung*, 30. 7. 83.

¹³ The programme of supply-side economics is not to be interpreted as a return to a pure *laissez-faire* liberalism (cf. Irving Kristol, op. cit.).

markets. Not a more irresponsible pursuit of profit but self-limitation of the short-term entrepreneurial pursuit of profit would be needed where this lay in the interest of the economy as a whole.

Effects of a Tax Reform

The programme for a supply-oriented policy includes demands for a general shift in the burden of taxation from direct to indirect taxes and for a reduction in marginal tax rates. This is supposed to stimulate individual effort, increase private saving and encourage the formation of risk-bearing capital. As a result, productivity is expected to rise and the demand for labour to increase, thereby triggering sustained economic growth to the ultimate benefit of all (the "trickle-down" effect). To what extent are the socio-cultural requirements met so that these effects can occur?

Excise duties already predominate in the present tax structure of the developing countries. The reasons for this are well known: strong resistance to direct taxes, low level of education, deficiencies in accounting documentation, relatively small proportion of the labour force with a formal contract of paid employment. The scope for reducing the burden of direct taxation and increasing indirect taxes is therefore narrow. As a rule there is also little room for reducing marginal tax rates. In many developing countries the highest rate of income

tax is far below that in Western industrial countries, and in any case the low level of truthfulness in tax matters ensures that actual payments of tax are even less than the relatively light theoretical burden. One would have to be very naive to claim that the scale of tax evasion, which is large by comparison with the industrial countries, is due to "excessive" rates of taxation. The situation can be explained much better in terms of the polarisation of society, the low level of social conscience and the semi-feudal orientation of the upper social classes towards consumption. The prerequisites for a re-arrangement of the tax system and a reduction in the burden of taxation are therefore met to a smaller extent than they possibly are in some industrial countries.

Let us assume for a moment that marginal rates of taxation were reduced in spite of these difficulties. The significance of socio-cultural influences suggests that this would have only a slight impact on individual output. According to the concepts of supply-side economics a reduction in the income recipient's tax burden leads to a strong substitution effect in his income/leisure calculation that is not offset by the simultaneous income effect. However, the strength of these two effects will obviously depend very much on the preferences of the households concerned. Where the culture of a country contributes to a relatively strong achievement motivation and has led to an "achieving society" in the sense used by McClelland,¹⁴ a low preference for

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"leisure" may be expected. But as in these cases productivity is already close to its physical maximum for non-material reasons, the scope for further increasing labour output by offering the material incentive of a tax reduction is probably small. On the other hand, where achievement motivation is low, labour output cannot be increased significantly by cutting taxes – if taxes are paid at all. This is not to deny that production by, say, subsistence farmers can be influenced by material incentives in the shape of suitable price signals. Nevertheless, there is a difference between the call for market-related prices, which is far from new in development theory, and the demand for a cut in marginal rates of taxation. Reactions that can be expected in the special case of supply management by means of market prices will not by any means necessarily occur if the tax burden on higher income brackets is reduced.

In this connection it is pertinent to ask what effect a cut in state welfare benefits would have on the willingness to work of those affected, where such benefits play any role at all. George Gilder, one of the most forthright apologists of supply-side economics, expects a considerable impact. According to him, the poor must feel the thorn of poverty so that they are spurred to greater effort,¹⁵ and conversely the rich should flaunt their luxury as conspicuously as possible in order to give the poor a graphic picture of the rewards of work. In countries where paralysing, output-stunting poverty and unbridled consumer extravagance live cheek by jowl, Gilder's demand displays such cynicism that it is unnecessary to treat it seriously. At most, his view seems worthy of consideration in those countries where the generosity of national and international aid organisations has neutralised existing work incentives. It is not difficult to find examples of this, such as the refugee aid for the Sudan, which seems to have exacerbated the problem of famine in that many farmers were only prompted to become refugees by the prospect of a free allocation of food.

Such manifestations of the "moral hazard" cannot be overcome by cutting off aid, which after all arose because of a genuine emergency; unless of course one was willing to accept the death of many people from famine in order to prevent any misuse of aid. Instead, the answer lies in conscientiously seeking forms of aid that do not paralyse the existing willingness to work but stimulate it, such as by coupling aid with reasonable

expectations of performance by the recipient himself. This requires great sensitivity and an accurate knowledge of the cultural and social environment. As Kenneth Boulding has said, it is a question of finding an optimum relation between the incentives and sanctions of the exchange economy and the aid and encouragement of the gift economy.¹⁶ The one cannot operate without the other. Anyone who calls only for a cut in aid appears not to have recognised the urgency of the task described by Boulding.

In spite of the doubts expressed, let us just suppose that a cut in welfare benefits and rates of taxation were possible and led to increased effort and higher profits. Will this generate higher capital formation? Will it give rise to a sustained economic upswing that will finally benefit the entire population via a trickle-down effect? Is this the long-sought path out of economic underdevelopment?

For many countries it would probably lead instead to heightened dualism. Ethnic and legal discrimination, an inadequate infrastructure, an impenetrable education system, a close interweaving of economic and political power and the safeguarding of privilege that this permits are only some of the factors that contribute to the manifold fragmentation of goods and factor markets in developing countries. In these circumstances, the investment of private capital abroad is more likely than an increased flow of private savings into the informal sector of the cities or into small-scale agriculture, where there are substantial productivity reserves. It is more likely that capital-intensive processes will be used than that large sums will be invested in education and training, which would give rise to significant external economies. The persistence of poverty among broad sections of the population is more probable than a trickle-down effect benefiting even the poorest. In the absence of fundamental social, legal and political reforms aimed at eliminating the many forms of discrimination and fragmentation in the domestic economy, activation of the free market system of incentives and sanctions will at best lead to growing socio-economic polarisation. This is no way out of the problem of underdevelopment.

Emergence of Dynamic Entrepreneurs

The programme of supply-oriented policies assigns a key role to the creative entrepreneur. In accordance with Schumpeter, he is expected to introduce technical and organisational innovations, create new products and

¹⁴ David C. McClelland: *The Achieving Society*, Princeton, N.J., 1961.

¹⁵ George Gilder: *Wealth and Poverty*, New York 1981, p. 118.

¹⁶ Kenneth E. Boulding: *The Economy of Love and Fear*, Belmont, Calif., 1973.

open up new markets. The emergence of an army of these entrepreneurs is synonymous with overcoming stagnation and the beginning of a lasting economic upswing. The revived interest in Schumpeter's development theory – Flassbeck calls it the one and only development theory¹⁷ – prompts us to look more closely at the picture of the entrepreneur sketched by Schumpeter and to ask the extent to which entrepreneurs of this type can be expected to exist in developing countries.

It is conspicuous that Schumpeter ascribes tremendous importance to the immaterial driving forces of entrepreneurship. Schumpeter's entrepreneur is motivated firstly by a "joy of creating, getting things done". He has an excess of energy and chooses a field of economic activity in which to expend it; he "seeks out difficulties, changes in order to change, delights in ventures".¹⁸ Thomas Edison must have fitted this description, about whom Robert Bosch, himself a successful entrepreneur, wrote in an obituary "The spur for his restless activity was never (!) personal gain, but the creative power of the Titan".¹⁹ With this picture of the entrepreneur in our mind's eye, it seems extremely naive to try to arouse entrepreneurial initiative by means of tax cuts.

According to Schumpeter the entrepreneur is driven secondly by "the will to conquer: the impulse to fight". He seeks success for its own sake. For him economic action becomes akin to sport; "there are financial races, or rather boxing matches".²⁰ Personal gain is in no way an end in itself but a yardstick of success, although in Schumpeter's view other measures of success are equally conceivable and would have to be considered in a system of socialism to be taken seriously. In another context Schumpeter names social prestige as a possible indicator of success. Anyone with the picture of the managers of Hungarian industrial plants in his mind's eye is inclined to agree with Schumpeter on this point.

Thirdly, Schumpeter's entrepreneur is motivated by an irrepressible desire to found a private empire, an industrial dynasty that gives a "sensation of power and independence".²¹ He does not think in terms of a single

generation, any more than he is mindful only to maximising his individual utility and profit. Instead, he plans and works for the family, which also includes the generations to come. His calculation thereby acquires a long time frame. He works for the future regardless of whether he will reap the harvest himself or not.²² According to Schumpeter, this future-oriented long-term way of thinking, which is closely linked with the "family motive", provides the most important impulse for capitalist development.

Although very different in its individual characteristics, this image of the entrepreneur has similarities with that sketched by Max Weber in his socio-religious studies.²³ For Weber too it is ultimately the immaterial values that determine entrepreneurial actions: the Calvinist work ethic, an "inner-worldly asceticism" and the religious urge to discern signs of being one of the chosen few in business affairs. According to Weber, these motives contributed greatly to capital formation and to the growth of production in capitalist societies. This assertion has been much criticised, but a lasting benefit of Weber's studies must surely lie in the fact that he drew attention to the importance of a country's cultural tradition in shaping the entrepreneurial class.

To what extent do entrepreneurs of the types portrayed by Schumpeter or Weber play a role in developing countries? To what extent are essential preconditions for the development path suggested by supply-side economics therefore met? It would obviously be a mistake to describe the rationalistic and individualistic culture of the West as a prerequisite for the emergence of a modern entrepreneurial class. Countries in East Asia such as Japan, Taiwan or South Korea have produced entrepreneurs who are more dynamic than can currently be said of many entrepreneurs in Western industrial countries. However, these examples themselves indicate that considerable significance attaches to the cultural tradition of a country. All the countries named belong to a cultural region suffused by Confucian thinking, which by virtue of its origins has a pragmatic and rationalistic orientation. The encounter with the West has breathed new life into these old cultural values, which have created the spiritual cornerstone for a remarkable economic upswing involving countless family firms.

¹⁷ Heino Flassbeck: Was ist Angebotspolitik? in: Konjunkturpolitik, 1982, pp. 75-138, here p. 87.

¹⁸ Joseph A. Schumpeter: Theory of Economic Development, 1912.

¹⁹ Theodor Heuss: Robert Bosch, Leben und Leistung. Stuttgart (no year), p. 60.

²⁰ Joseph A. Schumpeter: Theory of Economic Development, op. cit.

²¹ Ibid.

²² Josef A. Schumpeter: Capitalism, Socialism and Democracy, 1942.

²³ Max Weber: Die protestantische Ethik und der Geist des Kapitalismus, 1905; Die protestantischen Sekten und der Geist des Kapitalismus, 1920; Die Entfaltung der kapitalistischen Gesinnung, 1923; reprinted in: Max Weber: Die protestantische Ethik, eine Aufsatzsammlung, published by Johannes Winckelmann, 2nd edition, Munich and Hamburg 1969.

The cultural tradition of many other developing countries is markedly different and the type of entrepreneur to be encountered there accordingly differs strongly from Schumpeter's model. The dominant type is often the speculative trader with an eye to short-term results who has little in common with the innovator planning for the long-term whom Schumpeter had in mind. The "bazaar capitalism" they operate is correspondingly far from the kind of capitalism that has produced a lasting increase in productivity and raised the level of prosperity of the population as a whole. Hirschman once said that a dynamic entrepreneurial class was the scarcest "production factor" in developing countries;²⁴ that statement is probably just as true today.

If the cultural tradition of a country does not provide conditions favourable to the massive emergence of firms à la Schumpeter an important prerequisite for the success of a supply-oriented policy is lacking. The situation cannot be much improved by economic policy measures. The opportunity of profit alone does not make a creative entrepreneur. It can just as easily spawn a class of commercial adventurers that generates only an illusory and short-lived economic prosperity. As McClelland and Winter state, "Of course vigorous economic activity has been and can be successfully encouraged by a policy of changing incentives alone; but only if the 'target population' (entrepreneurs, managers in public enterprises, and the like) have the appropriate interests, strategies, time perspective, and perceptions – in short, if they have the appropriate structure of response to the situation. Changing the situation works only to the extent that the target population has a structure of response appropriate to the perception, evaluation, and action on these changed incentives".²⁵ Here too, then, it will be seen that the success of a supply-oriented policy depends on fundamental socio-cultural conditions beyond the reach of economic policy measures.

For a Realistic Regulatory Policy

At the beginning of this article we asked how far the socio-cultural conditions for a successful supply-oriented policy were present in developing countries or how they could be improved. Three requirements were named: that confidence in the advantages of a free market order can be strengthened, that individual achievement motivation can be stimulated and that favourable conditions exist for the emergence of a

dynamic class of entrepreneurs. An attempt has been made to demonstrate the extreme naivety of expecting the implementation of stock supply-side proposals to be able to improve these conditions to any notable extent. The withdrawal of the state from economic affairs would not strengthen confidence in market forces in the least if it entailed neglecting the task of providing a legal framework for competition and clearly defining property rights. A reduction in welfare benefits and tax rates would at most foster more marked dualism if the many forms of discrimination and fragmentation in the domestic economy were not overcome. The prospects of higher profit would not stimulate the emergence of dynamic entrepreneurs unless the mentality of the population changed. The transposition of an unmodified programme of supply-side economics would therefore be no way out of underdevelopment and would lead instead to fresh disappointment.

The alternative cannot be to strengthen state dirigisme. It would be wrong to conclude that because the requirements for a functional market economy were not present a planned economy would be better. The factors that have caused market forces to fail also jeopardise the success of a planned economy. Where fair competition is impossible because of the corruptibility of officials and the lack of self-restraint in striving for material success, planning cannot be expected to be efficient.

The solution lies rather in creating the elementary political and legal prerequisites for a functional market economy and in encouraging cultural changes that facilitate this task. This may mean not "less state interference" but increased state initiatives for the protection of private property (including that of the small man!), for the legal equality of citizens and the removal of ethnic and social discrimination, for the protection of elementary individual civil rights, for combating private restrictions on competition, for establishing an incorruptible civil service, for the reform of land ownership and the education system and for overcoming the fragmentation of goods and factor markets. In many countries this will be impossible without notable changes in political and social conditions. The break with the existing political structure that a consistent legal framework for competition entails may be no less radical than the change that revolutionaries have inscribed on their banners. The Western industrial countries should be campaigning for changes leading towards a realistic market order policy in developing countries rather than for the adoption of an economic programme that was devised to solve the problems of affluent Western societies.

²⁴ A. O. Hirschman: *The Strategy of Economic Development*, Stuttgart 1967, S. 23.

²⁵ David C. McClelland, David G. Winter: *Motivating Economic Achievement*, New York, London 1969, p. 25.