CLIENTELISM.

CORRUPTION

AND

CAPITALIST DEVELOPMENT:

AN ANALYSIS OF STATE INTERVENTION
WITH SPECIAL REFERENCE TO BANGLADESH.

Dissertation Submitted for the Ph.D. Degree.

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CLIENTELISM, CORRUPTION AND CAPITALIST DEVELOPMENT: AN ANALYSIS OF STATE INTERVENTION WITH SPECIAL REFERENCE TO BANGLADESH.

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The post-war experience with industrial growth in developing countries shows a substantial range of variation in terms of performance. Conventional economic theories have found it hard to explain why some countries such as South Korea have done as well as they have while others like Bangladesh perform worse than expected. The starting point of this thesis is to point out that industrial development involves processes of structural transformation which in the modern context requires a substantial amount of state intervention. State intervention can be more or less efficient in terms of its ability to direct resources in ways which generate growth. Differences in the efficiency of state intervention are then identified as a critical element in explanations of differences in industrial performance. The rent-seeking literature offers an explanation of the inefficiency of state intervention and this is critically examined. Comparing South Korea with Bangladesh, we find that efficient systems do not necessarily have lower state intervention or the associated rent-seeking type corruption compared to inefficient systems. On the other hand, in Bangladesh we find a lot of evidence of clientelism, which is defined as a system of payoffs to coalitions who have the organizational ability to disrupt income flows of patrons. Clientelist activity is much less in evidence in South Korea. These issues are discussed in Part I of the thesis.

Part II develops a theoretical framework for examining some aspects of the efficiency of state intervention. Stability and efficiency are identified as alternative goals of state decision-makers who have the task of maintaining the political and economic viability of the system above a minimum level. The argument then uses developments in the property rights literature to identify the nature of the tradeoff between stability and efficiency under different initial conditions. The rights underlying profits from asset ownership, clientelist payoffs and rents are identified. Since changes in rights affect income flows, changes in rights have implications for the stability of the state depending on the political organization of various constituencies. On the other hand, rights have implications for economic efficiency. The minimum conditions on rights for efficiency under various circumstances are identified. This allows us to develop the nature of the stability-efficiency tradeoff under various assumptions, and we see that this defines a political frontier for growth. With clientelism, the shape of the political frontier is shown to be particularly unfavourable for efficient state intervention.

Part III looks at the history of industrialization in Bangladesh in terms of the pointers provided by our model and finds that a number of phase changes can be identified in terms of the relative organizational power of different constituencies which conceptually changed the position of the political frontier over time. The success of industrial policy coincides fairly well with these changes in the political frontier.

For reasons of length, Part IV is presented as a summary and the original text is presented in an appendix which the examiners may consult but need not read in detail. Part IV examines the empirical evidence. Unlike South Korea or Taiwan, productivity performance in industry in Bangladesh follows a cyclical pattern. These cycles coincide with the changes in the political frontier identified in Part III. We also look at demand and supply side explanations of poor performance and find them to be insufficient on their own. On the other hand, we find statistical evidence that clientelist payoffs are a feature of the Bangladeshi industrial sector while there is little evidence of such payoffs in South Korea. The thesis thus points out the importance of identifying clientelist processes with greater precision and suggests that industrial policy in countries like Bangladesh requires as a precondition of success, institutional, contractual and political responses which can counter clientelist strategies.
I would like to thank my supervisor Bob Rowthorn for his interest in my work over the years. Without his patient guidance this thesis would not have been possible. Andrew Glyn's comments on various drafts were particularly valuable. The search for an explanation of industrial inefficiency emerged from an article I wrote with Syed Hashemi on the nature of capitalist growth in Bangladesh. We discovered that conventional marxist analyses of imperialism were inadequate for explaining our predicament. My interest in the economic implications of political instability was inspired by the work of another friend, Hussain Zillur Rahman, who looked at the political economy of state formation in Bengal during the colonial period. Nisar Ahmed was a constant source of support and went through many of the early drafts. Syed Akhtar Mahmood generously shared his knowledge of industrial statistics and it was reassuring for both of us that we had independently come to address quite similar problems. Hajoon Chang's help and comments were particularly helpful because of his knowledge of South Korea and the similarity of our methodology. Syed Mahmud Ali has not only been a friend and colleague, his experience as an officer in the Bangladesh army helped to corroborate some of the arguments of the thesis. Space prevents me from acknowledging individually all the people who helped with material for the thesis, but I am indebted to them all. I must however thank Akram Khan, Shahabuddin Mosherraf Hossain, and for their help at a much earlier stage, Shapan Adnan and Mahbubullah.

The thesis would not have been possible without the King's College External Studentship and the sympathy and patience of Nick Bullock. I also received a Cambridge Overseas Student Bursary and an Overseas Research Student's Award. Towards the very end of my research I was elected to a Junior Research Fellowship at Corpus Christi College, Oxford, which helped me to complete the work. I am indebted to all these institutions.

As required by the Board of Graduate Studies, I declare that this dissertation is the result of my own work and includes nothing which is the outcome of work done in collaboration. As originally written the dissertation had four parts. For reasons of length, Part IV has been presented as a summary and the original text is presented as an appendix which the examiners may consult but need not read in detail.

Mushtaq Husain Khan.
February 1989.
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PART ONE, POSING THE PROBLEM:
INDUSTRIAL DEVELOPMENT, EFFICIENCY AND THE STATE.

Chapter One Growth and Stagnation in Industry:
Efficient Markets or Efficient States?

Introduction

The post-war period has been one of new opportunities and expectations and not just for the developed countries. The growth in world markets was unprecedented. At the same time, international capital flows to the developing countries grew significantly, aided in the fifties by transnational corporations, in the sixties by development and aid agencies, and in the seventies by multinational banks. In such a context, developing country states perhaps could not but take an active interventionist interest in industrialization. As Table 1.1 shows, some relatively underdeveloped countries, particularly the East Asian NICs, achieved rapid industrial growth. At the other end of the spectrum were countries like Pakistan and Bangladesh, classified by one author as the 'non-starters', where growth was sporadic and where dynamic economies of scale failed to emerge.

<table>
<thead>
<tr>
<th>YEAR</th>
<th>S. KOREA</th>
<th>TAIWAN</th>
<th>PAKISTAN</th>
<th>INDIA</th>
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<td>11.6</td>
<td>4.1</td>
<td>2.9</td>
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<td>1975-80</td>
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<td>13.8</td>
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<td>5.8</td>
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Source: Growth rates for each period calculated by estimating the semi-log OLS equation. Index numbers for manufacturing industry for South Korea, India and Pakistan are from UN Statistical Yearbook for Asia and the Pacific and UN Yearbook of Industrial Statistics Vol.1, various years. The manufacturing index for Taiwan is from Taiwan Statistical Data Book 1985. The manufacturing index for Bangladesh for 1960-65 was based on figures for gross product in large scale manufacturing at constant 1960 prices in Alamgir & Berlage (1974) Table C-4. For subsequent years it was based on the gross value of production in large scale manufacturing - our construction of the Bangladesh manufacturing index is described in detail in Chapter 14 Appendix A.

Performance varied quite a lot, with a few developers emerging as NICs others confronting the spectre of a looming debt crisis and yet others being relegated as 'test cases of development' shored up more or less by the aid
lifeline. Studying the 'deviant' cases, whether more or less successful may enable us to isolate some of the variables which might plausibly account for the variance. Even if we were to conclude that the least successful could not conceivably have attained the rates of growth of the most successful, we may still find that performance need not have been so poor and that critical attention should be directed to specific areas.

Located as they are at opposite ends of the spectrum of industrial performance, a comparison of Bangladesh and South Korea may be useful for two reasons. First, both countries initially faced relatively similar endowments. Both are resource poor, densely populated non-oil producing countries.\(^3\) Even if resource endowments could account for part of the difference in their relative performance, it is unlikely to account for it entirely. A second and more general observation is that conventional tools cannot satisfactorily account for the performance of either country. South Korea did better than many countries in terms of conventional indicators like investment ratios but the relative variation in these variables is hardly sufficient to account for its extraordinary growth performance.\(^4\) Equally, Bangladesh with its cheap labour and large net resource inflows continues to perform far worse than it should.

The importance of understanding 'why growth rates differ' from a policy point of view need hardly be stressed. By the eighties the international context became less favourable. The growth in world markets slowed down and particularly for commodities, growth was sometimes negative. Multinational banks retracted from the financial expansionism of the seventies and the consequent growth in the importance of the IMF in financing trade deficits added to contractionary pressures through the imposition of conditionality on financing.\(^5\) These constraints are unlikely to undergo dramatic transformation in the coming decade and as the World Bank puts it, the prospects for the poorest countries are not very good.\(^6\) Not surprisingly, the rivalry between
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competing theories of growth has also intensified. In particular, the role of markets and states have come under scrutiny. The eighties will probably be remembered for the radical reappraisal of the economics of the state, not only in the pages of theoretical journals, but also in the real world of policy.

However, while the efficiency of markets have been extensively analysed, the factors constraining the efficiency of states have not. The efficiency of a state can be defined as its ability to direct resources to the most rapid growth generating areas. We shall see that neoclassical economics provides the most systematic critique of the state, and these arguments have some initial appeal. In particular, the recent literature on rent-seeking seems appropriate for analysing the pervasive phenomenon of corruption and inefficiency in developing countries. We will argue that the neoclassical thrust against the state in general is misdirected.

Part I sets out the problem. First we outline our approach and briefly contrast it with that of other methodologies in this chapter. Chapter Two gives a brief overview of the industrial sectors in South Korea and Bangladesh. Chapter Three compares state intervention in these countries and shows that while intervention has been extensive in both, it has achieved quite different results. Chapter Four argues that these differences cannot be understood in terms of the neoclassical analysis of rent-seeking and corruption. Empirically, corruption seems to have been rife in both countries, but a distinction is made between the rent-seeking type of corruption which happens in South Korea and the clientelist transactions which are observed in Bangladesh, where corruption is often ultimately based on the power of an organized group to negotiate a payoff from a patron. There is far less evidence of clientelism in South Korea where some of the conditions which allow such transactions are absent.
Part II analyses clientelism and corruption using tools derived from the property rights literature. Clientelism rather than corruption is shown to have more serious consequences for the efficiency of the state. Clientelism is based on a specific structure of rights. It is shown that efficient interventions by the state are constrained by clientelist rights and the clientelist surplus appropriation associated with it. We develop the notion of a 'political frontier' constraining efficient state interventions. The analysis indicates why the frontier may be more or less constraining in one country compared to another and also how and why the frontier may shift over time. These results are consistent with the empirical observation of extensive state intervention and corruption in both successful and unsuccessful developers.

Part III is an examination of the industrial history of Bangladesh in terms of the analytical model developed. The concern with Bangladesh in this section reflects the fact that clientelist processes are not only much more important in Bangladesh, political changes over the sixties and seventies affected the political frontier in terms of our model. We thus have a number of hypotheses about how the frontier shifted over time in Bangladesh which contrasts with the much more favourable and stable frontier facing South Korea.

Part IV looks at industrial productivity trends in Bangladesh and South Korea, arguing that the model helps us to understand the poor performance of Bangladesh and the cyclical trends in efficiency indicators observed there. It also looks at alternative explanations of industrial performance in Bangladesh and argues that supply-side and demand-side explanations of industrial performance are on their own unsatisfactory. On the other hand, the ways in which labour markets and productivity growth interact in Bangladesh and South Korea are consistent with what we would expect from our analysis. For reasons of length Part IV is presented as a brief summary with the original text in an appendix which the examiners may wish to consult but need not read in detail.
§ 1.1 Perspectives on Performance: Marxist Structuralist and Neoclassical

Marxists have been the most critical of capitalist performance, usually basing their analyses on mode of production or dependency frameworks. Contributors have attempted to establish whether capitalism exists in particular countries, and have debated whether development is or is not possible under contemporary capitalism. However, marxist economists have by and large been interested in general characteristics of 'peripheral', 'dependent' or 'neo-colonial' capitalism rather than in explaining differences in performance across such countries.

Moreover, poor performance, for instance in Bangladesh, often led marxists to ignore the industrialization that was taking place. Apart from the usual mechanisms of dependency theory, relatively crude theories of state power were often suggested, where the state is seen to be controlled by the metropolitan bourgeoisie, local trading and financial interests, the remnants of the 'feudal' classes or their various combinations. Industrial stagnation for some marxists was the intended consequence of the interventions of a particular kind of state. But as the Bangladeshi marxist Abu Abdullah points out,

the government has, without doubt, been encouraging industrialization, attempting to create a capitalist class based in industry - much as Ayub Khan had tried with considerable success in Pakistan. There too there was plenty of over invoicing and under invoicing (misappropriation of state subsidies-MK), but nevertheless industrialization occurred. Even here it is not that there is no industrialization going on at all, it is mostly rather light, biscuit production, cosmetics, and now shrimps and clothing for export. Currently there has been quite a lot of pharmaceutical production, some production of spare parts for irrigation equipment and so on. It is impossible to accurately evaluate the present if we stubbornly refuse to see these things.

The problem, even in the slow growers, has not been that some states actively opposed industrialization. Nor is it true that industrial growth was negligible in most cases. Indeed it would have been remarkable if there was no industrial growth in an economy the size of Bangladesh. Instead we need to assess how
effectively resources potentially available for industry were allocated, and whether the allocation could be improved.

Mainstream economists have used either neoclassical or structuralist models for assessing performance and proposing policy. Neoclassical prescriptions are based on an analysis of the efficiency of markets. These include cutting back bureaucratic controls since they are inefficient, encouragement of export orientation which allows production according to comparative advantage and the promotion of the private sector because it is profit-maximizing and therefore efficient. The success of some countries is then explained in terms of their greater adherence to market-oriented neoclassical prescriptions.9

In particular, neoclassicists argue that state intervention and quantitative restrictions results in an irreducible mass of conflicting objectives which bureaucrats try to resolve by applying inefficient rules of thumb. They also give bureaucrats the opportunity for corruption as licenses and other instruments of control acquire an illicit market price. Corruption tends to move the system back to the equilibrium it would have reached anyway, but drains resources to unproductive activities.10 In recent years official policy documents have taken on board the new radical neo-classicist orthodoxy with its terminology of 'structural adjustment' and 'administrative reorganization'.11

Many of the neoclassical mechanisms linking market with efficiency will be critically examined in this and later chapters. Theory and evidence are actually not very favourable for the neoclassical argument.12 Nevertheless, since performance and especially 'efficiency' have traditionally been the subject of neoclassical economics, policy debates have been constrained by an analytical framework which was often quite restrictive. For instance, policy-makers rarely asked why both the private and public sector performed so much better in some countries. Similarly, they were not equipped to ask why some
countries were able to change their trade and industrial policies in response to market conditions, while others failed despite the export-oriented policy declarations of their governments. Most damaging for the neoclassical argument as we shall see is the fact that the non-interventionist state simply does not exist. Successful states generally have a strong tendency to intervene when growth is threatened. What distinguishes their intervention is their success.

We would have to search for more satisfactory analytical explanations if market-oriented policies did indeed produce dynamic results in specific cases. Productivity growth involves processes which were described by Schumpeter as creative destruction. As we shall see in Part II, these processes become more complicated as technology becomes large scale and requires that rights be defined in particular ways. It is possible that a greater emphasis on the market may enforce distributive changes which amount to rights being redefined in these ways. But there are no a priori reasons why rights will be altered just so. Moreover, the state remains important, not only because it is the ultimate arbiter of rights, but also because the economic arguments which justify state intervention do not disappear.

Market-promoting policies may thus be a convenient myth which sometimes helps to enforce a social balance favourable for dynamic capitalist growth. However, the main thrust of Part I of this work will be that the evidence of state intervention in successful developers indicates that the market by itself is not sufficient for this task. Equally, less successful developers do not necessarily have a lower commitment to the market, and in many cases, the quantitative balance between the private and public sectors, or between market and plan are quite similar. It is hard to argue a priori that less successful developers are stagnating because of state intervention. If all states intervene, we really need to understand the constraints which prevent some economies with state intervention from being 'efficient'.

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Structuralism was one response to the neoclassical paradigm. It rejected the important neoclassical assumption of high elasticities of substitution in production, trade and consumption. Without this, systems possess substantial tendencies to stay in disequilibrium. The malleable-capital neoclassical growth model is thus rejected as inapplicable for developing countries where large underutilized labour reserves are a persistent economic feature. Moreover, poverty itself clearly makes economic systems less flexible. Intervention, structuralists say, has to be judged in comparison with such persistent disequilibrium states of the economy. Bureaucratic foot-dragging may well be an unavoidable rationing mechanism when aggregate investment is chronically above aggregate savings, an excess-demand situation common in developing country industrial sectors.

Moreover, it was argued that neoclassical efficiency was static and thus inappropriate for understanding the problems of growth. If resources are allocated such that price equals marginal cost, the rate of industrial transformation may not be adequate. Even in a purely market economy, outcomes would depend on the distribution of rights over resources. For instance, the rate of industrial growth could differ across two similarly endowed countries with similar static allocational efficiency if the distribution of rights over assets made capitalists in potentially dynamic sectors better endowed in one case relative to the other. Putting it differently, if private costs and benefits diverge from social ones, it is possible to imagine circumstances in which growth could be enhanced by sacrificing static efficiency. As against this, an improvement in static efficiency has only a once-and-for-all effect on output and therefore a negligible effect on the growth rate.

Till very recently, official policy discussions in most developing capitalist countries have largely been informed by versions of structuralism. These have stressed the need to identify and overcome resource constraints such as the
savings or foreign exchange constraints. Success was a measure of the extent
to which such constraints were being attacked. Models such as the Harrod-Domar
growth model, Kalecki's wage goods constrained development model for non-
inflationary growth, or two-gap models and their many extensions were
developed for identifying particular resource constraints and making policy
proposals. In such models, aggregate and sectoral resource availability is
fed into sectoral input-output coefficients till the limiting resource runs out.
The results indicate the materially-constrained potential rate of growth of the
economy or sector and provide the basis for planning and evaluation.

Faced with different kinds of disequilibria, states have in fact responded with
policies such as import substitution, primary product specialization, export
orientation or balanced growth. One way in which structuralists have assessed
the performance of countries has been to compare individual performance with
the expected figures observed for the group. Studies by Chenery and others
have attempted such comparisons, adjusting countries for resource endowments,
size, level of development and so on. The results have generally supported
policy eclecticism. In a study covering a large number of developing countries
over the period 1960-75, Chenery concluded that

each of the four strategies for transforming the structure of production and trade has
produced its share of successes and failures in the period following World War II.
Success in sustaining relatively high rates of growth has depended more on an ability to
modify trade and investment policies in the light of the results achieved than on the
initial choice of strategy.

But structuralist work, while pointing out the inadequacy of the neoclassical
analysis of efficiency, did not proceed to replace it with more appropriate
analytical frameworks for explaining the greater success of some countries in
implementing growth-enhancing policies. The neoclassicists' strength was that
despite its obvious shortcomings, they had a model of price and quantity
determination in the absence of intervention, and they evaluated the effects of intervention with reference to this model. Structuralists pointed out the inadequacy of the model but took the patterns of resource-allocation and the associated technologies as given. They then tried to evaluate the implications of marginal changes in patterns of resource use.

Evaluations of the efficiency of the process through which resource allocation and the productive structure had interacted over time was exogenous to the structuralist model. The productive efficiency of the system was implicitly described by coefficients determined by exogenous technological, institutional and structural features. From the large number of structuralist studies explaining industrial performance in terms of an agricultural constraint or an import gap, it is clear that the limitations imposed on policy and evaluation by the assumption of a stable set of relationships between inputs and outputs across sectors were often not confronted.19

While neoclassical assumptions and mechanisms may be unrealistic, the evidence links growth not simply to the passage of more or of a different mix of resources down a fixed productive structure, but rather to the ability of an economy to effectively use available resources to transform its productive structure, at least as fast as its competitors. Leibenstein's observation that changes in national ICORs could usually be predicted from changes in the rate of growth, (rather than being stable constants from which the rate of growth could be predicted) had indicated more than twenty years ago that structural coefficients were not independent of other processes in the economy.20 There is no reason to believe that this is any less true today.

Thus paradoxically, while structuralist analysis began with much more realistic data, when the search for policy prescriptions became critical in the seventies and eighties, neoclassical economics enjoyed a resurgence of influence.
Realistic or not, it could offer a theory of how the economy and the state interacted to change the productive structure. In contrast, the most important assumption for the structuralist was the data describing the productive structure which was rapidly changing and moreover needed to be changed.

§ 1.2. Efficiency and Structural Transformation

The empirical evidence of post-war growth has increasingly associated successful industrialization with the ability of an economic system to carry out structural transformation. We shall mean by structural transformation the process of reallocating resources in line with the needs and possibilities of growth. It is therefore a shorthand for a range of supply-side activities which result in productivity growth in existing sectors, the transfer of resources from low productivity to high productivity sectors, and the adjustment of production to the changing structure of demand.

In a disequilibrium context, growth can occur not only through secular increases in productivity (technical progress), or through the productivity growth accompanying increases in the capital-labour ratio as the investment-share is raised, (capital deepening or intensive growth), but also by replicating investments in sectors with given capital-output ratios (capital widening or extensive growth). The last is substantially important in the context of developing countries where growth can occur without, strictly speaking, productivity growth in existing sectors, as previously unemployed or underemployed resources are brought into play.

Clearly, both extensive and intensive growth are processes of structural transformation. But the conflicts between gainers and losers, and consequently the costs associated with resource reallocation during intensive growth are often thought not to exist during periods of extensive growth. This is because it is assumed that the existence of unemployed or underemployed resources
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makes resource re-allocation conflict-free: if new production units are set up, changes are positive-sum at the macro-level and for all agents at the micro-level. We shall presently argue that successful structural transformation involves a permanent process of upgrading high-productivity sectors as well. Success is therefore usually associated with the zero-sum choices at the micro-level which often accompany intensive growth, in the sense that some agents or groups of agents lose in absolute terms or relative to others as productivity growth in the modern sector is pursued. It therefore requires institutions to manage these conflicts.

Many developing countries have vast reserves of labour subsisting on traditional activities with very low marginal rates of return. It is often assumed that the absorption of additional labour in modern activities having marginal rates of return several times higher is conflict-free as long as the gain in marginal product is greater than the increase in consumption. This appears to be the case since there are no losers in this transition: wages in the modern sector are higher than in the traditional sector, and the new activities profitable. The conditions of production can then be regarded as fixed coefficients in an input-output framework where output may be indefinitely increased by a corresponding increase in inputs.

The fallacy in the dualist model lies in ignoring the stream of future economic costs in the form of implicit or explicit subsidies to the modern sector which follow if productivity cannot be increased as efficiently as one's competitors. If viability calculations included the economic consequences of failing to match resource re-allocation and productivity growth in more successful countries, it would be difficult to avoid the unwelcome conclusion that the modern sector is often not so modern after all, and can only be sustained by a growing level of subsidization. Even using world market prices evades the dynamic aspect of the problem, since the cost of the project should include the
growing subsidy required to compensate for any difference in productivity growth over time.

One of the consequences of structural transformation would be a change in the sectoral pattern of value added. In a UNIDO Report on industrial development, concentrating on 1963-80 and covering both the developed and the developing countries, the authors call this changing pattern of value added 'structural change'. They argue that growth was significantly related to 'structural change' which in turn is achieved by shifting resources into those sectors in which labour-productivity-growth is above the average and away from the lagging sectors. Of course, the above average growth in labour productivity may result from above average growth in the output of the sector by the operation of Verdoorn's Law. But there is clear evidence that a measure of relative productivity growth correlates well with the measures of structural change.

Several decades of development experience have shown that the reasons which make efficient investment allocation and restructuring a life and death matter in the advanced capitalist countries are not suspended for the others. Even though the market may never approach the neoclassical model with a high degree of substitutability everywhere, some substitutability always exists, particularly in product markets. Even with such limited substitutability, the failure to generate a growth in productivity equal to one's competitors ultimately implies either bankruptcy, or subsidization and a loss of resources for other groups or sectors in the economy.

While the market eventually compels enterprises and nations to face the consequences of slow productivity growth, it does not automatically ensure i) that economic growth will be the dominant objective of decision makers, ii) that the growth-maximizing set of investments will be identified or identified in time, iii) that the resources will be available to implement them,
iv) that losers and gainers will smoothly re-negotiate the appropriate rights or v) that social contracts once made will be honoured. None of the industrial miracles of the twentieth century were the result of spontaneous responses to market forces. Successful countries have rather been distinguished by having strong interventionist states which were able to manage resource allocation in ways which efficiently reorganized the productive structure.

Since this is an important point which will be taken up again in later chapters, our affinity with and divergence from the structure of neoclassical analysis can be shown with a simple model. Assume the simplest case of product market substitutability where two countries produce a single tradeable product. Supply is perfectly elastic, so cost of production in the most efficient country determines world prices. Country 1 has a lower labour productivity than Country 2, but can sell its products because of a state subsidy paid to the enterprise. Prices in both countries are determined by a markup on costs. The equilibrium price is then given by the following equation:

\[
\left( \frac{W_1}{L_1} + \frac{1}{S_1} + \sum p_{1i} \alpha_i \right) (1 + m) = P^* = e \left( \frac{W_2}{L_2} + \frac{1}{S_2} + \sum p_{2i} \alpha_i \right) (1 + m)
\]

\(W_n\) is the level of money wages, \(L_n\) labour productivity, and \(p_{ni} \alpha_i\) the unit cost of input \(i\) in country \(n\). Both countries have a combination of taxes and subsidies, the net effect of which is that the enterprise has to recover only a fraction \(1/S_n\) of unit labour cost from sales. If \(S_n < 1\), there is a net tax on the enterprise while if \(S_n = 1\), there is no net transfer. For \(1 < S_n < \infty\), there is a net subsidy to the enterprise and in the limiting case of \(S_n = \infty\), the entire unit labour cost is met by a transfer from the state. For simplicity we assume \(S_n\) lies in the range \(1 < S_n < \infty\) in both countries. The markup in both countries is \(m\), \(P^*\) is the price of the product in the currency of country 1, \(e\) is the fixed rate of exchange. The source of the subsidy could be a tax on other sectors or a tax on workers paid back to the enterprise.
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\[ \frac{W_1}{\Pi_n} \cdot \frac{1}{S_n} + \sum p_{i1} \cdot \alpha_i (1 + m) = P^* = e \cdot \left( \frac{W_2}{\Pi_n} \cdot \frac{1}{S_n} + \sum p_{i1} \cdot \alpha_i (1 + m) \right) \]

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countries is m, \( P^* \) is the price of the product in the currency of country 1,
e is the fixed rate of exchange. The source of the subsidy could be a tax on
other sectors or a tax on workers paid back to the enterprise.
We assume for the sake of simplicity that the unit cost of labour $W$ remains constant (but not necessarily equal) in both countries, and the cost of inputs at world prices are constant and equal in both countries, so that $E_{p1 \alpha_1} = e_2 p_{21} \alpha_1$. Inputs include raw materials, intermediary goods and capital goods. The assumption is therefore that the two countries face constant relative prices, and this helps us to concentrate on technical inefficiency (operation within the production frontier) and technological progress (movements of the production frontier) as opposed to choice of technique (movements along the production frontier). This emphasis may be justified if we agree that in developing countries efficiency in manufacturing depends more on importing and operating technology developed in more advanced countries, and the relative gains from factor substitution given this technology are rather small compared to the gains from absorbing new technology rapidly.

If we define equilibrium in terms of maintaining the markup $m$, we can see that the post-subsidy unit labour cost has to be the same in both countries. In a dynamic context, if $W_2$ grows faster than $W$, the international price falls as a result of the growth in $W_2$. Consequently product wages in country 1 go up to a level which prevents the markup $m$ being earned. If the enterprise is to survive, the rate of subsidization (measured by $S$) has to increase. Clearly the difference in the rates of growth of productivity of the two countries has to be exactly matched by the difference in the rates of growth of $S$, or by a growth in $S$, if $S_2$ stays constant. In our simple model, the growth or faster growth of $S$ in country 1 means that the share of subsidy in unit labour cost $(1 - 1/S)$ grows or grows faster compared to country 2.

With input price and wage inflation, and particularly periodic devaluations, the picture becomes more complicated but is not substantially changed. The basic argument also holds if instead of a single product, the enterprises produce two tradeable products with an international relative price which is
exogenously determined. The relative price constraint would force similar policies on the low productivity growth economy. In reality, the prospects for the low growth country may be even more bleak. Input costs at world prices may be higher both because of inefficient use and because domestic suppliers of non-tradeable inputs are also likely to have higher costs ($\alpha$ and $p_{1e}$ are both likely to be higher relative to the competitor). Furthermore, quality advantages (or simply greater market power) may allow high-productivity countries to differentiate their prices to earn bigger markups or force greater cross-subsidization in country 1.

The increasing level of 'protection' for particular capitalists in country 1 may not be permanently acceptable to workers or to capitalists in other sectors. The protection of a structure of rights in specific sectors in the low productivity country maintains profitability, but the failure to enforce changes in rights which generate productivity growth deprives other sectors and the system as a whole of resources which may have been better invested. Our argument is neutral with respect to the nature of the rights protected in the low-productivity growth enterprises, they could be the rights of particular capitalists or categories of workers or both. Whatever the cause, the long-term growth rate of Country 1 would indicate its failure in managing technical progress. If the enterprise or sector was a modern one, the model shows very simply why a simple replication of existing technology in the modern sector is not viable even if unemployed resources are available. Viability over time requires that $S$ should not have to systematically increase to compensate for differential productivity growth.

So far this argument would be acceptable to most neoclassicists. However, they go on to argue that if only the state liberalized and retracted from the interventionist policies which amounted to the net subsidy, the market would force efficiency on the low productivity growth country. This argument is
compelling but fallacious. Since there are no countries where the state does not intervene, and because some countries may face particular disadvantages, the level of subsidy to industry and to particular sectors may be high even when the sector is a high-growth sector. Secondly, productivity growth is not independent of state intervention. We look at these points in turn.

The first problem for the liberalization argument is that $S_2 \neq 1$. While the dominant forms of state intervention differ from country to country, in terms of what the outcome would be in its absence, virtually all intervention analytically has an element of cross-subsidization. An enterprise in an advanced country which enjoys an educated work force or sophisticated infrastructure might be getting a far bigger subsidy than the developing country enterprise which is forced to negotiate a direct subsidy to allow it to compete. It follows that the size and trend of direct subsidies in country 1 is an inadequate indication of the viability of the enterprise since even with productivity growth equal to country 2, a stable or growing level of cross-subsidization in country 2 would require appropriate strategies in country 1. Moreover, although direct subsidies are more visible, if country 1 is a late developer, the only realistic response to the high level of infrastructural development in other countries may be to distribute direct subsidies.

This brings us to our second point. The reasons why state intervention can generate growth are actually well known and much of the most interesting microeconomic analysis has been done by neoclassicists. Externalities, economies of scale, learning by doing, transaction costs and prisoner's dilemma situations each describe powerful sets of reasons why growing economies and particularly developing ones may need state intervention if they are to sustain growth. Even when markets are competitive, a large range of rights are defined by competing states in ways which establish the costs and benefits of individual and collective action. The free transferability of resources,
knowledge or work practices is restricted not only by obvious restrictions such as borders but also by transaction costs, conventions, prisoner's dilemma type strategies of investors and workers and so on. If profit margins are small, even a small subsidy in country 2 may ensure that it enjoys the direct and indirect benefits of output growth in the sector while the absence of a subsidy in country 1 can mean that it has no production in that particular sector. In such cases a subsidy may even benefit the sectors being taxed, though this need not be the case.

Suppose for instance that the subsidy to the industrial sector comes entirely from agriculture. Suppose also that the subsidy allows the production of $Y_1$ units of output but that without it production would not be possible in the industrial sector at all. This is quite credible if $\frac{W_2}{W_1} < \frac{W_1}{W_2}$, and given the existing restrictions on the movement of resources, transaction costs and so on, $W_1$ cannot be raised sufficiently in the short run. The total subsidy to the sector in country 1 is then $(1-1/S_1)(\frac{W_1}{W_2})Y_1$. Let us assume that industrial workers spend their wages on agricultural commodities and the markup in agriculture is $m$. The increased profits in agriculture as a result of the additional demand from industrial workers would then be $(\frac{W_1}{W_2})Y_1m$, and the subsidy would be worthwhile for agriculture as long as $m > (1-1/S_1)$.

The linkages may of course be more complex. Not all wages may be spent on agriculture while some industrial profits may be. Industrial production may also directly produce or allow the import of commodities which increase agricultural productivity or improve the consumption pattern of agricultural tax-payers. A more realistic case is when agriculture suffers a short term loss because state decision-makers feel that there will be long term benefits for the economy with industrialization. These are problems all developing countries face not only because of their backwardness, but also because of the nature of modern technology and the inter-relatedness of production decisions.
Nevertheless, when it comes to policy prescriptions, neoclassical theory assumes that capital is perfectly divisible, information is costless, strategies are cooperative and there are no transaction costs. In such a world state intervention would indeed be pointless, and moreover getting rid of state intervention would be unequivocally beneficial in terms of improved allocational efficiency through the market, lower rent-seeking activities over subsidies and so on.

The question therefore is not whether $S_1 = 1$ or even whether $S_1 = S_2$, but really whether state intervention in country 1 increases average social productivity, and in the long run, the viability of state intervention depends on whether the state can ensure that $\Pi_1$ grows at least as fast as $\Pi_2$. Note that a reduction in state intervention in country 1 would quite probably lead to a once and for all increase in productivity if it meant an across the board cut in the level of subsidization as this would knock out some less productive enterprises and sectors. In our model, a cut in $S$ is equivalent to an increase in money wages $W$, and both could lead to a once and for all increase in productivity if the spread of technologies was smooth, that is the number of enterprises or sectors scrapped were not so large that the viability of the remaining sectors was also affected.

This Ricardian mechanism is not at issue in the debate over liberalization. The question is whether the resources thus freed could be more effectively allocated by the market. For the reasons mentioned above, the market alone may not be the most efficient allocative mechanism given realistic assumptions about the nature of technology and rights. There is no reason to believe that a lower overall $S$ will in the long run automatically lead to a higher overall $\Pi$. Our approach will be to explicitly recognize the indeterminate relationship between $S$ and $\Pi$ and to identify the constraints which prevent states from approaching an allocation of $S$ which maximizes $\Pi$ over time.
§ 1.3 The State and Rights

At one level, the role of state intervention in managing these transitions has long been recognized. In the UNIDO Report for instance, the authors suggest that it is quite possible, indeed likely, that the differential abilities of countries to undergo structural change, and hence growth, cannot be entirely explained by market responses to opportunities as and when they arise. In the case of Japan, they point out for instance that during the 1960s and 1970s, Japanese policy makers came to realise the need to restructure their economy in response to the challenge of industrial progress and competition from developing countries... When market forces were weak or sluggish in implementing such restructuring, the Government devised incentives including the provision of information, special taxes and subsidies. The overall result of restructuring (among other factors) was to increase labour productivity, which in turn enabled Japan to compete effectively in the world market including other OECD countries. It seems no accident that Japan has suffered the least from stagflation, having achieved rapid growth in value added based on efficient resource allocation via vigorous industrial restructuring.23

We will try to generalize some of the constraints operating on the state which prevent it from moving towards more efficient strategies. The state may be defined as the set of institutions involved in the legitimation and protection of rights over assets and resource flows. Conversely rights are politically defended claims over assets and resource flows. Thus the rights defining the ownership of a machine are analytically identical to the politically defended access to subsidies. The problem of growth may then be seen as one of allocating rights over resources to generate the fastest rate of growth subject to the constraint of maintaining a politically sustainable pattern of rights across classes of agents.

Not all state institutions are directly involved in decision-making about rights. In neoclassical literature, this subset of institutions is often referred to as the 'government', whereas marxist literature normally does not
make a distinction between institutions which are active in decision-making and those which may potentially be called into action to preserve a particular allocation of rights. The distinction is nevertheless important. For instance in Bangladesh, the army is in some periods active in decision-making, while in others it is a passive component of the state apparatus, as it is for instance in Britain. When we refer to the state, we will refer to the active decision-making subset of institutions.

We will argue that ultimately, structural transformation requires a reallocation of investible resources, and consequently management of the changes in rights which ensures this. Since our central concern is with the industrial sector, we define the aggregate surplus available to the industrial sector as the fund potentially available for investment there. All resources potentially available for investment in industry are not necessarily generated there, and hence we will identify a number of components of the aggregate surplus in the analysis of Part II. It should be obvious though that the total net subsidy which is allocated by the state through its various activities is potentially investible and therefore a part of the aggregate surplus. This is because an appropriate allocation of subsidies to sectors contributing to overall growth could serve to change the productive structure and increase productivity.

Not all of the aggregate surplus is invested. The investible surplus is a variable fraction of the aggregate surplus and is what remains after the consumption of the surplus-appropriating classes. We shall see in Part II that the nature of rights over assets determine the components of the aggregate surplus as well as the size and allocation of the investible surplus.

From the point of view of growth, there are two aspects to the allocational problem. The first is the question of the appropriateness of existing rights over resources with respect to the direction of potentially investible
resources to the most productive investments. This problem is restated in Part II in terms of a set of conditions on the allocation of rights which generate the most efficient allocation of investible resources and hence the fastest rate of growth. The second aspect of the allocational problem may be described as the resistance to change particular patterns of rights when attempts are made to move in the direction of greater efficiency. Clearly the question of change depends to some extent on the historical allocation of rights, but it also depends on the strength of political mobilizations which emerge to protect particular categories of rights, on the efficacy of state institutions and perhaps even on the abilities of a few individuals. Outcomes therefore are not a foregone conclusion nor will the most efficient allocation of rights always emerge. Indeed since existing assignments of rights are rarely appropriate, our task is to identify the factors which constrain the emergence of efficient structures of rights for achieving growth.

While the first point refers to the adequacy of the existing assignment of rights for achieving growth, the second refers to the nature of the path away from it. If an assignment has to be changed this has implications for the political viability of the state and its ability to manage the transformation. The question of appropriateness and change seems to be a critical link in the chain of cause and effect involved in any process of structural transformation and one which has enjoyed surprisingly little attention in the literature.24

Efficiency in the case of the state may be conceived of as the ability to direct the available aggregate surplus to the fastest growth generating areas. Since this efficiency can only be measured in terms of its economic outcome, we could just as well have spoken of the efficiency of the economy. However, our concept of efficient state intervention will allow us to focus on the the constraints set on efficient industrial transformation by the appropriateness of rights and their responsiveness to growth inducing changes.
We are not however suggesting that state decision makers attempt to compute these outcomes, and indeed the statistical requirements for a precise judgement would make such an attempt virtually impossible. Conceptually, a precise calculation would require knowledge of how marginal changes in the allocation of the aggregate surplus could be engineered through marginal changes in rights and the possible growth paths which are available at each stage from alternative allocations of the aggregate surplus. The first question can at best be approached analytically and in very general terms, and in Part II we will attempt to do this. The subsequent empirical implications of alternative allocations of potentially investible resources could only be predicted ex ante on the basis of a range of data not realistically available. Since performance in the real world clearly varies across cartels, groups and even individuals, the planner would need to know the allocation of the surplus within each class, across groups and individuals, and their corresponding expenditure patterns. Moreover, technology is not static and technological progress in different sectors depends on the allocation of the aggregate surplus, so to compute alternative growth paths, the planner would also need to know the annual input-output tables corresponding to each growth path.

Neither economists nor bureaucrats can be expected to 'know' ex ante what the best allocation of rights should be, nor are more successful states characterized by having better planners or planning techniques. The difference rather seems to be that successful states are better equipped to grope towards superior allocations. Mistakes are often quite obvious and require very little economic sophistication to comprehend. Efficient states characteristically react by changing rights and allocations which attempt to rectify these. On the other hand, inefficient states are characterized by their inability to change allocations or alter rights except at considerable cost. By comparing state intervention in Bangladesh and South Korea, we aim to identify some of the factors which may account for such differences.
Notes to Chapter One.

1. Of course all developing countries did not pass through these phases. In Bangladesh, the domestic economy was too underdeveloped to take advantage of the spurt in foreign commercial lending in the seventies, and foreign inflows are still made up primarily of aid and soft loans. Griffith-Jones & Rodriguez[1984] p. 48.


3. In an assessment of the regional distribution of natural resources, John Cole ranks South Korea below Bangladesh in terms of the availability of resources. Cole[1981] Table 7.10. The resources considered are land (adjusted for productivity), fossil fuels, non-fuel minerals and 'territory', the last being a measure of the size of the country and therefore the potential for further development and discoveries. In terms of population density, Bangladesh has approximately 2 sq. km of usable land per 1000 inhabitants compared to approximately 3 sq. km for South Korea. Cole[1981] Table 4.5.


7. Dependency theories based on Frank[1967] and Wallerstein[1974a] and [1974b], 'Unequal Exchange' theories based on Emmanuel[1972], and more sophisticated theorizations of centre-periphery relationships, such as in Amin[1974] have greatly influenced the categories used by radical Bangladeshi economists. (For a review of these theories, see Brewett[1980].) Sobhan's analysis of the constraints imposed by foreign aid, for instance, is implicitly much influenced by the dependency framework. Other economists use the concept of 'dependent capitalism' and 'state sponsored capitalism'. See for example the series of articles entitled 'Industrialization in Bangladesh' (in Bengali) by M. M. Akash, in the Shongbad of the 10th, 17th and 24th of February and the 3rd of March, 1986, and Akash, M. M.[1987].

The mode of production debate in Bangladesh has been largely over the characterization of the agrarian sector. There has been a largely inconclusive debate on the classification of the economy, 'semi-feudal', 'semi-colonial', 'capitalist' and 'underdeveloped capitalist' being among the contenders. A summary of recent opinion is contained in Bangladesh Lekhok Shibir[1985] (in Bengali). Much of this debate is guilty of what Zillur Rahman has called 'counterfactual theorization', that is, the setting up of abstract categories and then disputing whether reality matched the definitions. Rahman, H. Z.[1986] pp. 2-8.

9. Neoclassical growth theory in its 'classical' form was developed in Solow (1957), but modern neoclassicals do not necessarily believe that the production function is anything more than a useful simplification. They do however have faith in the efficiency of markets. Examples include Little, Scitovsky & Scott (1970), Ramas & Fei (1975), Bhagwati & Desai (1970), Bhagwati & Srinivasan (1975) and (1983), Balassa (1980), Balassa et al. (1982), Little (1982), Krueger (1974) and IRRO (1983b).

10. Bhagwati & Desai (1970) and Bhagwati & Srinivasan (1975), and especially pp. 36-41 of the latter,

11. The emphasis on 'administrative reorganization', 'structural adjustment' and denationalization can be seen in recent World Bank documents on Bangladesh, such as IRRO (1984) and (1986). 'Structural adjustment' became a condition for loans to some countries from 1980. Mosley (1987) pp. 39-42.

12. The neoclassical critique of Import-Substituting Industrialization (ISI) has been empirically and analytically questioned in Nixon (1982) and Kirkpatrick, Lee & Nixon (1984) pp. 197-201. They argue that Export-Oriented Industrialization (EOI) countries like South Korea have extensive import controls and are different only in that they have been able to use controls to develop the domestic economy. The growth of exports could well be a manifestation of a dynamic economy rather than its cause.


13. Schumpeter (1961) pp. 81-6 and (1939) pp. 72-129. In the Schumpeterian vision, it is not the efficiency of static allocation which recommends the capitalist market, but rather the context it creates in which innovators are rewarded and the less effective can be wiped out or taken over, with obvious consequences for growth.

14. What is loosely known as 'structuralism' actually developed through the work of a large number of economists, including Paul Rosenstein-Rodan, Ragnar Nurksie, W. Arthur Lewis, Raül Prebisch, Hans Singer, Gunnar Myrdal and Michal Kalecki (see Note 17). Contemporary exponents include Hollis Chenery, for instance in Chenery (1979), Chenery & Strout (1966) and Chenery & Syrquin (1975), and Lance Taylor, for instance in Taylor (1979) and (1983).

15. Aniya Bagchi takes this position in his critique of the neoclassical approach of Bhagwati & Desai, in Bagchi (1971). The thrust of Bagchi's critique is to reiterate the well-known macro-inefficiencies of the market which may well result from an attempt to discipline bureaucrats by bringing in more of the market.


17. Kalecki consistently emphasized the foodgrain constraint to growth in developing countries in a number of writings, Kalecki (1960a), (1960b), (1970) and (1976). For an early exchange on the two-gap analysis, which
covered most of the issues, see Grubin[1969] and Chenery's reply in Chenery[1969]. In Bangladesh, Rahman[1978] uses Kalecki's framework to empirically show the existence of an agrarian constraint to GDP growth. His results depend on the estimated supply and demand functions for foodgrains. In any case, we would not really dispute the contention that in a poor economy like Bangladesh, poverty is the 'ultimate' problem.


19. Ian Little suggests that if investments had been planned on the basis of such models, the Far Eastern 'miracles' would have been effectively prevented. Little[1982] pp. 134-5.

20. Leibenstein argues that the rate of investment rather than the incremental capital-output ratio ( ICOR ) is the more stable of the variables affecting growth in the conventional Harrod-Domar growth equation. In Leibenstein's evaluation of the growth process, the importance of non-capital inputs and the level of their utilization means that ICORs are a function of growth rather than vice versa. Leibenstein[1966], pp. 20-24.


22. Ranis & Fei[1988] for instance argue that the very political desire for growth and the associated state intervention results in policy cycles which lower the rate of growth. They prescribe a minimalist monetarism, which in the development context is a step beyond, though clearly a logical extension of previous neoclassical work on export orientation and comparative advantage or the work on rent seeking.


25. A base-year input-output table would not be sufficient for such a projection, because we would want to know whether a different surplus allocation would lead to a faster transformation of the coefficients.
Chapter Two Industrial Growth in Bangladesh and South Korea

This chapter provides a brief overview of industrial growth in South Korea and Bangladesh. We will follow convention and mean by industry, divisions two to five of the International Standard Industrial Classification (ISIC). These cover mining, manufacturing, electricity gas and water, and construction. However, we will concentrate for the most part on manufacturing and its subsectors (division three) since we would agree with the judgement that manufacturing is the engine of growth, certainly within the industrial sector.

Table 2.1 shows the pace of structural change in the two countries. In Bangladesh there was a rapid growth in the share of industry following the partition of India in 1947, but this growth was not sustained. The early growth was partly a response to the disequilibrium brought about by partition, which left the bulk of Indian industry in what became the Indian republic, and partly a product of the political arrangements of the early sixties which we shall see allowed rapid industrial growth. Subsequently, however, growth was extremely poor. In South Korea in contrast, industrial growth accelerated in the sixties and this was reflected in its rapid structural transformation.1

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>65.4</td>
<td>53.3</td>
<td>47.5</td>
<td>50.3</td>
<td>26.2</td>
<td>11.8</td>
</tr>
<tr>
<td>Industry</td>
<td>3.6</td>
<td>15.3</td>
<td>15.1</td>
<td>7.8</td>
<td>31.6</td>
<td>51.3</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>[3.0]</td>
<td>[7.8]</td>
<td>[9.3]</td>
<td>[5.9]</td>
<td>[25.0]</td>
<td>[39.9]</td>
</tr>
<tr>
<td>Large Scale</td>
<td>(0.6)</td>
<td>(3.7)</td>
<td>(5.3)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Small Scale</td>
<td>(2.4)</td>
<td>(4.1)</td>
<td>(4.0)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Services</td>
<td>31.0</td>
<td>31.4</td>
<td>37.4</td>
<td>38.6</td>
<td>32.2</td>
<td>36.9</td>
</tr>
</tbody>
</table>

Sources: Bangladesh figures for 1949/50 and 1969/70 are at constant 1960 prices from Alamgir and Beriag[1974], Appendix C, Table 5. The 1980/85 figures are multiyear averages IIMD[1986] Vol.II, Table 2.2 at current market prices. Given the trend in the agriculture-industry terms of trade, the 1980/85 figures probably underestimates the growth in the share of industry but the discrepancy is unlikely to be large. South Korea figures are at constant 1970 prices for all periods and are from Kim and Reemer[1979] Table 55 and UN National Accounts Statistics, UN[1985].
Indeed in Table 2.2, looking at the structure of output and employment in 1985 in the two countries it is clear that they had by then become quite dissimilar. Current exchange rate conversions almost certainly understate the output and therefore the output per person in Bangladesh compared to South Korea. Nevertheless, the gap in the average level of productivity had become so large that it would be reasonable to expect the two economies to have quite different dynamic characteristics. We are however interested in the process which led to this transition during the sixties and seventies, when both economies pursued strategies to industrialize economies which were predominantly agricultural in the fifties.


<table>
<thead>
<tr>
<th></th>
<th>BANGLADESH</th>
<th></th>
<th>SOUTH KOREA</th>
<th></th>
<th>80 VA/Person</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Value Added</td>
<td>Labour Force</td>
<td></td>
<td>Value Added</td>
<td>Labour Force</td>
</tr>
<tr>
<td></td>
<td>million US$</td>
<td>millions</td>
<td>Person US $</td>
<td>million US$</td>
<td>millions</td>
</tr>
<tr>
<td>Agriculture</td>
<td>6,640</td>
<td>16.4</td>
<td>403.7</td>
<td>11,6304</td>
<td>3.7</td>
</tr>
<tr>
<td>Industry</td>
<td>1,999</td>
<td>3.1</td>
<td>648.3</td>
<td>34,3276</td>
<td>4.6</td>
</tr>
<tr>
<td>Services</td>
<td>4,534</td>
<td>6.8</td>
<td>663.5</td>
<td>29,6561</td>
<td>6.6</td>
</tr>
<tr>
<td>Total</td>
<td>13,174</td>
<td>26.3</td>
<td>500.8</td>
<td>75,6141</td>
<td>15.0</td>
</tr>
</tbody>
</table>


If we take industrial productivity as an index of economic development, a comparison of Bangladesh and South Korea in the eighties in Table 2.2 shows that this is where the gap in productivity performance became largest. This assumes of course that intersectoral terms of trade in the two countries are not substantially dissimilar, but a priori we would expect terms of trade differences to understate industrial productivity in the more advanced country. There are some other reasons which make the stagnation in industrial productivity especially critical for Bangladesh.

An adverse conjuncture of economic and demographic processes over the last five decades produced a substantial increase in the proportion of the rural landless in Bangladesh from 20% to around 50% of the rural population. The scale of the agrarian problem rules out the possibility of advocating purely
agricultural responses. Moreover, agricultural productivity growth may itself depend on the supply of industrially produced inputs and the incentive of industrially produced consumer goods. On this issue at least, there is wide agreement across the political spectrum. For instance, the marxist Badruddin Umar, writing on the failure of land reform, writes that

it is clear that as long as an adequate growth in the industrial sector is not possible, the critical situation in the provision of employment opportunities will continue.4

The World Bank apparently does not disagree:

Rapid industrial growth is a necessary condition for the eventual solution of Bangladesh's problems of slow GDP growth, mass poverty and heavy dependence on foreign investment resources. Agricultural development alone will be insufficient to overcome these problems. Although soil fertility is high, its present productivity low and farmers' response to output incentives by recent years' experience highly encouraging, the total contribution of agriculture to economic growth will remain strictly circumscribed by the relatively very small area of available land. Tentative calculations by the Bank suggest a maximum possible sustained growth rate of agriculture of three to four per cent per year.5

Incomes per head of even the working population in agriculture are already amongst the lowest in the world.6 Let us assume (and hope) that Malthusian options are not politically viable in the existent international order. Paradoxically, the very population density and volatile borders of the region perhaps makes such a strategy too politically risky. A discussion of viable strategies therefore has to confront the problem of industrial stagnation even if one did not believe that all countries would experience a similar growth in the share of manufacturing industry as a consequence of development.

Slow growth in the Bangladesh manufacturing sector cannot be attributed to low profitability. Table 2.3 shows that while manufacturing profitability in Bangladesh declined from 1960 to 1980, it remained fairly high. The decline was not due to a rising wage share but rather low productivity growth and a
Part I

Chapter Two

rising capital output ratio. Columns 6 and 8 of Table 2.3 show that the wage share in manufacturing remained fairly constant in both countries which implies that productivity in both countries moved in line with product wages (money wages deflated by the product price), which is what is significant for enterprise accounting.

### TABLE 2.3: PROFITABILITY IN MANUFACTURING

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>5.48</td>
<td>3.4</td>
<td>6.1</td>
<td>67%</td>
<td>37.6%</td>
<td>5.68</td>
<td>38.3%</td>
</tr>
<tr>
<td>1965</td>
<td>12.61</td>
<td>10.2</td>
<td>17.5</td>
<td>58%</td>
<td>24.3%</td>
<td>13.01</td>
<td>36.1%</td>
</tr>
<tr>
<td>1970</td>
<td>16.24</td>
<td>11.6</td>
<td>18.7</td>
<td>62%</td>
<td>24.0%</td>
<td>16.12</td>
<td>37.4%</td>
</tr>
<tr>
<td>1975</td>
<td>11.10</td>
<td>6.1</td>
<td>25.8</td>
<td>23%</td>
<td>34.1%</td>
<td>29.04</td>
<td>38.1%</td>
</tr>
<tr>
<td>1976</td>
<td>14.32</td>
<td>9.4</td>
<td>29.0</td>
<td>32%</td>
<td>34.5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1982</td>
<td>25.84</td>
<td>17.4</td>
<td></td>
<td>38%</td>
<td>32.5%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


Employee compensation as a share of value added was slightly higher in South Korea. But labour productivity there was high enough and grew fast enough to keep this share comparable to that in Bangladesh despite very different levels of wages and real wage growth. Indeed we shall see in Part IV that when we look at sub-sectoral wage shares, many of the important manufacturing sub-sectors in South Korea had a lower wage share than in Bangladesh because of very large productivity differentials.

Industrial wages in Bangladesh are amongst the lowest in the world. In 1976, average daily wages for skilled workers were about US$ 0.53, and for unskilled workers about US$ 0.43. This compares with average daily wages in the same
Part I

Chapter Two

rising capital output ratio. Columns 6 and 8 of Table 2.3 show that the wage share in manufacturing remained fairly constant in both countries which implies that productivity in both countries moved in line with product wages (money wages deflated by the product price), which is what is significant for enterprise accounting.

**TABLE 2.3: PROFITABILITY IN MANUFACTURING**

<table>
<thead>
<tr>
<th>Year</th>
<th>Value Added</th>
<th>Operating Capital/Stock</th>
<th>Rate of Return</th>
<th>Labour Cost/Value Added</th>
<th>South Korea</th>
<th>Labour Cost/Value Added</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>5.48</td>
<td>3.4</td>
<td>6.1</td>
<td>57%</td>
<td>37.6%</td>
<td></td>
</tr>
<tr>
<td>1965</td>
<td>12.61</td>
<td>10.2</td>
<td>17.5</td>
<td>58%</td>
<td>24.3%</td>
<td></td>
</tr>
<tr>
<td>1970</td>
<td>15.24</td>
<td>11.5</td>
<td>18.7</td>
<td>62%</td>
<td>24.0%</td>
<td></td>
</tr>
<tr>
<td>1975</td>
<td>11.10</td>
<td>6.1</td>
<td>25.8</td>
<td>23%</td>
<td>34.1%</td>
<td></td>
</tr>
<tr>
<td>1976</td>
<td>14.32</td>
<td>9.4</td>
<td>29.0</td>
<td>32%</td>
<td>34.5%</td>
<td></td>
</tr>
<tr>
<td>1982</td>
<td>25.84</td>
<td>17.4</td>
<td>na</td>
<td>38%</td>
<td>32.5%</td>
<td></td>
</tr>
</tbody>
</table>

Source: (3) is Value Added minus Employee Cost, with no adjustment for depreciation or taxation, (4) is based on census respondent figures for 'Value of Fixed Assets', which the World Bank corrects by adding investments at constant rather than current prices, Accountancy depreciation conventions also diverge from physical scrapping rates but these are not corrected. See IPRD(1978) p. 181, (5)=(3)/(4)X100, (6) is the share of employee compensation (workers and employees) in value added, both at constant prices. By definition value added = employee compensation + operating surplus, 1960-76 figures are from IPRD(1978) Vol. II Annexes I.5, 1.6 & I.7, 1982 figures for (2), (3) and (6) are directly from the Census of Manufacturing Industries of the Bangladesh Bureau of Statistics used by the World Bank. The 1982 figure for (5) is from Atiq Rahman(1985) Table 11, where (5) is estimated at current prices, using the net worth of capital as the measure of capital stock, (7) and (8) are based on UN National Accounts Statistics, UN(1982) and (1985).

Employee compensation as a share of value added was slightly higher in South Korea. But labour productivity there was high enough and grew fast enough to keep this share comparable to that in Bangladesh despite very different levels of wages and real wage growth. Indeed we shall see in Part IV that when we look at sub-sectoral wage shares, many of the important manufacturing sub-sectors in South Korea had a lower wage share than in Bangladesh because of very large productivity differentials.

Industrial wages in Bangladesh are amongst the lowest in the world. In 1976, average daily wages for skilled workers were about US$ 0.53, and for unskilled workers about US$ 0.43. This compares with average daily wages in the same
year in Hong Kong (US$ 4.67), South Korea (US$ 3.16), and Taiwan (US$ 4.24). Table 2.4 based on ILO figures for 1986 shows that the wage differential between South Korea and Bangladesh in comparable sectors was in most cases even larger than the average differential ten years earlier.

### TABLE 2.4: COMPARATIVE INDUSTRIAL WAGES IN SOUTH KOREA AND BANGLADESH-1986

(Average hourly earnings in US Dollars)

<table>
<thead>
<tr>
<th>Industry</th>
<th>Bangladesh</th>
<th>South Korea</th>
</tr>
</thead>
<tbody>
<tr>
<td>Thread and Yarn Spinner</td>
<td>0.15</td>
<td>1.53</td>
</tr>
<tr>
<td>Cloth Weaver (Machine)</td>
<td>0.15</td>
<td>1.32</td>
</tr>
<tr>
<td>Garment Cutter</td>
<td>0.34</td>
<td>1.06</td>
</tr>
<tr>
<td>Sewing Machine Operator</td>
<td>0.26</td>
<td>1.03</td>
</tr>
<tr>
<td>Engineer</td>
<td>0.45</td>
<td>3.49</td>
</tr>
<tr>
<td>Supervisor</td>
<td>0.30</td>
<td>2.15</td>
</tr>
<tr>
<td>Machine Operator</td>
<td>0.25</td>
<td>2.09</td>
</tr>
<tr>
<td>Sawmill Operator</td>
<td>0.06</td>
<td>1.20</td>
</tr>
<tr>
<td>Machine Operator</td>
<td>0.31</td>
<td>1.25</td>
</tr>
</tbody>
</table>

**Source:** ILO Bulletin of Labour Statistics 1986, Average Earnings/Month adjusted by Average Hours per Week Paid For, and converted at current exchange rates from UN Monthly Bulletin of Statistics 1987.

The fairly constant share of labour in manufacturing value added in Bangladesh does not mean that real wages have kept in line with productivity growth in manufacturing, since a large part of money wages are spent on agricultural products where inflation may be higher because of a relatively lower productivity growth. In fact, as Table 2.5 shows, while real wages in South Korean manufacturing have been rapidly growing, in Bangladesh over the last two decades, the trend of real wages has been stable or declining.

### TABLE 2.5: MANUFACTURING REAL WAGES INDICES (Base 1970)

<table>
<thead>
<tr>
<th>Year</th>
<th>Bangladesh</th>
<th>South Korea</th>
</tr>
</thead>
<tbody>
<tr>
<td>1964</td>
<td>102.5</td>
<td>100.0</td>
</tr>
<tr>
<td>1966</td>
<td>101.3</td>
<td>104.4</td>
</tr>
<tr>
<td>1968</td>
<td>95.5</td>
<td>153.9</td>
</tr>
<tr>
<td>1970</td>
<td>100.0</td>
<td>219.4</td>
</tr>
<tr>
<td>1972</td>
<td>101.3</td>
<td>227.6</td>
</tr>
<tr>
<td>1974</td>
<td>61.0</td>
<td>241.0</td>
</tr>
<tr>
<td>1976</td>
<td>56.7</td>
<td>276.5</td>
</tr>
<tr>
<td>1978</td>
<td>59.9</td>
<td>316.5</td>
</tr>
<tr>
<td>1980</td>
<td>74.1</td>
<td></td>
</tr>
<tr>
<td>1982</td>
<td>78.6</td>
<td></td>
</tr>
<tr>
<td>1984</td>
<td>94.7</td>
<td></td>
</tr>
<tr>
<td>1986</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Whatever the causes of industrial stagnation in Bangladesh, workers rather than capitalists seem to have suffered the consequences. A competitive wage share has been maintained at the expense of stagnant real wages. Profitability of course, does not by itself adequately describe production conditions. Labour militancy, infrastructural support and political stability also matter. Nevertheless, with a stable wage-share and virtually unlimited supplies of labour, Bangladesh would seem to conform with all the dual-economy model requirements for rapid industrial growth. Yet industrial growth in Bangladesh has been much poorer compared to the NICs as we saw in Table 1.1.

Ever since the work of Paul Baran, economists have put forward possible explanations for the lack of capitalist dynamism in undertaking industrial investments, particularly in developing countries, even when they are potentially profitable. However, conventional economic analysis underlying most neoclassical and marxist work predicts a positive relationship between profitability, industrial investment and growth. In Part II we argue that such models implicitly make important assumptions about technology and the rights agents have over assets and income.

Industrial transformation requires not only that the conditions of production are appropriate, but also that an adequate institutional process exists for re-negotiating the changes in rights associated with the changes in output. The fact that the industrial sector in a particular country has managed to negotiate an appropriate level of profitability does not ensure that the dynamic changes in rights necessary for growth will also occur. The latter, as we shall see, requires an additional set of assumptions. In the general case, a crisis may be brought about by the periodic fluctuations of profitability relative to the expectations of entrepreneurs, but stagnation is more usefully seen as the failure of the economic system to manage the dynamic transformations necessary for growth.³
Notes to Chapter Two.

1. The patterns corroborate the argument of Rowthorn & Wells [1987] pp. 5-24 about the expected trend of sectoral shares at constant prices. See particularly Figs. 1, 2 a-c. The share of services remains fairly constant, agriculture declines and industry increases. The relative development of these trends is thus an indication of the relative development of the economy.

2. All currency conversions in this work are at current exchange rates. However, exchange rate conversions do not capture differences in the relative purchasing power of currencies. The UN's International Comparison Project (ICP), attempts to correct for this by applying a common (world market) set of prices to the quantities of goods and services in each country's final expenditure on GDP. Comparing per capita GDPs in US$ at official exchange rates and 'International Dollars' obtained in this way, in 1975 (Phase III of ICP), it was found that the former measure gave significantly lower results than the latter in the case of the developing countries. In the case of India, the International $ measure of per capita GDP was 323% higher and in the case of Pakistan 312% higher than the US$ measure of per capita GDP. Kravis et al [1982] pp. 11-13, and Kravis [1976] pp 1-44.

Per capita GNP in Bangladesh in 1984 was US$ 135 according to the regional tables compiled by the Far Eastern Economic Review's Asia 1986 Yearbook. In purchasing power terms, looking at the results for Pakistan and India, Bangladesh's per capita GNP may be about three times higher. Since Purchasing Power conversions were not available for Bangladesh, we have used current exchange rates for all countries for consistency.

3. Analysis of landlessness trends is complicated by differences in the categorization of the rural population. The Floud Commission estimated in 1940 that 18.6% of the 'farm labour force' was landless. (Stepanek [1979] p. 94). A contemporary estimate is provided by Stepnke, who finds 40-60% of the rural population to be landless, on the basis of village records maintained by Union Councils. (Stepanek [1979] p. 100). The Land Occupancy Survey conducted by the Statistical Division of the Bangladesh Ministry of Planning in 1977 found three categories, those without any land, those with only homestead land and those with less than half an acre of arable land, to amount to almost 50% of all rural households, who may be considered to be functionally landless. The figure of 50% is also accepted by the World Bank, see for instance [IBRD [1984] p. 1.


6. One estimate of the average agricultural wage, calculated from weighted district figures puts it at $0.68/day in 1982/3 (one dollar approximately equalled 25 Taka in 1983). ([IBRD [1984] Vol.II p. 116). Employment is presumably on a seasonal basis. The trend has been one of stagnant wages. The average daily real wage for agricultural workers in Taka at 1969 prices, were:

<table>
<thead>
<tr>
<th>Period</th>
<th>Real Wages/Day</th>
</tr>
</thead>
<tbody>
<tr>
<td>1949-50</td>
<td>3.15</td>
</tr>
<tr>
<td>1954-55</td>
<td>2.75</td>
</tr>
<tr>
<td>1959-60</td>
<td>2.80</td>
</tr>
<tr>
<td>1964-65</td>
<td>3.42</td>
</tr>
<tr>
<td>1969-70</td>
<td>3.13</td>
</tr>
<tr>
<td>1974-75 (Famine)</td>
<td>1.89</td>
</tr>
<tr>
<td>1979-80</td>
<td>2.27</td>
</tr>
</tbody>
</table>
(Sources: Samad[1981] Table 1A p. 87, IRAQ[1984] Tables 9.10 and 9.12, pp. 116 & 118). These figures are indicative of the bargaining power of the land-poor. The Land Occupancy Survey 1977 indicates that only 10.5% of arable land is cultivated exclusively with family labour, but hired labour is not the dominant form of organizing production. Sharecropping is widespread, a usual form giving 50% of gross output to the cultivator.


8. Evidence of the worsening terms of trade of manufacturing as productivity grows faster in this sector is available for an early period of Bangladesh’s industrialization (1951-64), in Lewis & Hussain[1966].

9. Expectations cannot be an important part of a theory of stagnation without the argument becoming circular. Keynes’ theory of investor expectations is a theory of the short run, although Keynes would argue that this was longer than people thought. If long term trends are the subject of study, expectations, if they were rational, would be derived from the working of the economy. Hence it would be circular to explain the economy in terms of investor expectations. Differences of opinion about how expectations are formed are therefore really differences of opinion about how the economy works. See Dow[1985] pp. 137-166.
Despite the claims of neoclassical liberalizers, a growing amount of evidence has shown that the experience of South Korea is actually very damaging for their case. As Foster-Carter points out,

the étatisme that pervades South Korea makes nonsense of any claims on behalf of the 'free market'. Seoul is emphatically not Milton Friedman territory... the state over the years has persistently intervened in every way and at every level in the South Korean economy: by no means just 'fine tuning' or correcting market imperfections, but shaping and directing the entire process.'

This chapter provides some evidence and points out some of the ways in which intervention in South Korea and Bangladesh compare and contrast. The evidence of this chapter and the next serves to introduce the analytical arguments of Part II, where we look at the constraints set on the state's efficiency by political processes which maintain different balances of rights. State activities are examined under three heads. First, the state mobilizes and directs the utilization of a part of the aggregate surplus, through direct investments or through credits to the private sector. It is also involved in running the public enterprise sector. And finally it is responsible for maintaining a system of regulation and control.

§ 3.1 Surplus Mobilization and Allocation

States in late developing capitalist countries have perceived the need and have had the ability to allocate a substantial part of the aggregate surplus. The Annual Development Programme (ADP) of the Bangladesh state allocates resources to the industrial sector, infrastructural and power development programmes and social programmes. Not all of this is investment, but table 3.1 shows that ADP allocations have in recent years amounted to around 10% of the gross national product at market prices. Most of the ADP allocations to investment go to
public sector enterprises or semi-autonomous authorities. Table 3.1 shows the large share of these public investments in total investments and in the industrial sector. As a result of denationalizations and policy shifts towards the private sector, the importance of public industrial investment has declined since the mid-seventies, but as column four shows, state funding has been directed to the private sector through credit institutions and have accounted for a significant part of private industrial investments.2

<table>
<thead>
<tr>
<th>YEAR Programs / SME %</th>
<th>Public Investment $</th>
<th>Total Investment $</th>
<th>Public Industrial Investment $</th>
<th>Total Industrial Investment $</th>
<th>Private Industrial Investment $</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973 8.8</td>
<td>88.7</td>
<td>15.8</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1974 4.3</td>
<td>90.3</td>
<td>7.9</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1975 3.1</td>
<td>49.4</td>
<td>90.5</td>
<td>24.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1976 7.9</td>
<td>45.2</td>
<td>84.0</td>
<td>22.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1977 9.5</td>
<td>47.0</td>
<td>87.7</td>
<td>36.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1978 9.7</td>
<td>55.2</td>
<td>84.2</td>
<td>31.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1979 10.9</td>
<td>52.3</td>
<td>78.7</td>
<td>42.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1980 13.1</td>
<td>61.0</td>
<td>68.1</td>
<td>54.4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1981 11.7</td>
<td>58.6</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1982 13.3</td>
<td>50.4</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1983 11.3</td>
<td>52.2</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AVERAGE 9.4</td>
<td>52.4</td>
<td>84.0</td>
<td>29.5</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Column (1) Tables 2, 4 and 5, [1984] Vol.II, [2] [1984] Vol.II Table 2,7, [3] From our Table14-6,1, [4] BSB and BSRS are the two state owned institutions specializing in long-term financing (these institutions are discussed later). Loans refer to annual disbursements. A small additional amount of state credit for private capital formation comes from the nationalized commercial banks, Govt.of Bangladesh[1984] Tables pp, 118 and 132 and our Table14-8,1.

In South Korea, the share of investible resources channelled through the state has not been very different. In 1962 Park Chung Hee brought virtually the entire banking system under public ownership. Interest rate reforms increased private savings while enforcement of tax collection increased tax revenue. Together with the surplus generated in the public sector and its control over foreign investment allocation, Datta-Chaudhuri estimates that by the early seventies, the South Korean state directly or indirectly controlled the allocation of more than two-thirds of investible resources.2

The proportion of total investment allocated by the state ensures that its sectoral expenditure pattern and efficiency of resource use will have
substantial dynamic implications. It also implies that the state's success in mobilizing domestic savings would have a correspondingly large effect in determining the country's aggregate investment share. However, at an early stage of development, the importance of foreign inflows in total investment means that the state's allocative efficiency is probably more important than its success in mobilizing savings. Table 3.2 compares the availability of investible resources in Bangladesh with that in other developing countries. Gross investment resources gives a rough comparative indication of the size of what we have called the aggregate surplus potentially available for investment.

**TABLE 3.2: AVAILABILITY OF DOMESTIC AND EXTERNAL RESOURCES**

<table>
<thead>
<tr>
<th>Country</th>
<th>Gross National Savings</th>
<th>Gross Foreign Capital Inflow</th>
<th>Gross Investment Resources Available</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chenery and Strout's  sample of 31 developing countries: 1962</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Median Values,†</td>
<td>12</td>
<td>5</td>
<td>17</td>
</tr>
<tr>
<td>South Korea:‡</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1953-61</td>
<td>2</td>
<td>8</td>
<td>10</td>
</tr>
<tr>
<td>1962-71</td>
<td>12</td>
<td>9</td>
<td>20</td>
</tr>
<tr>
<td>1972-73</td>
<td>20</td>
<td>4</td>
<td>24</td>
</tr>
<tr>
<td>Bangladesh:§</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1973-76</td>
<td>0.5</td>
<td>6.9</td>
<td>7.4</td>
</tr>
<tr>
<td>1977-84</td>
<td>4.1</td>
<td>5.6</td>
<td>9.7</td>
</tr>
</tbody>
</table>


† From Chenery (1979), Table 10.1, p. 388, Gross foreign capital inflow was calculated as the difference of the other two figures.

‡ From Hong (1976) Table 3, p. 19

§ Calculated from IRAI (1984) Vol,II Table 2.5, p. 12, Shares in constant 1973 prices. For details of deflators we have used for GNP, savings and foreign capital inflow, see Appendix 15-A.

Median values for thirty-one developing countries in 1962 show the significance of external inflows as a share of gross investment resources available. Compared to Bangladesh, the median value of gross national savings as a share of GNP is much higher in Chenery and Strout's sample, but this included countries at very different levels of development. A comparison of Bangladesh's recent savings performance with South Korea at an early period of its growth is perhaps more revealing. During the fifties and up to the early
sixties, because of an inflow of external resources, largely in the form of payments deficits with the U.S., South Korea was able to sustain a gross investment share of ten percent of GNP, despite gross national savings of only two percent. As growth accelerated, national savings steadily grew as a share of GNP, while the significance of external capital flows declined.

The situation of the Bangladesh economy in the latest period shown, the second half of the seventies, is superficially comparable to the earliest South Korean period. A fairly high resource availability for investment of around ten percent of GNP is achieved despite a gross national savings share of just over four percent, due to a substantial inflow of foreign resources. Few economists, however, would argue that Bangladesh is about to follow the South Korean trajectory. In Part II we will take a critical look at the influential body of economic thinking in Bangladesh which argues that external aid and credit flows cripple development potential. The South Korean experience is at least one counterexample which shows that this need not be so.

While there is some similarity across countries at roughly comparable levels of development in terms of the potential investment share states have been able to mobilize, no such systematic patterns are observed when we come to observe the use which is made of resources. Although somewhat dated, a cross-section study completed by the World Bank in 1968 covering forty-six developing countries demonstrates this.

The authors used simple regression analysis with the sectoral pattern of government expenditure for the period 1962-4 as the dependant variable and per capita income (as a proxy for the level of development) as the explanatory variable. Government expenditure was decomposed by function into current and capital heads. These were disaggregated into 'General', 'Defence', 'Economic Services' and 'Social Services'. 'Economic Services' were further
disaggregated into 'Agriculture', 'Industry, Mining & Utilities' and 'Transport & Communications'. 'Social Services' were disaggregated into 'Education', 'Health' and 'Housing & General Welfare'. Despite sectors being relatively broadly defined, there was no simple relationship between the level of development and the pattern of state expenditure. The authors concluded that they had learnt two important facts: one, that we must not make facile statements about the level of development or income causing a certain pattern of government expenditure - the disturbing factors are too prominent for that; two, that any further study of this broad problem of public expenditure allocation must have far better and broader data and must include other explanatory variables besides income.\(^4\)

The sectoral rigidity of investment allocations in Bangladesh and thus implicitly the state's inability to independently identify investment priorities and enforce them has been recognized for some time. For instance, looking at state allocations of investment through the Annual Development Programme from 1973/4 to 1980/1, Akhlaqur Rahman pointed out that

"the intersectoral priorities of investment in Bangladesh would seem to have remained more or less invariable over the decade under study. One might have expected some shift in investment priorities while moving from one plan period to another, due to possible changes in demand and supply conditions consequent upon structural changes in the economy. The situation existing in Bangladesh might have been due partly to a discontinuous planning procedure, in which priorities once set, are difficult to change, due to built-in pressure by development agencies in order to maintain their relative shares in plan allocation year after year. The marketability of projects in the 'aid' market could have been another factor.\(^5\)"

These factors would however affect any economy with a planning process and a significant inflow of foreign resources. If the contemporary Bangladeshi state was affected, we need to ask why the South Korean state in the early sixties was not similarly constrained. Moreover, changes in resource use do not just have to adjust to demand and supply changes, success is often predicated on the state's ability to anticipate change.
With a manufacturing rate of growth of almost twenty per cent per annum over two decades, the large share of investible resources directed by the South Korean state were clearly allocated efficiently. The primary mechanism through which these resources were allocated was not however the market. It was not even a system of indirect controls on commodity markets. It was rather one of direct controls on the capital market. In practice, this meant that the state had the ability to decide which sectors should be developed and which phased out, and it had the political muscle to either carry out production in the public sector, or more often, decide which industrialist or group would get the necessary resources. This ability was demonstrated for instance in the state's ability to enforce restructuring during the crisis of 1979-82.

§ 3.2 Public Enterprises

The public enterprise sector is the set of productive entities which are owned and/or controlled by public authorities and whose output is marketed. This is a useful definition despite differences of opinion about what marketed output or ownership and control means. Nevertheless, differences in coverage and lack of statistics particularly in developing countries have hampered inter-country comparisons of the sector.

A comparative evaluation is however important for several reasons: public enterprises account for a substantial part of developing country industrial value-added and capital formation. Secondly, they operate production in key capital-intensive areas which often have substantial backward and forward linkages and whose efficient operation results in large externalities. More significantly, the pricing and particularly employment policies of public enterprises are especially sensitive to the mobilizations of key urban constituencies. They are therefore a good indicator of the political context in which processes of structural transformation are occurring, a point often implicitly recognized in the literature.
Thus apart from the usual questions about the operation of the public sector, Bangladeshi economists have addressed the question of how distributive conflicts between sections of the politically important urban classes may have affected the performance of the sector. As a general problem, if not in the specific balance of social interests, this is an experience shared with many other developed and developing countries.

From table 3.3, we see that the quantitative significance of public enterprise is quite similar in all four countries though they profess substantially different development ideologies. The only exceptional figure is the large share of public enterprise in manufacturing value added in Bangladesh which reflects, in our opinion, a particularly stagnant manufacturing sector. Virtually all the early industrial initiatives in post-colonial East Pakistan were undertaken by the state as the capitalist class was initially very small. The Bengali bourgeoisie remained weak during the Pakistan period and this once again limited the options for the state in the aftermath of the second
Independence of 1971. The departure of Pakistani capitalists left an ownership vacuum and far-reaching nationalizations followed the 1971 Liberation. Public enterprise came to account for 56 percent of value added in mining and manufacturing and 80 percent of value added in large-scale industry.9

A very similar combination of reasons had left the South Korean public enterprise sector in command of the economy following the departure of the Japanese in 1945. Japanese private and state capital dominated Korea's industry and finance during the colonial period. Enterprises located in the South were eventually inherited by the government of the Republic as 'vested property' and according to one estimate, these accounted for 90 percent of commercial and industrial capital at the time.10

Both countries thus had weak national capitalists during the colonial period and consequently a large public sector in the immediate post-colonial period. However the motivation for the 1972 nationalizations in Bangladesh was at least partly political, pressure being articulated primarily by a section of the urban middle classes rather than a working class movement. This set specific constraints on enterprise performance and the sector failed to establish employment and investment strategies which could generate productivity growth. The size of the sector in turn ensured that manufacturing as a whole stagnated. From the mid-seventies onwards, the trend has been one of denationalization in a context of bitter struggles whose damaging economic consequences, at least, are obvious to everyone. Denationalization started with smaller enterprises in 1976, followed by the larger jute and cotton mills after 1982. Recent figures for the share of public enterprises in manufacturing value added in Bangladesh should therefore be closer to other countries, but largely because of changes in the ownership pattern rather than a rapid growth of the private sector. Part III will look at some of the conflicts within the politically dominant urban groups in post-1971 Bangladesh.
In contrast, while there is a lot of evidence of corruption in the South Korean public enterprise sector, even its critics admit that performance here has been much better than in other developing states and in some sectors comparable to the advanced economies. Existing public enterprises are periodically divested, but new ones replace them, and despite a rapid growth of the manufacturing sector, the share of public enterprise in total investments and manufacturing value added remains substantial. Our contention will be that corruption in South Korea reflects the sizable rents the state has access to, and its willingness to distribute these on the basis of nepotism and corruption. This process is fundamentally different from the political constraints facing the Bangladeshi state and will be shown to have different implications for dynamic efficiency.

In a comparative study Leroy Jones offers an explanation of why the share of public enterprise remains large even in avowedly 'private enterprise' countries such as South Korea. In the sectors where it is dominant, public enterprise is said to have a 'revealed institutional advantage'. For instance, he finds public enterprise firms in South Korea to be concentrated in sectors with output market concentration - in 1972 only about 10% of their value-added was sold in reasonably competitive markets. Absolute size too was strongly correlated with public enterprise status, twenty of South Korea's fifty largest enterprises being in the public sector. Finally, South Korean public enterprise was overwhelmingly capital intensive: in 1972, the ratio of capital stock to employee compensation there was twice that of manufacturing, and almost triple that of the non-agricultural economy.

A similar pattern of public enterprise activity is observed in other developing countries, allowing for historical and political differences. In Bangladesh, for example, overall public enterprise capital intensity is lower because of the absorption of large numbers of small, consumer-goods enterprises into the
public sector following the 1971 civil war. With the recent divestitures, capital intensity is likely to shift towards the general pattern.

Public enterprise activities are thus large because there are many activities where such enterprises have what Jones calls an institutional advantage. If certain economic activities are perceived to be important and their existence requires cross-subsidization, public enterprise would emerge to operate these activities in the absence of alternative institutional arrangements. Public enterprises would therefore manage a greater or lesser range of activities in most countries. But differences in the process of institutional adaptation mean that rights and the bargaining power of the different classes relevant for performance evolve differently. Public enterprise is therefore not always and certainly not everywhere subject to similar constraints.

Studies of public enterprise performance have indicated that performance is not only better in some sectors compared to others, performance also varies significantly across countries. Most worrying for those who see the public sector as inherently inefficient is the equivocal evidence of relative performance. The private sector in comparable industries sometimes performs better, but not always.

Performance also seems to have little to do with the size of the public sector. Row 2 of table 3.3 showed that simply in terms of the public enterprise sector absorbing overall investment resources of the economy, South Korea displayed the strongest indications of a possible 'crowding out'. Despite the estimation in one study of an incremental capital-output ratio for the South Korean public enterprise sector in 1972 of 6.12, compared to 1.69 for manufacturing as a whole, it would be difficult to argue that the size of the public enterprise sector has constrained the growth of the manufacturing sector as a whole. ICOR figures need to be interpreted with care. The figures may indicate lower
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efficiency but the same study points out that the result is to a substantial extent due to the underpricing of South Korean public enterprise output. In addition, a large share (53 percent in 1972) of public enterprise investment was devoted to capital-intensive electricity and infrastructure, where the incremental capital-output ratio would be technically higher and production efficiency would depend on whether labour productivity was high enough. Moreover, these sectors have large externalities not captured in output figures.

With South Korean public enterprise taking thirty percent of investment, its efficiency should perhaps be judged by the fact that the economy manages to grow by ten percent a year. The source of the remarkable efficiency of South Korean public enterprise should perhaps be sought in sectoral studies of productivity and resource utilization. Leroy Jones, the author of one such study remarks that

it is simply not possible to find in Korea any prolonged examples of the sorts of egregious inefficiency which characterize many public enterprise sectors. Indeed, preliminary work on Korean fertilizer and iron and steel industries suggests that, in at least some cases, Korean public enterprise engineering efficiency is extraordinarily high by LDC standards, and not markedly deficient when compared with similar operations in industrial nations ...

... I suggest that the potential efficacy of public enterprise varies with the 'softness' of the state in a Myrdalian sense. When market restraints (via 'exit') on enterprise behaviour are foregone, an enforceable political response to 'voice' must be substituted. In Korea, while there is substantial slack before the political mechanism becomes effective, sustained and blatant inefficiency in larger entities is eventually brought to the attention of the Blue House; then things happen quickly. Public enterprises may thus be potentially less inefficient in 'hard' states where political authority is able to act decisively. 16

But why are some states less able to act 'decisively'? The classification of these states as 'soft' does not by itself answer the question. In Myrdal's original argument, the soft state referred to third world states with limited
efficiency but the same study points out that the result is to a substantial extent due to the underpricing of South Korean public enterprise output. In addition, a large share (53 percent in 1972) of public enterprise investment was devoted to capital-intensive electricity and infrastructure, where the incremental capital-output ratio would be technically higher and production efficiency would depend on whether labour productivity was high enough. Moreover, these sectors have large externalities not captured in output figures.

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powers of policy implementation deriving from what he called 'a low level of social discipline'.17 Where the attempts of third world dictatorships, for instance in Burma and Pakistan, failed to impose such discipline this was because 'these efforts were not very persistent'.18 This was a remarkable observation for its time, when development was still seen by many as essentially defined by the numerator and denominator of the Harrod-Domar growth equation. But with the benefit of contemporary development experience behind us, Myrdal's argument may be questioned. The avowed 'law and order' goals of many dictatorships together with the violence they have unleashed leads us to ask why many states have failed to attain such social discipline despite what undoubtedly has been a great deal of 'persistence'.

In Bangladesh the state's ability to allocate resources through the public sector enterprises became a critical political question from the early seventies onwards. The problems of managing the newly-expanded sector were painfully obvious even to those who ideologically supported it. As a component of 'Mujibist socialism' the size and share of the sector reached a peak by the mid-seventies. As table 3.4 shows, output and profitability problems plagued the sector throughout.

<table>
<thead>
<tr>
<th>TABLE 3.4 : PUBLIC ENTERPRISE PERFORMANCE IN BANGLADESH</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Production Index for Public Enterprises: 1974=100.</strong></td>
</tr>
<tr>
<td>101 82 100 94 97 105 n a n a n a</td>
</tr>
<tr>
<td><strong>Net Profits of Corporations Taka Millions:</strong></td>
</tr>
<tr>
<td>n a -249 13 -207 -377 -385 -489 876 586 -904</td>
</tr>
<tr>
<td><strong>Net Profits as Percentage of Sales:</strong></td>
</tr>
<tr>
<td>n a -7.1 0.3 -2.2 -4.3 -4.1 n a n a n a</td>
</tr>
</tbody>
</table>

  b) Covering Jute, Textiles, Chemicals, Steel & Engineering, Food, and Forestry Corporations.

We know that the early seventies were a period of deep crisis for the industrial sector as a whole, and in any case the figures cover too brief a
period to allow us to draw general conclusions. The World Bank acknowledges that the major reasons for the poor performance at the time included irregular and insufficient raw material supply (partly caused by foreign exchange scarcity), and lack of demand. Moreover, the profitability figures should be treated with caution given the political determination of the government's pricing policy for public enterprises as well as the presence of explicit and implicit subsidies to the sector.\textsuperscript{19}

However as table 3.4 partly shows, the broad features of public enterprise performance continued beyond the Awami League period. This was despite the substantial changes which took place in the composition and politics of the government following the assassination of President Sheikh Mujibur Rahman in 1975 and the subsequent accession of military governments. Thus even in 1983, after several years of ostensibly concerted attacks on the size of the public sector, the World Bank reported that

since the public sector still dominates industrial production, investment and employment, many of the causes of the country's poor industrial performance can be attributed to the public enterprises. While there has been some improvement in capacity utilization of public enterprises, the scope for achieving significant improvements in their overall performance has been limited by basic inefficiencies and/or unsuitability in the organization and management of these enterprises, and the Government's labour and pricing policies which have led to overmanning and restraints on sale prices.\textsuperscript{20}

These limitations have consistently been critical in Bangladesh. Apart from pricing policy which is explicitly political and concerns the demands of politically volatile urban groups, the problems referred to by the Bank relate to the control mechanisms operating on public sector enterprises. Inefficiency in Bangladesh no less than efficiency in South Korea does indeed seem to depend on a persistent ability or inability to take 'decisive actions'. The factors constraining such actions therefore need to be understood.
Part I  Chapter Three

If management systems referred only to accounting systems or technical procedures for controlling production processes, they would be relatively amenable to institutional adaptation. Productivity enhancing changes would always be adopted if they furthered the interests of the enterprise. If this was all that was involved, then whether the overall characteristics of the system approximated more closely to 'pressure' or 'suction', the overall characteristics of the system approximated more closely to 'pressure' or 'suction',2 in the long run, 'organizational progress' would occur whenever enterprise decision-makers perceived the need for change. In reality, individual, group, enterprise, and social rationality need not coincide. For instance, productivity growth often requires the reallocation of labour. We shall see in Part IV that the Bangladesh manufacturing sector as a whole has been characterized by employment consistently growing at the same rate as output, effectively preventing productivity growth. There is some evidence that these outcomes reflect the bargaining power of white collar workers who primarily benefit from employment generation.

Concentrating solely on the rationality of decisions from the point of view of the enterprise assumes intra-enterprise losers are never able to block change. The efficacy of organizational control depends on the rights which agents have established at each level of the organizational hierarchy. This determines both the nature and the strength of opposition to particular kinds of changes. If we accept this, it is no longer possible to isolate institutions and enterprises from the broader social milieu since the bargaining power of classes of personnel depend on the constituencies they identify with, and at times are able to mobilize.

We would therefore expect some differences between the public and the private sector in the same country and over the same period, because they would not be equally exposed to social constraints. But we would also expect such differences to be rather less compared to the differences across countries,
simply because institutional and political histories differ. In other words we should not be surprised to find for instance that the Bangladeshi private sector is much more like the Bangladeshi public sector than the South Korean private sector. It may be more relevant to ask why the nature of social constraints in some periods or countries allows or prevents efficient changes in rights in both the public and private sectors.

While private enterprise is also subject to political constraints imposed on its organizational freedom of action, public enterprise is particularly susceptible for two reasons. First, the political viability of the state depends in some measure on its responsiveness to social pressures. This makes public enterprise less able to insulate itself from the claims and demands of broader coalitions, of which classes of agents within the enterprise may be only a part. Secondly, the state is often directly an arena of distributive conflict, in the sense that alternative coalitions do compete to take over the commanding heights of the state to impose different distributive arrangements. Public sector enterprises are therefore under greater pressure to conform with a politically defended pattern of resource allocation across classes. Nevertheless, while these social processes may be more transparent in the public sector, the relative bargaining power established between different economic groups as a result of a political settlement is clearly relevant for the performance of the private sector as well.

§ 3.3 Regulation and Control

Market economies no less than planned ones depend on state regulation and control. The state has at least to maintain the property rights over assets and the enforcement of contracts, without which even the free market model of neoclassical economics collapses. In reality, there are always additional controls and regulations, and moreover, all states respond to the pressures of specific constituencies to validate systems of cross-subsidization.
As in South Korea, state regulation in Bangladesh is based on both 'field manipulation' and 'command'. Field manipulation in Bangladesh includes tariff policy, multiple exchange rates, tax holidays, and industrial financing through the state-owned development finance institutions. Command interventions have included an (increasingly decentralized) system of investment sanctioning. But perhaps the most important 'command mechanism' has been the import licensing system in an economy where virtually every manufacturing process uses some imported components in its machinery and raw materials.

Business interests, neoclassical economists and some representatives of the state have pointed out the inefficiency of these arrangements, which may well be true in terms of reasonable textbook notions of economic efficiency. However, we need not always take business or state representatives at their word when they advocate deregulation as an end. All modern economies depend on systems of cross subsidization, as private sector lobbyists well know. Since these arrangements persist even in successful 'free-market' economies, the question is really about the nature of regulation which achieves rapid growth. Certain types of successful regulation have often been confused with deregulation. The success even of market oriented policy choices for instance depends on the state being able to enforce the rights of losers and gainers. As Jones and Sakong point out in their analysis of South Korean success,

similarly endowed nations could espouse equally appropriate policies with far less dramatic results. There is, after all, much to be done between a proclamation of export priority and the appearance of Korean shirts on Sears shelves or "Pony" automobiles on Riadh streets.

Like the performance of public enterprise, the outcome of a system of state regulation depends not only on the objectives of the state, but to a large extent on the bargaining power of those affected. Indeed the latter also determines to some extent the formal structure of state regulation. For
instance, the post-1982 attempt at administrative decentralization in Bangladesh faced concerted opposition from organizationally powerful urban constituencies since, as we shall see, it challenged rights which had important economic implications. In contrast, the recommendations of various commissions to streamline the structure of the central bureaucracy have not become politically relevant nor is there any indication that they will be implemented. It seems to be just this kind of interaction of interests within and outside the state which determine the evolution of the state's institutional mechanisms and the range of economic rights regulated.

A regulatory issue which has attracted much policy attention in Bangladesh in recent years has been the repayment of loans to the two development finance institutions. The Bangladesh Industrial Bank (BSB) and the Bangladesh Industrial Credit Corporation (BSRS) provide 15 to 25 percent of private sector industrial credit, and a much larger share of the long-term credit which finances fixed capital formation. Economists of all persuasions have criticized the state's inability to enforce productive activities on the part of loanees or even enforce repayments as Table 3.5 shows.

<table>
<thead>
<tr>
<th>Year</th>
<th>Recovery as Percentage of Annual Repayment and Interest Due to BSB and BSRS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1977/78</td>
<td>14.62</td>
</tr>
<tr>
<td>1978/79</td>
<td>13.25</td>
</tr>
<tr>
<td>1979/80</td>
<td>11.60</td>
</tr>
<tr>
<td>1980/81</td>
<td>14.46</td>
</tr>
<tr>
<td>1981/82</td>
<td>12.88</td>
</tr>
<tr>
<td>1982/83</td>
<td>15.81</td>
</tr>
<tr>
<td>1983/84</td>
<td>10.21</td>
</tr>
<tr>
<td>1984/85</td>
<td>7.50</td>
</tr>
<tr>
<td>1985/86</td>
<td>7.63</td>
</tr>
<tr>
<td>1986/87</td>
<td>10.40</td>
</tr>
</tbody>
</table>

Source: Sobhan & Sen[1987] Table 1, BSB is the Bangladesh Industrial Bank and BSRS the Bangladesh Industrial Credit Corporation.

Soon after coming to power in 1982, the new military regime set up two tribunals to investigate the records of the financial institutions, and to
examine the problems of specific enterprises. Several 'corrupt businessmen' were arrested. There was a small improvement in recovery over 1982/83 but this was not sustained. Under pressure from foreign donors and creditors of the two finance institutions, the government adopted an 'action programme' in 1985 following the signature of a Memorandum of Understanding with the principal foreign donors. Legal sanctions were authorized against defaulters, but as table 3.5 shows, these measures too proved to be inadequate. Most major defaulters could use political leverage to escape legal proceedings being used to sequester the production units involved. The corrupt businessmen were released without the reasons for their release being made public.

The constraints on the Bangladesh military may be contrasted with those on Park Chung Hee's administration after the May 1961 coup. One of Park's first acts was the "Special Law for Dealing with Illicit Wealth Accumulation". Many of the country's businessmen were arrested and threatened with confiscation of assets. Their release was on condition that they would pay off their obligations to the state by investing in basic industries and donating shares to the state. South Korean businessmen unlike their Bangladeshi counterparts, failed to find any basis for bargaining a less painful solution with the state, a result which indicates a significant difference in the political context in which the bargaining was conducted and perhaps also in the determination of the respective leaderships.

Leadership determination is difficult to measure, but it does seem that there are in addition systematic reasons which prevent the Bangladesh state from risking efficiency-enhancing control, even when the long run gains are apparent and the particular constituency being attacked is relatively weak. The nature of rights and how effectively they are defended are thus relevant for understanding how appropriate the regulation and control mechanism is for achieving rapid growth.
The significant aspect of the state's failure in Bangladesh was not, as some have argued, that state policies resulted in the granting of gifts of industrial enterprises to privileged groups. This has often occurred in the early stages of state-promoted capitalist industrialization in many countries, including Japan.\(^3\) What is more significant about the state's failure to ensure a rollover of funds is that it demonstrated its inability to impose its will on some of its constituents despite its ostensible attempts to do so. On the other hand, it seems to be precisely this ability of the South Korean state that has enabled it to manage growth-enhancing structural change, particularly during periods of crisis. State intervention in South Korea has included the organization of mergers, product specialization and rationalization.\(^3\)

The ability of the state to change resource allocations is not necessarily indicated by bad debts or even, as we shall see in the next chapter, the extent of corruption. It is well to remember that in South Korea, with a level of investment in real terms many times that achieved in Bangladesh, the wastage of resources through 'bad debts' of the financial system has been quite large. According to one estimate in 1988, bad debts leading to 'non-performing assets' accounted for about 15-20 per cent of total lending in South Korea.\(^3\)

The evidence of state intervention in Bangladesh and South Korea over the last two decades shows that while both states responded to the challenge of industrialization, intervention in South Korea led to rapid growth while in Bangladesh state intervention was inefficient. The advocates of private enterprise in Bangladesh have pointed out the poor performance of the public sector enterprises and the large financial deficits which have burdened the budget, while their opponents have in turn highlighted the loan repayment performance of the private sector. In fact, the evidence put forward by both 'right' and 'left' shows more convincingly the sustained inefficiency of the Bangladeshi state in implementing different strategies of growth.
Notes to Chapter Three

1. Aidan Foster-Carter[1985], p. 28.

2. In the fifties and sixties, the small size of the Bengali bourgeoisie meant that the role of the state was even larger. The public sector's share of total development expenditure averaged about 70 percent. Sobhan & Ahmed[1980] p. 33.


13. Ibid.

14. Santt & Dutta[1968] provide a summary of public sector enterprise performance in twenty-six countries over a seven year period. The evidence is that performance varied widely across sectors and countries. Latin American countries managed a 2.1% surplus over current operating costs whereas for Asia and Africa the averages were 16.4 and 19.5%. When depreciation was added to current costs, none of the areas generated a surplus over costs. Sobhan[1983] measures gross savings (post-tax profits plus depreciation) as a share of gross fixed capital formation and finds that even within the South Asian countries, the share ranged from 31% in India to over 100% in Pakistan and Sri Lanka over 1970-75. Most studies, however, are concerned with the performance of public sector enterprises in different sectors within the same economy, or are concerned with the relative performance of public sector enterprises compared to the private sector in the same country.
The evidence of public sector enterprise performance relative to the private sector is mixed. Krueger & Tuncer (1982) in their study of manufacturing sectors in Turkey over the period 1963-76 and Dholakia (1978) in a study of manufacturing sectors in India over 1961-76 found that the growth of total factor productivity was higher in the public sector. Krueger & Tuncer, however, also found that absolute levels of single factor productivity were much lower in the public sector enterprises. Many studies have found the public sector to be a poorer performer compared to the private sector according to a range of criteria. These include Kim (1981) which compared financial performance excluding government taxes and subsidies in Tanzania over 1970-5, Funkhouser & Marayev (1979) which compared profit margins (sales revenue minus direct costs excluding depreciation and interest) and unit costs in different industries in Indonesia in 1971, Perkins (1983) which compared capital and labour productivity and unit costs in ten major industries in Tanzania, Tyler (1979) which looked at technical efficiency in the Brazilian steel and plastics industry in 1971, Hill (1982) which looked at capital and labour productivity in the Indonesian weaving industry in 1976, and Gupta (1982) who studied total and single factor productivity in the Indian fertiliser industry. These and other studies are reviewed in Kirkpatrick, Lee & Nixson (1984) pp. 175-84. Joint inter-country comparisons of both the public and private sector have unfortunately not attracted much research effort.

The experience of the Bangladesh jute and cotton textile industries after denationalization in 1982, compared to the performance of enterprises which remained within the public sector has been looked at in Sobhan & Mahmood (1986). They found no evidence of an improvement in the performance of enterprises in terms of output, output per machine and profitability as a result of denationalization, but their data covers only three years following the denationalization and no adjustment was made for the disruptions caused by change of management. However, we would agree with them that there is no case for the general argument that the private sector performs better.

18. Ibid. p. 894.
19. Profitability is clearly critically dependent on pricing policy. One of the reasons for the large losses of the Bangladesh Chemical Industries Corporation before 1977 was that it was forced to supply fertilizer to farmers at a subsidy. In contrast, the Bangladesh Steel and Engineering Corporation had a much better profitability performance because it was allowed to follow a cost plus pricing policy. World Bank quoted by M. M. Akash in Shongbad 3rd December 1984 (in Bengali).
21. Kornai [1971] proposes Pressure and Suction as characterizations of two alternative states of the economy: the first where sellers queue for buyers, the latter where buyers queue for sellers. They are not equivalent to excess supply and demand because demand and supply in Kornai are not merely functions of price. Hence there is no tendency for neoclassical equilibrium to be reached. Even without the restrictive neoclassical assumptions, we can have models of technological and organizational change if we appropriately model the economic system (Kornai himself does this for the planned economies in Kornai [1980] and Kornai [1982]) and identify the factors constraining the options of what Kornai calls the 'control sphere': the decision-making sphere of the economy.

22. The terms are from Jones & Sakong [1980] Ch. 4. The distinction is between parametric and non-parametric regulation.


25. IBRD [1978] Tables 2.3 and 2.4.


32. The South Korean state is not very forthcoming about the financial performance of the banking sector. These figures are estimates by analysts quoted in the Far Eastern Economic Review, 5th May 1988, p. 100, in a comparative assessment of banking in a number of Asian countries, including South Korea and Bangladesh. Under pressure from its first opposition dominated parliament, the South Korean government also revealed (FEER 4th August 1988) that seventy eight companies with loans of over 6800 billion won were unable to make principal and interest repayments on time on 4195 billion won. The non-performing debts of these companies alone thus amounted to over 5.76 billion U.S. dollars, about a third of Bangladesh's GNP.
Chapter Four Clientelism Corruption and the State

The critique of state intervention has if anything become more far-reaching in recent years. The Hayekian argument that planners could not possibly know the preferences of all individuals or the consequences of all choices is not really at issue any more. No planner would try to justify an all-encompassing plan. Instead selective state intervention has become the subject of contention. The rent-seeking literature argues for instance that even such limited intervention is inefficient because it leads to a loss of resources to unproductive activities through bribery or corruption, or simply through the withdrawal of resources from production to rent-seeking activities.¹

At first sight rent-seeking appears compelling as an explanation of inefficiency particularly in developing countries. State intervention here not only seems to be arbitrary, rent-seeking activities take overtly unattractive forms such as corruption. We have seen however that both South Korea and Bangladesh have had high levels of state intervention. In this chapter we confront the evidence which shows that corruption has also been rife in both countries. Indeed this is what rent-seeking theory would predict given the high levels of state intervention. Rent-seeking cannot therefore be very useful for explaining the significant differences in the efficiency of state intervention in these countries. This shortcoming is significant because rent seeking theory makes policy recommendations which may be quite inappropriate.

State interventions of various types have also been examined as instances of patron-client transactions. An explicit modelling of such bargaining could indeed be useful for identifying types of intervention and their implications. Analyses have however usually suffered first for not being comparative, but more importantly for not specifying the rights on the basis of which the trade was conducted.² Clearly the outcome of a patron-client transaction would
depend on the relative bargaining power of the parties and the assets or services over which rights were defined and which were being traded.

Such transactions would be particularly significant in what have been described as patrimonial states. Patrimonial in this context refers to a bureaucracy which is able to disburse benefits (prebends) with fewer constraints than bureaucracies which evolved in feudal societies with a relatively well-defined set of decentralized rights. It has been argued that the distribution of subsidies by the modernized patrimonial state should be analysed as a patron-client transaction rather than one motivated by the kind of economic logic described in Chapter One. Interestingly, both Bangladesh and South Korea belong to the large group of developing Asian countries whose social structures have been described as patrimonial.

However, state intervention may always be modelled as a bargaining outcome. Bargaining between the state and coalitions of beneficiaries is not just a feature of patrimonial states. The implications for productivity growth and structural transformation need to be separately examined. One way of proceeding is to identify the rights underlying the bargaining. We will argue that in South Korea corruption is appropriately modelled as a patron-client relationship between state decision-makers and others in a context where there are substantial rent-seeking possibilities. While rent-seeking leads to losses of resources to rent-seeking activities, these losses have to be compared with the gains from the particular set of restrictions imposed by the state.

In contrast, we describe patron-client relationships in Bangladesh as clientelist, and we use this term to refer to the subset of patron-client exchanges where the client can bargain for resources on the basis of an organizational ability to disrupt the income flows enjoyed by the patron. We will argue in Part II that clientelism is based on a particular set of rights
distinct from those which underlie corruption or nepotism under rent-seeking conditions. Compared to corruption, the implications of clientelism for dynamic efficiency are much more serious. Not only does it lead to a loss of resources, it also constrains the state to a low level of efficiency. Clientelism therefore needs to be distinguished from corruption which is endemic in virtually every developing country, even in efficient economies such as South Korea, and indeed in quite a few developed ones. The distinction will be shown to have important analytical and policy consequences.

Before we turn to that analysis we examine a number of ways in which patron-client relations operate in practice in the two countries and the ways in which they differ. In section 4.1 we see that rights can be more or less well defined and that this has implications for patron-client exchanges. The factors preventing rights being well-defined are discussed. In section 4.2 we look in particular at organizational ability as an explanation of the differences in the extent to which clientelism is found in our two societies. While the dynamic efficiency implications of clientelism will be looked at in Part II, section 4.3 looks at some microeconomic implications of clientelism.

§ 4.1 Weakly-Defined Rights and the Clientelist Payoff

The state manages rights not just over subsidies, it is also responsible for policing rights over assets in general. It should be intuitively convincing that how effectively the state can enforce rights would have important implications for the bargaining outcomes loosely described by terms such as corruption and nepotism. A formal statement of the problem and derivation of some of the implications for dynamic efficiency will be attempted in later chapters, but here we want to illustrate some of these processes in practice.

Consider the case of an economy where rights are not well-defined in the sense that right-holders are not assured of the security of their rights in the face
of challenges from organized contenders. Intuitively, we can see that it would be rational for right-holders in such a context to make payoffs to those who could organize such challenges if the payoffs allowed them to retain their rights and the associated income flows. Patron-client relationships in this context, whether between state functionaries and entrepreneurs, or between higher and lower levels of the state and even between entrepreneurs and intra-firm clientelist groups would reflect the weakly defined rights of existing right-holders. We will argue that in the case of Bangladesh much of what is described as corruption is based on this type of clientelist bargaining.

Large firms in Bangladesh for instance, whether in the public or private sector are characterized by a form of organization which may be described as populist. Accountability is low and there is a liberal distribution of resources down the enterprise hierarchy. Consider the following transaction observed in a large private sector textile mill in Bangladesh. A group of enterprise agents negotiate a purchase on behalf of the enterprise. The purchase price is competitively negotiated but the price which appears on the invoice is higher than the one negotiated. The margin represents a payoff to the group which is distributed between the buying and selling agents.

As is typically the case the procedures and the shares of different agents are well established and the process takes place quite openly with the knowledge if not the connivance of the decision-maker authorizing the transaction. Since the decision-maker in this case is a director with a vested interest in the profitability of the mill, it is necessary to ask why the transaction was authorized. Intra-firm lobbies loyal to particular decision-makers are vital for maintaining effective control in a context where the rights of the decision-maker are not clearly defined and enforceable by the state. In this case as in others, a payoff to a clientelist group which allows a patron to exercise property rights is typical of what we describe as clientelism. A great
many types of transactions may be based on clientelist bargaining and the payoff may be delivered in a variety of direct and indirect forms.

Clientelism is observable at all levels of the economic and political structure in Bangladesh. Examples from politics are particularly easy to give as Bangladeshi politics is largely a process of intermediaries gaining access to resources by organizing pressure. Just as clientelist organization within an enterprise can lead to a payoff under appropriate circumstances, state decision-makers too, at all levels of the state machinery are susceptible to the challenges of clientelist lobbies and would under appropriate circumstances agree to a payoff. General Ershad's cabinets are composed almost entirely of individuals who have previously been very successful in organizing opposition to the government either as individuals, trade unionists or members of opposition parties. A similar correlation between successful organization against existing right-holders and an associated payoff is also observable at lower levels of the political hierarchy and even in rural factional struggles.

This does not mean that everyone participating in the political process is conscious of the clientelist strategy, or actually gains. But clientelism establishes its own logic on political participants despite their intentions. Whatever the objectives of a particular group, success in the political market requires at least a degree of participation in organizing pressure and negotiating payoffs for supporters because each level has in turn to satisfy the clientelist demands of the constituencies they depend on. And the strategies which are more likely to lead the group or individual to a position where they are able to claim (and distribute) resources are precisely those which are the most 'oppositional'.

A consequence of substantial sums being allocated through the political system by means of clientelist payoffs is that entrepreneurs understandably align
themselves with factions at the appropriate decision-making level of the state. This ensures them a share in the payoff managed by that level. While the primary beneficiaries of a clientelist payoff are definitionally organizational entrepreneurs, to increase returns, they may well associate with an entrepreneur to invest resources in trade or industry or undertake this role themselves. There is a substantial amount of evidence that successful entrepreneurs in Bangladesh do indeed have such political links and that their political connections protect the allocation of resources to them when threatened. We shall later describe these arrangements as symbiotic. Note that in this case any 'rents' the capitalist may be acquiring have quite a different microeconomic logic compared to the rent described in rent seeking literature.

We shall see in Part II that clientelism works through the clientelist lobby engineering an increase in the effective demand for its services. This contrasts with the corruption and nepotism associated with rent-seeking, where the excess demand is the result of the successful enforcement of a restriction by the state. However, if the excess demand generated by clientelism is very large, which would be a realistic assumption in the case of Bangladesh, the scarcity of real resources would result in de facto rationing. Nepotism or corruption would again emerge in the sense that lobbies which were particularly favoured or those which were willing to share the payoff with a decision-maker would have an advantage. These interdependencies make clientelism and corruption difficult to distinguish till the basis of the excess demand is investigated. But the distinction is important to make if we are to explain some of the differences in the performance of the respective economies. The difficulty may be illustrated with the following contemporary newspaper sub-editorial. Commenting on the lack of enthusiasm of private investors in Bangladesh, the editorial says that

the problem is not an absence of sufficiently enticing conditions, Rather it is ultimately and primarily the result of procedural delays and complexities facing the
Entrepreneurs are left with no alternative but to bribe at each and every level. Project costs and implementation times bear the consequences. It is impossible to proceed without the connivance of this class of officials and public employees.

Those who neither have connections nor manage to arrange them are thwarted by a barrage of requirements regarding statistics, feasibility reports and so on. And the requirements are of course revealed slowly, one a day. Only those who can answer all the questions or otherwise satisfy the official can proceed further. The more the levels of decision making, the longer the delays and the greater the unofficial costs.

The editorial clearly refers to the rationing of state allocated resources which are in excess demand. The excess demand could simply be the result of state intervention creating a set of artificially 'enticing conditions' as the neoclassicists suspect. On the other hand, it could be primarily the result of a clientelist generation of excess demand for resources across a number of sectors which the state has to manage. 'Connections' could create a very large excess demand since virtually every realistic entrepreneur would have some connections at the appropriate level of the state machinery. If we also remember that clientelism by entrepreneurs is probably a small part of the demand for resources generated by clientelism, we can understand why rationing could accompany clientelism such that clientelist lobbies would also participate in rent-seeking type activities.

In principle, clientelism can operate without corruption or nepotism, for instance through a politically organized system of distribution of benefits. Readers familiar with Bangladesh may be persuaded of this by recalling the experience at the highest level of decision-making during the period of President Zia ur Rahman. Zia is widely regarded as being the contemporary president least associated with either nepotism or corruption. Yet most observers would agree that during the latter half of his presidency there was an extensive and undisguised distribution of favours through his Bangladesh
Nationalist Party. This was part of a concerted attempt to neutralise pressures challenging the legitimacy of the regime.  

The link between political pressure and the access to economic benefits is not of course limited to Bangladesh. In other South Asian countries too, we find evidence for instance of loans being distributed as a response to political pressure, but the extent of clientelism may well be different across these countries.  

The basis for corruption in South Korea has been quite different. Till the end of the Chun period, the state was able to insulate itself against pressures from below fairly effectively. The rights the state chose to enforce in South Korea were much less challengeable by contending clientelist lobbies. But because large rents could accrue to those assigned such rights, the state could and did engage in rationing resources on the basis of the personal preferences of state decision-makers or on the basis of bargaining for a share of the rent. This may be illustrated by the Yang Chang Mo case. Yang, the chairman of what was once South Korea's seventh largest business group described how his group had been systematically stripped of its holdings when the state-controlled banking system switched off credit. Yang had refused to make large payments to an organization run by President Chun's brother.  

Corruption of this type seems to have been endemic in South Korea during the period of its rapid growth. With the end of the Chun period and a relative relaxation of political control there were widespread and fairly credible allegations of large-scale corruption by the president and his associates. The evidence suggests though that corruption in South Korea has been restricted to transactions within a fairly limited group of interests, and concerned the sharing of rents generated by an extensive system of state controls which were rather effectively imposed.
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Norman Jacobs' critique of South Korea as a patrimonial system actually supports our argument. Jacobs rightly points out the arbitrariness of much of South Korean state intervention. Indeed in a society where decentralized rights have not become well-established, not only is there greater scope for arbitrary state interventions, virtually all state intervention would appear to be arbitrary. This is because most state intervention would amount to the creation of new rights and not just the defence of existing rights. However, Jacobs' view that the South Korea of the seventies and eighties was not developing because of its patrimonial system is not defensible. A prosaic look at growth figures tells us that South Korea was rapidly developing, indeed growing much faster than the developed countries.

While South Korea resembles many other developing countries in the arbitrariness of its state, it seems that once the South Korean state decides on an allocation of rights, that decision is not subsequently challengeable by alternative coalitions. Jacobs' argument that non-challengeability is common to all patrimonial states is unacceptable, and it is perhaps understandable why he then sees no difference between South Korea and all the other societies which have failed to 'develop'. For instance in his discussion of the South Korean public sector, Jacobs argues that

as in all patrimonial orders, resolute leadership from above can and has dramatically overcome even the most formidable bureaucratic inertia to lead to economic expansion, but this has its own problems, because in all patrimonial economies such pressure can be selective as to place and time and subject to extra-economic patrimonial political goals, and hence is reversible when the leader's interests change.

The ability of the state to define or redefine rights 'from above' is certainly lacking in clientelist societies such as Bangladesh. On the other hand we will argue that such an ability has been an important factor behind South Korea's success. In contrast to clientelism, which operates when the state is
relatively weak and essentially incapable of enforcing rights, corruption in South Korea occurs in the presence of a strong state with rather exceptional abilities in enforcing or revoking rights. It would be quite appropriate to model venality in the latter case as corruption in the context of rent-seeking possibilities, and we shall further argue that rent-seeking of this kind is not as damaging for growth as the rent seeking literature suggests.

Since clientelism operates with weakly-defined rights, we need to understand the factors which prevent rights from being well-defined. How effective the rights of an existing decision-maker are would depend on at least three factors. First, it would depend on the general perception of the legitimacy of the right, since this would determine the costs of enforcement. Secondly it would depend on the policing abilities of the state. A third factor would be the organizational abilities of the lobbies challenging the right.

The process through which rights were acquired is important for understanding the legitimacy right-holders enjoy. The mythology and traditions a ruling class is able to invest itself with are also to a large extent responsible for the degree of acceptance it enjoys. It should not be surprising that when a capitalist ruling class has emerged out of a pre-existing social structure with authoritarian and repressive traditions it has generally found it far easier to gain legitimacy by borrowing and manipulating the traditions of the past. Property rights over the means of production can be protected at a much lower cost if the privileged position of a few does not constitute a break in cultural continuity. In contrast, in relatively 'democratic' tribal and peasant societies, legitimacy has been more of a problem for emergent capitalists.¹⁴

In some societies, an encounter with colonialism further weakened any popular consciousness of a 'natural order' in social hierarchy which emergent capitalists could draw on. In fact one of the pre-conditions of imperialist
survival was the destruction of the legitimacy of traditional ruling groups. This created a vacuum which the colonial state could fill, but it also destroyed any popular perceptions of legitimate authority. This aspect of colonialism has only fairly recently begun to attract attention.  

These two factors partly explain why an allocation of rights may have greater or lesser social acceptance or 'legitimacy' in different societies or in the same society at different times. The greater the legitimacy of an allocation of rights, the more difficult would it be to put pressure on those endowed with such rights for a payoff. However, it would be hard to explain the difference between South Korea and Bangladesh in these terms. Capitalists in both these countries are deprived of the decentralized authoritarian traditions of feudalism, and colonialism hardly enhanced the legitimacy of capitalists, who in both countries extensively collaborated with the colonial power.

We therefore turn to the other two factors which could explain differences in the extent to which rights were well-defined in different contexts. Policing powers of the state and the organizational ability of lobbies are discussed together in section 4.2 where we argue that the latter is more significant in explaining the extent of clientelist bargaining in Bangladesh.

**§ 4.2 Organizational Abilities, Policing Powers and the Extent of Clientelism**

Given the legitimacy of existing right-holders and any particular level of policing ability of the state, we would expect an increase in the organizational ability of clientelist coalitions to lead to an increase in the magnitude of the clientelist payoff. As the distribution of organizational power becomes more and more conducive for clientelist bargaining, a growing part of the potential income of existing right-holders may be appropriated by the clientelist coalition. To protect their rights, asset holders in turn find
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it rational to participate in lobbies aimed at other right-holders or the state.

Were rights over social assets more rigidly defined, individuals and groups would still participate in politics to re-negotiate rights to the advantage of their group or class, but political activity would not be one of the primary methods of resource appropriation and upward mobility. The distinction is clearly one of degree, but it is an important one nevertheless.

There is a lot of indirect evidence that clientelist strategies have become significant in Bangladesh. In a study looking at the social backgrounds of Bangladeshi entrepreneurs receiving loans from the state-owned Development Finance Institutions, Sobhan and Sen observed that their political connections were extensive. The authors did not however include politics as one of the categories classifying the social backgrounds of entrepreneurs. The reasons they gave for this indicate the scale of such activities:

A significant number of loanees appear to have been politicians at one time or another. However, political elites as such do not constitute a separate entrepreneurial group in the strictest sense because of the wide diversity of their socio-economic backgrounds. Political elites originate from almost every entrepreneurial group, starting from professionals and ending with industrialist-cum-traders... Political power is traded for public services and resources. Conversely access to state resources is translated into a political resource to enhance the power of the beneficiary and through him the influence of the regime.16

The difficulty of trying to treat 'political elite' as an occupational group similar to 'industrialist' or 'trader' becomes explicable if we see clientelism not as the activity of a specific set of agents, but as a broad process of upward mobility, with agents at all levels of the social pyramid participating. Moreover, while the authors found 'a significant number' of loanees to have been (presumably full-time) 'politicians', they would no doubt agree that
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virtually all loanees must have exerted some political influence to have their loans allocated and released.

The nature of politics in countries such as Bangladesh gives another indication of the extent of clientelist activities. In a book entitled 'The Politics of Rhetorics, 1972-79', Rizwan Siddiqui examines the consistent lack of consistency in the actions and declarations of political participants in Bangladesh. Slogans and 'rhetoric' serve the function primarily of exerting pressure and are rapidly abandoned when a payoff is negotiated. The lack of consistency is too systematic to be explained away as a series of betrayals. It is explicable if the underlying rationale of politics is clientelism, not if political movements and participants actually represented and therefore seriously wanted to defend established class or group rights.17

Since South Korea has in fact been described as a patrimonial state, and the state in South Korea does co-opt individuals, why do we not see a similar process of political organization and upward mobility there? An important part of the answer seems to lie in the distribution of organizational skills. Relative to the centralized power of the state, the diffuse distribution of organizational power throughout the rest of South Korean society has been described as the 'atomized' nature of the polity,18 or as the 'political isolation of Korean individuals' once they step out of the boundaries of their primary kin organizations.19

The relative weakness of organized clientelist groups in South Korea cannot be entirely explained by the draconian policing powers of the South Korean state, though it needs to be said that these are considerable.20 Spontaneous protests are frequent and sometimes successful. Such protests ousted Rhee in 1960 and forced the 1987 elections which led to the replacement of Chun Doo Hwan and the loss of the governing party's absolute majority in the legislative
assembly. What seems to have been different about South Korea at least prior to 1987 was the absence or failure of intermediary organizations which could channel popular discontent and acquire payoffs for clientelist coalitions. One reason for this was that potential clientelist groups were unable to politically defend their right to organize, a fact which reflects the social processes which led to the emergence of the modern South Korean middle class.

Unlike the British in India, the Japanese in Korea did not encourage the formation of a succession of middle class organizations which balanced each other. Moreover, the Japanese eventually left South Korea not as a result of a cumulative middle class offensive, but after a defeat in a war with foreign powers. Compared to ex-colonial countries where the middle class led the anti-imperialist struggle, the 'atomization' of South Korean society in the post-war period is hardly surprising. Clearly it was the South Korean middle class which was relatively unorganized compared to other developing countries. However, middle class organizers are critical even in mass organizations given the economic, educational and therefore organizational backwardness of the vast majority of the population in the typical developing country. Jacobs' conclusion is therefore entirely credible when in discussing the relative organizational power of the state, he says that

save for the learned-bureaucratic, no Korean occupational grouping is corporate; that is, no grouping can, as a legitimate right, define its own occupational interests and pursue them maximally through organizations of its own choosing and design. Rather, those initiatives are privileges which the learned-bureaucratic corporate occupational groupings alone can authorize and, equally pertinent, then only as a graceful prebend from particular individuals within the learned-bureaucratic occupational grouping to particular segments, or better yet to particular individuals, within the noncorporate occupational groupings.21

Our comparison of clientelism in Bangladesh and South Korea should not be taken to mean that rent-seeking corruption does not occur in economies like
Bangladesh. Allocations of credit, of licenses to import or export, allocations of industrial plots, virtually all such state decisions are linked to the sharing of benefits with the decision-makers involved. Moreover we have seen why the excess demand generated by clientelism could allow state bureaucrats to absorb some rents in ways which appear quite similar to rent-seeking. On the other hand, organized lobbying similar to clientelism occurs in economies where rights over resources are fairly rigidly defined. The demise of Chun in 1987 has also served to change the relative balance of power in South Korea. Organized lobbies can no longer be ignored. As the former vice-president of the Korea Development Institute put it,

> in [former president Chun's administration] a few elites set the priorities, drew up plans and presented them to the president. If we got approval we went ahead. The [ruling] party played a passive role. There were a lot of complaints from the party, especially about the price stabilization role, but the president just ignored them. Now it will be different. Many things will be initiated from the street.  

Instead of forced donations to organizations run by the president, businessmen are discovering that contributions have to be made to competing political parties. "Democracy, it turns out, is no cheaper than corrupt authoritarianism." Despite these changes, South Korean clientelism remains very underdeveloped. In any case South Korea is now a middle-income country where the costs of clientelism will be less keenly felt. We are primarily concerned with explaining the differences in performance of the two countries during the sixties, seventies and early eighties when Bangladesh and South Korea were located at opposite ends of the clientelist spectrum.

§ 4.3 Some Microeconomic Consequences

The efficiency implications of clientelist rights will be explored in Part II. At this stage we examine how the clientelist bargaining process can help us to understand the microeconomics of inefficiency in clientelist economies. A
rigorous account of the microeconomics of clientelist lobbies must, however, remain a task for further research.24

Observers would agree that in economies like Bangladesh, one of the features of intra-organizational operation is the obstruction of organizational change and particularly the retrenchment of employees by lobbies working within departments, ministries and even private sector enterprises. Such lobbies involve competing groups of decision-makers and their clientele. Clientelist bargaining may explain some of these microeconomic outcomes.

In an enterprise whose internal organization was dominated by clientelism, there would be one or more competing lobbies operating within the enterprise. Normally, the larger the enterprise, the greater would be the number of such competing lobbies. Because the strength of each lobby depends on its size, and since each lobby would typically incorporate members at various levels of the organization some of whom would be decision-makers, the retrenchment of individuals at any particular level of the organization would be resisted by the competition between lobbies.

In addition to class opposition to threatened unemployment, in the clientelist organization there would also be the resistance created by inter-lobby competition. We would expect this resistance to be greater in larger organizations because there would be the possibility of a greater number of lobbies in competition. This would apply whether the organization was in the public or the private sector, with the difference that lobbies in the public sector would be more likely to include influential interests outside the enterprise, and politically powerful groups would be able to exert much greater pressure in the public sector than was warranted by their strength in internal lobbies.
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Investment decisions are also influenced by whether 'operational' lobbies exist involving the relevant ministries, banks and politicians. The entrepreneur who wants to invest in a new area not only has to account for the usual risks, he also has to either invest in the creation of a new lobby in the state and political structure which will negotiate the appropriate payoffs. If the cost of creating a clientelist lobby appropriate for investment in a new sector is high enough, entrepreneurs would naturally be conservative in choosing sectors for investment.

Compared to conventional economic explanations, this is probably a more accurate explanation of the virtually suicidal overcapacity which develops in countries like Bangladesh once an initial investment is organized. The factors conventionally identified, such as overinvoicing capital imports and pressures from aid donors are of course important, but what we have to explain is not a general tendency to excessively import capital goods, but a tendency to excessive importation in specific sectors. No one, after all, would argue that there is a general overcapacity of capital goods in a capital starved economy such as Bangladesh. In a recent report, the World Bank implicitly recognizes this problem:

Undertaking an investment in a sector where similar investments are made significantly reduces information and processing costs. Existing project documents and designs can be used; machinery suppliers and factory designs are known and can be easily copied. In cases of overinvoicing (the misappropriation of foreign exchange subsidies given by the state through its overvalued exchange rate for capital imports – MK) the mechanisms are already well developed. Furthermore, since other entrepreneurs have already obtained credit for similar projects, it becomes easier to apply political pressure for further lending by calling for equal treatment of entrepreneurs.

Equally, once clientelist lobbies involving state bureaucrats, organizationally powerful political interests and private entrepreneurs become established, it is understandably difficult to alter the size of a sector or rationalize it in
any way. Once again, the cost of rationalization is not just the discrete economic interests which are hurt. The beneficiaries of a lobby may be a fairly large group who even when they do not get direct benefits from the particular interest being hurt, would politically oppose any reduction in the allocation of resources to their lobby. By definition, the potential opposition is great enough for the payoff to have been worthwhile in the first place.

Rent-seeking may be wasteful but faces no such constraint to changes in the allocation of resources over time. The current allocation of resources may result in rents for those endowed and they may be persuaded to share these with state bureaucrats, but if the allocation has to be changed, the resistance offered may be minimal. The parties involved may not even suffer. The state bureaucrat would certainly have new rent-sharing opportunities, while the recipient of resources may simply be allocated a new sector. The parties may find the changes unsatisfactory, they would not necessarily be able to challenge them. Part II formalizes these possibilities and explores the analytical consequences.

Conclusion

The argument in Part I has had a number of components. We first argued that success in sustaining economic growth in a world where technology and demand are rapidly changing is essentially success in managing a process of structural transformation. Human and material resources have to be directed to sectors where demand is growing and profits can be made as the opportunities arise. Equally ruthlessly, uncompetitive sectors have to be phased out.

A central argument of this thesis is that an analysis of the political constraints on structural change would be a fairly important component of a theory of growth and stagnation in developing countries. How 'efficiently' a state can intervene in the process of economic transformation is in turn
argued to be a function of the structure of rights within a society, and the constraints on the creation of structures of rights more appropriate for rapid structural change.

Contemporary conventional wisdom argues that state intervention leads to rent-seeking and corruption and hence to inefficiency. We argue that this interpretation of state intervention is not consistent with the evidence. State intervention is extensive in efficient South Korea as in inefficient Bangladesh. Moreover, so is corruption. The dismal failure of Bangladesh in managing the supply-side changes which generate productivity growth are not correlated with greater state intervention, but rather with the inefficiency of the state in changing resource allocations.

Finally, we argue that clientelist transactions are endemic in Bangladesh but there was far less evidence of such transactions in South Korea during the period of its rapid growth. This is related to the distribution of organizational power in the respective societies. Part II takes up the story by formally defining the distribution of organizational rights necessary for clientelism and shows the implications of clientelism for the efficiency of the state. The neoclassical attack on rent-seeking and the state is shown to be misdirected. The policy implications for overcoming clientelism may however be more, not less of a challenge.
Notes to Chapter Four

1. See for instance Krueger (1974). The rent seeking argument will be examined in greater detail in Part II.

2. Veingrod (1968) distinguishes between two strands in the literature on patron-client relationships. The first looks at patron-client relationships at the level of local politics, typically within the peasantry. A much quoted work in India is Bailey (1963) which looks at how voters in Orissa were linked to their candidate through a chain of intermediaries who were primarily interested in the rewards offered by the party. A second strand in the literature has looked at patron-client relationships at the centre, ranging from descriptions of American machine politics to the politics of tropical Africa. See Randall & Theobald (1986) pp. 50-64.


4. President Ershad's cabinets have included 'marxists' like Kazi Zafar and Anwar Zahid, while 'revolutionaries' like Ziauddin Bablu have served as special advisors. But they are only conspicuous because of the ideology of opposition they employed, in terms of their social base and strategy, they are quite similar to other upwardly mobile clientelist organizers.


7. The Bangladesh Nationalist Party was in fact formed by absorbing political parties and groups whose primary activity hitherto had been opposition to Zia's administration. See Siddiqui, Rezwan (1984) pp. 91-117.

8. The Far Eastern Economic Review's survey of banking (5th May 1988), In India politicians staged wholesale giveaways of uncollateralized credit or simply wrote off sizeable bank credits to buy votes. Ibid, p. 76. In Pakistan borrowers use their political influence to delay or refuse repayment, and estimates of bad debts suggest these could be in the region of Rs 660 million annually. Ibid, p. 94.

9. Far Eastern Economic Review 21st April 1988 pp. 58-9. Yang had made a contribution of only Won 300 million to Saemaul Undong, an organization run by Chun's brother, at a time when other corporations were contributing at least Won 1 billion annually. One billion won is roughly one and a quarter million U.S. Dollars.

10. Allegations have been made of forced contributions during the Chun period to organizations such as Saemaul Undong and the Ilhae Institute which were subsequently misappropriated. Far Eastern Economic Review 24th Nov. 1988 pp. 14-15. Evidence of corruption during the Park period is provided by Jacobs in Jacobs (1985) pp. 118-21.

12. Ibid, pp, 149-54, Jacobs defines lack of development as unbalanced growth, but if growth can be sustained, the notion of imbalance becomes a subjective one.


14. Marxist economists have observed that dynamic forms of capitalism have emerged almost always from 'feudal' type economies. The role of pre-existing repressive social structures in allowing the emergence of a narrow set of agents as a legitimate ruling class has not however been adequately recognized.


17. Siddiqui, Rezwan[1984].


24. Modelling of some microeconomic aspects of 'lobbying' has been attempted, see for instance Collier[1986].

25. Conventional explanations of overcapacity have stressed the underpricing of capital and the pressure of donor countries. Winston[1970] looked at over invoicing and argued that this mechanism ensured that profits from expansion of capacity were greater than the profits from balancing and adjustment to bring the full capacity into use. Islam, Rizwanul[1978] adds the effects of the rigid licensing system which discriminates against the import of raw materials, and tied foreign aid which encourages the import of capital goods.


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Chapter Five Viability Constraints and the State

Introduction

A comprehensive comparative approach to system efficiency would require a methodology of the type suggested by Koopmans and Montias. Such a project assumes that a consistent set of hypotheses can be proposed on the basis of existing theory for the functional form of relationships between system variables and outcomes. It also assumes that our data is good enough to falsify all but the correct hypothesis. The approach of the subsequent chapters is far less ambitious. The analysis isolates a particular set of differences in the economic organization of societies, but one which we feel would be an important part of a conceptually complete analysis of system diversity.

The analysis in Part II examines the relationship between the evolution of rights and economic dynamics. A number of questions are addressed: first, the implications of different allocations of 'property rights' for industrial efficiency and structural change, secondly the conditions constraining the evolution of efficient structures of rights and finally, the implications of changes in these conditions over time or across countries.

The questions raised about the relationship between state and society are certainly not new. Marxist analytical work in particular has addressed the question of how property rights and the state constrain economic outcomes. Although marxist and neoclassical arguments will be looked at in later chapters, it may be helpful to begin by locating the questions we are asking in the context of existing research.

The marxist 'mode of production' methodology was grounded on the insight that economic systems follow distinct 'laws' of development which put bounds on the
nature of technical change, the character of economic crises and so on. The
task of political economy was to identify and explain these differences. In one
of the most lucid defences of the mode of production methodology, Oskar Lange
argued that the laws of economic dynamics were derived from the different
'relations of production' which described the class ownership of the means of
production. Property rights were the basis of an analysis of dynamics because
at the microeconomic level they determined the aims and means of action, and
at the macroeconomic level, the market and plan interactions which allocated
the society's investment fund. In this way, patterns of economic activity
transcended the consciousness and intentions of individuals.²

In the first place the relations of production constrain what Lange calls the
laws of human behaviour, the way objectives are defined and the strategies
available to attain them. Neoclassical economists would not categorize certain
types of income flow as surplus appropriation, but they would agree that
property ownership provides a framework for analysing the microeconomic
bargaining process which results in the production of output and the
associated streams of income. Property rights indicate the options available to
any individual and the variables which could be maximized according to his or
her perception of self-interest. The functioning of the economic game at the
micro-economic level thus depends on the nature of these property rights.

Examples in this tradition include Witold Kula's analysis of the market
economy during Polish feudalism. Kula showed how feudal production relations
determined the means available and the objectives maximized even when the mode
of social interaction was ostensibly the market.³ His analysis was thus able
to explain economic outcomes in the feudal economy which were quite different
from the market outcomes expected under capitalism. Within a neoclassical
framework, the work of Douglass North has looked at the major inflexion points
in the rate of growth of western economies in terms of the evolution of
property rights which lowered transaction costs. Changes in the structure of property rights played a critical role in encouraging patterns of individual decision-making which were efficient for society.4

The second aspect of the relations of production is perhaps more important, and has to do with the macro-economic allocation of investment through market or plan. Microeconomic bargaining outcomes generate a range of income flows, some of which in aggregate constitute the potential investment fund of society. We define these flows as the aggregate surplus. We shall see that property rights are relevant for an analysis of the size of the surplus and how efficiently it is allocated. Some of the most innovative marxist analytical contributions have analysed the interdependence of property rights in the means of production and the allocation of the surplus through market or plan. For instance the work of Wlodzimierz Brus has examined how differences between capitalist and socialist systems of property ownership may be relevant for analysing differences in the operation of markets and plans.5

The microeconomic and macroeconomic analyses are of course inter-related. They both emphasize the importance of property rights in explaining different patterns of resource allocation and use and hence differences in economic dynamics. Since property rights can only be defined politically, the state as the institutional expression of political power is clearly a relevant subject for economic analysis. The existing literature has not, however, adequately examined the variations possible within broadly similar structures of rights.

Economic performance is clearly affected by the structure of property rights over productive assets, but this does not completely specify the constraints set by property rights on economic dynamics. An important set of economic transactions in modern states are the implicit and explicit cross-subsidies which come about as a result of state intervention. We will call such cross-
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subsides or transfers side-payments. Side-payments are ubiquitous in contemporary economies because they are indispensable for managing both the processes of structural transformation and the political balances on which modern states depend. Like other types of income flows, side-payments are the outcome of an implicit or explicit process of bargaining and we can investigate the rights on the basis of which this bargaining is conducted. This would be one way of investigating the efficiency implications of different patterns of state intervention.

States do not simply protect a pattern of rights over physical assets, because the owners of physical assets are not the only politically and economically powerful constituency on which the viability of the state depends. If we only specify rights over the means of production, it is possible for two systems to have identical endowments and an identical class ownership of the means of production while their economic performances differ. We therefore extend the conventional analysis by investigating in addition:

a) the implications of different structures of rights which underlie the bargaining over side-payments, and

b) the efficacy with which the state can manage processes of transition when structural transformation requires changes in the allocation of such rights. This depends not only on subjective factors such as the quality of leadership but also on the nature of the political constraints facing the state.

There is no reason to expect, simply because a fraction and perhaps even a large fraction of the economy is owned by capitalists, that we should be able to unravel from this fact alone, the dynamics of all societies which share this characteristic. The dynamics of surplus utilization imposed on this sector by the nature of property rights within it has to be understood in the context of
the implications of other politically-sustained rights in the society in which it operates.

We retain the marxist concern with investment and growth while extending the analysis beyond property rights over the means of production. The neoclassical approach of considering a range of rights relevant for analysing the efficiency of outcomes is thus adopted, but the neoclassical definition of static allocational efficiency is replaced with a definition of efficiency in terms of resource allocations which maximize growth. As a corollary, we are no longer restricted to considering the effects of rights related to a static allocative problem and instead we focus on the rights which underlie the bargaining over 'side-payments'. The objective of Part II is to show that the nature of these rights have significant implications for the dynamic allocation of the investment fund and for the process of structural transformation.

In this chapter we introduce the notion of viability constraints on the policy options of the state. Keeping other factors constant, it is argued that the state, by recognizing different allocations of rights, can change the relative viability it enjoys with respect to specific political and economic criteria. The distinction between the two is argued to be crucial.

In Chapter Six we see why changes in the structure of rights can change the political viability of the state. A range of income flows can be modelled as bargaining outcomes given allocations of rights over certain types of assets. We look at the allocations of rights which underlie capitalist and 'clientelist' surplus appropriation. Changes in rights thus imply changes in income flows for politically powerful groups and this can have obvious implications for the political viability of the state.
Chapter Seven argues that at the same time, the structure of rights has implications for the static and dynamic efficiency of the system. Dynamic efficiency depends on a number of conditions being imposed on the allocation and protection of rights, and it is misleading to assume that these are always satisfied. The most important of these conditions are analytically identified for systems successively approximating real world situations. Changes in rights therefore also have implications for efficiency.

Chapter Eight draws together these ideas and suggests the notion of a political frontier constraining the emergence of more efficient structures of rights. This is shown to be equivalent to the 'Stability-Efficiency Tradeoff'. We aim to explain why the most efficient structure of rights does not necessarily emerge. Attempts by the state to move towards greater dynamic efficiency by supporting alternative allocations of rights are shown to have different implications for the political viability of the state, depending on the initial allocation of rights and the political settlement which underlies it. The shape of the tradeoff or political frontier thus sets limits to the efficiency of the state and limits its options. Chapters Nine and Ten develop the implications of the model.

§ 5.1. Viability and the State

Common sense suggests that the viability of a state may be threatened by either an economic crisis brought about by a deterioration in economic conditions, or by a political crisis, when powerful coalitions seek to change the personnel in control of the state, or less frequently, the state structure itself. To analyse the options available to the state, we need to examine the conditions which make the state unviable. The self interest of state-decision makers will ensure that they will try to limit the possibility of being replaced (or deposed). Consequently, they will ceteris paribus try to achieve changes which maximize the economic and political viability of the state.
The performance of the economic system affects the state's viability, or in other words its prospects for survival, not only because the state has fiscal needs for the maintenance of its institutional structure, but primarily because an economic crisis creates constituencies which have the incentive to mobilize against the existing personnel and policies of the state. An economic crisis may therefore be the harbinger of political change, which is why it is possible to independently identify a set of conditions necessary for what we may call the economic viability of the state. States do in fact perceive the importance of economic performance, and react to economic signals often long before political pressures materialize.  

On the other hand, the political viability of the state may be threatened independently of economic performance, as a result of the political mobilizations of social groups who seek to replace particular decision-makers in the state, alter institutions and laws through the political process or even carry out far reaching institutional changes which may be described as revolutionary. Indeed the crux of our argument will be to formalize the kinds of situations where conflicts between economic and political viability conditions impel states to behave in inefficient ways. To see how this happens, we make an analytical distinction between what we will call efficiency conditions on the one hand and stability conditions on the other.  

Many of the conditions contributing to the attractiveness of investment and its efficient allocation have been tackled within conventional economic theory, factors such as profitability, market distortions, expectations and aggregate demand. However, there are some factors which are specific to an analysis of the state. These include the protection of some types of rights and the renegotiation or denial of others. We will later argue that some patterns of rights can be identified as more conducive for growth-enhancing investments than others. Efficiency conditions are the set of factors which together ensure
the direction of investments to growth-generating areas and they can clearly be more or less appropriate for generating the fastest growth. Clearly, how favourable the conditions are for the most efficient dynamic allocation of resources depends not only on the quantity of investible resources, but also on the conditions determining its allocation. Although the two are clearly related over time, efficiency conditions need to be distinguished from accumulation.

To isolate the effects of alternative structures of rights on the growth potential of an economy, we will hold the conventional factors affecting investment and growth, in particular resource endowments, constant. With this assumption, an assessment of how favourable the existing efficiency conditions are depends on the relative position of the given assignment of rights within an ordinally ranked set of alternative assignments of rights, ordered in terms of their relative ability to induce allocations of investible resources to the fastest growth generating areas.

For such an assessment, we require that it should be possible to rank two states of the economy X and Y, assuming unchanged resource availability, in terms of how well the respective allocations of rights induce the allocation of investible resources to the fastest growth-generating areas. What we mean by this needs to be carefully specified. Consider an economy with given assets and a set of rights defined over these assets. Call this allocation of rights X. Resource availability remains unchanged, and we keep the allocation of rights over most assets fixed. However rights over some assets are then re-assigned such that surplus use now generates a faster rate of growth. Since the achievement or even the complete specification of the rights which generate the fastest rate of growth is practically impossible, the possibility of marginal adjustments of this sort is never ruled out. The new allocation Y is then unequivocally superior in terms of efficiency conditions compared to X.
Clearly all sets of assignments of rights may not be ranked in this way. But with resource endowments fixed, for any given structure of rights, a range of successively superior assignments of rights in terms of efficiency conditions may be identifiable, and this is all that is required. Recalling the definition of Chapter One, it will be seen that one aspect of the efficient state is that it can attain the assignment of rights which is most favourable from the point of view of efficiency conditions, given initial resource endowments and the initial assignment of rights. An improvement in efficiency conditions would, ceteris paribus, improve dynamic investment allocation and growth, and over time the size of the investible fund itself. And since this serves to improve the viability of the state, the incentive to move in this direction operates not only through the pressure of the economic interests involved, but directly through the self-interest of the agents directing the state apparatus.

However, it would be misleading to imagine that the state is free to attempt to improve these conditions even within the actual or perceived limits of the technical resources available. Of the factors which serve to limit adaptive evolution in assignments of rights in line with growth-augmenting possibilities, the most important are those which collectively define what we call the stability conditions.

**Stability conditions** are the set of conditions which together ensure a low level of political opposition to the state. Stability conditions may therefore be more or less favourable depending on the extent and intensity of such opposition. Once again, a number of factors would together determine the political opposition to the policies of a state, but one element would be the degree of correspondence between structures of rights legitimized by the state and the relative strength of politically expressed demands of groups and classes in the economy. We describe the relative balance of power between the various politically relevant classes and groups at any given time as the
political settlement. A change even in the relative balance of political power between groups and classes or between them and the state therefore constitutes a change in the political settlement which would have an effect on the acceptability of a given structure of rights.

To isolate the effects on stability conditions of changing assignments of rights, we hold constant the political settlement. With this assumption, how favourable the existing stability conditions are refers to the relative position of the present assignment of rights within an ordinal ranking of alternative assignments of rights, ranked in terms of their compatibility with the balance of politically expressed demands of groups and classes. Thus an improvement in terms of stability conditions refers to state-sponsored changes in assignments of rights over resources, which bring the latter more into line with the balance of politically expressed power of the various classes and groups contending for allocations of rights.

What we require for such an assessment is that given a particular political settlement, we should be able to rank states $P$ and $Q$ of the economy in terms of the degree of political opposition to the respective assignments of rights. Once again we need to specify exactly what we mean. Consider an economy with given assets and a set of rights defined over these assets. Call this allocation of rights $P$. The political settlement remains unchanged, and we keep the allocation of rights over most assets fixed. However rights over some assets are then re-assigned away from classes with a lower organizational power and political 'voice' and hence a lesser ability to threaten the political viability of the state to groups or classes with a greater organizational power and political 'voice'. The new allocation $Q$ is then unequivocally superior in terms of stability conditions compared to $P$. 

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Once again, while all assignments of rights may not be successively rankable in terms of stability conditions, all that we require is that for any given political settlement and initial assignment of rights, a range of successively superior sets of assignments of rights in terms of stability conditions is identifiable.

§ 5.2 Conflicts Between Economic and Political Viability

Any given structure of rights, provided it is compatible with the balance of political power between various classes of right-holders, will have a built-in negative feedback system. A structure of rights implies a corresponding set of income flows and we shall later categorize broad patterns of rights as distinct surplus appropriation systems. Changes in rights therefore imply changes in income flows and coalitions will mobilize to put pressure on the state to prevent such changes. To maintain the political viability of the system, the state has to respond to political pressures in managing the allocation of rights such that stability conditions do not deteriorate below a notional 'politically tolerable level'. Nevertheless, the structure of rights is not immutable, and state decision makers do have the option of accepting a lower level of social stability if other pressures persuade them to reallocate rights in this way. What is critical therefore, is whether growth-augmenting transformations benefit or threaten the rights on which the dominant coalitions depend, and secondly, on whether the pursuit of superior efficiency conditions takes the system below the politically tolerable level of stability.

Just like the political balance, economic conditions can also be a factor limiting the degree of possible variation in rights. Rights have an economic content because they describe allocations or flows of social resources. Any structure of rights within the economy has consequences for the accumulation process, and this too sets limits to variations in rights. A non-viable economic system will eventually threaten the state with an economic crisis or
an alternative mobilization of social forces. Just like the minimum politically tolerable level of stability, there is also a notional 'minimum sustainable level of economic efficiency', beyond which the economic reproduction of the existing allocations of rights becomes unsustainable over a period of time.

Only rarely however will a pattern of rights which entail low economic viability lead to a revolutionary political challenge which overthrows the institutions of the state. If such a crisis was a result of existing property rights over the means of production being inappropriate for new technology, we have the marxist scenario of revolution. Normally, declining economic viability has effects which are capable of being accommodated within the existing state apparatus. The deterioration, stagnation or unacceptably slow improvement in efficiency conditions results over a period of time in economic pressures which are communicated to the state through a number of possible signals. Bankruptcy of productive units, inflation, unemployment, balance of payments difficulties and pressures from taxpayers, lenders and donors are the most important. Alternative coalitions may eventually mobilize to put pressure on the state to attempt to return the system to greater economic viability, if necessary by overturning the existing political settlement. Moreover we shall see that if the groups directly interested in an improvement in efficiency conditions are politically weak, state institutions may be persuaded to take 'autonomous' action.

Changes in assignments of rights thus have implications for stability and efficiency conditions. Our first step will therefore be to identify the nature of the relationship between stability and efficiency under different circumstances. This is done in the next three chapters. In the subsequent chapters of Part II we examine the theoretical implications of this relationship.
Notes to Chapter Five


2. Lange[1963]. Lange identifies a 'residual' category of economic laws, clearly of lesser significance, which are derived from the influence of the superstructure, and includes the operation of the currency, taxes and so on. This distinction reflects the marxist argument that the base has primacy in the long run. This may well be true, but we would argue that the constraints on the superstructure can and should also be modelled. If the maintenance of rights in the base is attributed to the superstructure, the implications of how the superstructure works and what factors constrain it may have more than residual significance. The superstructure can only be ignored if we believe that there are a finite number of possible variations in rights over assets, that rights over the means of production are the only rights which matter for an analysis of economic dynamics, that this finite number of possible variations are mutually exclusive, and that once a switch from one set of rights to another has been made, this is perfectly enforceable by the state. The notion of a limited number of rigidly defined and linearly successive series of modes of production is based on these assumptions. Our rejection of these assumptions distinguishes us from Lange.

3. Kula[1976],


6. This does not imply an instrumentalist view of the state. The state may be responding to signals such as business confidence rather than being a 'committee' of the capitalist class. See for instance Block[1977] for an analysis of state responses explained in these terms.
Chapter Six Rights Incomes and Stability

In this chapter we identify some of the components of the potential investment fund. These income flows can in turn be modelled as the outcome of a bargaining process where rights over certain assets are defined. In the next chapter we shall see that the rights underlying the flows of income which are potentially investible are not necessarily the rights which are most appropriate for its efficient allocation. This problem is at the core of conflicts between stability and efficiency.

Classical economists analyzing 'surplus' were also, we believe, trying to identify and analyse the allocation of the potential investment fund in an economy. They saw surplus as the net output of society, its current output minus the 'necessary costs of production'. Necessary costs are however difficult to define, and hence in Chapter One we introduced a definition of the aggregate surplus where its components were implicitly identified 'institutionally'. In this chapter we take this approach further. The components of the potential investment fund are identified with reference to prevailing institutions and the rights which generate them are subsequently examined.

Mark Blaug thoroughly misunderstands the classical economists in his critique of Marxian surplus. He argues that the surplus concept is misplaced unless it can be assumed that capital has no long-run supply price. If the rate of profit is the long-run supply price of capital, Blaug argues that profits are necessary and surplus can only be understood as the rents accruing to certain enterprises or sectors in the process of adjustment.

The validity of Blaug's criticism depends on whether Marx's objective was to identify the property rights which produced investible resources under capitalism or to show that capitalist profit had no economic justification. We believe Marx's attempt to define necessary cost was primarily directed by the
first motive though his economic terminology (eg 'the rate of exploitation') was often influenced by his moral and political opposition to capitalism.²

In a capitalist economy profits, rents and super-profits are income flows which are potentially investible after the consumption of the classes and groups with rights over these resources. To the extent that profits are invested, they are clearly necessary for growth. There is also quite conceivably a notional supply price of capital, in the sense that capitalists directly or through the state take corrective measures if profitability falls far enough. However we shall see that there is no unique relationship between the quantity of capital and the income flows identified as profits. The latter depend in critical ways on the rights which are defined over the stock of assets. This implies that the response to falling profits does not simply amount to an adjustment in the quantity of capital supplied. Casual observation confirms that often and perhaps primarily the response is a reassignment or reassertion of rights given the existing capital stock which leads to a return of profit flows to levels appropriate for investment and growth to continue.

Our interest in a notion of surplus is to identify particular sets of rights which are relevant for an analysis of growth and stagnation in capitalist economies. The concepts of aggregate and investible surplus which we have already encountered are useful in terms of this objective. We define the aggregate surplus as the sum of income flows which are potentially investible given the institutional arrangements of a particular society. With given resource endowments, particularly the stock of productive assets, and the structure of property rights over them, a bargaining process which may be more or less competitive results in the production on the one hand of different goods and services and on the other a set of income flows. Which of these are potentially investible and constitute the aggregate surplus of society, depends on our assessment of prevailing institutional arrangements.
For instance if institutional arrangements exist which could encourage the investment of a significant part of wages, the part of wages diverted to investment-managing institutions would be included in the aggregate surplus. We would then be interested in the rights which encouraged workers to invest in such institutions. In the societies we are concerned with, institutions for investing wages are not significant, so of the value added by firms only profits would be part of the aggregate surplus.

On the other hand, state institutions do exist which provide implicit or explicit subsidies to business enterprises and to political claimants. The resources a state has or can create net of the wages and salaries of state employees may be bargained for in a number of ways. However, since net state resources are potentially investible in ways which raise social productivity, and institutions do exist which attempt to do this, we regard all of these resources as part of the aggregate surplus. The allocative process does of course matter, and we will distinguish between two allocative procedures.

First, allocations to capitalist or state capitalist (public sector) enterprises could be the outcome of bargaining sectoral allocations on the basis of the state's perception of how the net present value of social output can be maximized and the relative cost to the state of increasing output in different sectors or enterprises. These allocations would subsequently show up in enterprise accounts as increased profits or reduced losses. Note that we are not concerned with an 'objective' analysis of growth maximizing allocations, but only with what the allocation would be given the perceptions of state decision-makers. On the other hand, some or much of these resources may also be bargained for by clientelist coalitions in the way described in Chapter Four. Part of such allocations may also show up in enterprise books as increased net profits, but the basis of the bargaining would be different. We need to understand why a part of net state resources may be allocated on the
basis of clientelist bargaining, and the implication of this for efficiency. The appropriateness of state perceptions of growth possibilities, in other words of policy, is a separate question which not only has a large literature, it is also less interesting for explanations of state inefficiency given the large gap we normally find between policy pronouncements and implementation.

We have made several analytical simplifications, some of which will be relaxed later. We assume that the bargaining of capitalist or state capitalist enterprises for net subsidies given the state's objective of maximizing the direction of resources to growth generating sectors can be sharply distinguished from the bargaining for resources on political considerations. In practice, perceptions of growth possibilities may themselves be modified by political pressures and later we shall examine the possibility of these bargaining procedures being coterminous.

We have also assumed that the resources the state can allocate are state revenues less the consumption of the state, the state being defined as in Chapter One as the set of decision-makers making decisions about rights. (Thus state capitalist enterprises are not part of the state narrowly defined.) The consumption of the state is not unproblematic. Clientelist payoffs can be bargained for not only by lobbies outside the state but also by lobbies within it. In other words, net state resources may be larger than the size of net state allocations. We avoid this problem by identifying clientelist payoffs ex post, that is only when the bargaining which maintains them becomes explicit.

As with payoffs made to outside claimants, we would only identify administrative expenditures as clientelist payoffs when, for instance, conflicts with existing decision-makers exposed the clientelist bargaining underlying particular resource flows. Our definition of the state then allows us to see these as payoffs allocated by a redefined and smaller set of state decision-makers to clientelist lobbies from 'net state resources'. We thus avoid the
problems facing \textit{a priori} definitions of 'unproductive labour' or Baran's distinction between actual and potential surplus, which we will discuss later.

Finally we have assumed that the state makes no resource allocations on the basis of independently specified welfare objectives. This is clearly a simplification but it may not be a very unrealistic assumption in the case of developing countries in particular. Most welfare allocations could be analysed either as allocations made on the basis of state perceptions of future social productivity (e.g., allocations to primary education) or as responses to the pressures exerted by powerful coalitions (e.g., subsidized urban rationing). This does not mean, of course, that state allocations do not have welfare implications, our assumption is simply that allocations are primarily the \textit{outcome} of two distinctly identifiable bargaining processes.

For the sake of simplicity, and given prevailing institutional arrangements in developing capitalist countries, we look only at a number of income flows which we believe constitute the bulk of the aggregate surplus in these societies: enterprise profits, clientelist payoffs and rents. Enterprise ownership is either capitalist or state capitalist (public sector). Before we examine the rights which give rise to these income flows, a guide to the argument is provided in figure 6.1. The rights over physical assets which generate profits (row one) will be examined in section 6.1. The range of rights generating state revenues (row two) cannot really be exhaustively examined, we will be concerned primarily with how net state revenues are subsequently allocated. The rights generating state revenues include the state's power to tax, print money and to bargain with other states and international institutions for credit and aid. It also includes the power to impose restrictions on markets (row three). This is really a subset of the second row, but has been separated because of the importance given to rent-seeking in recent literature.
We will argue that state intervention which results in rents does not have the necessary inefficiency implications which much of the literature suggests. It does result in new flows of income both for the state, if it absorbs a share of the rents, which is shown in the diagram as an addition to the second row, and it additionally results in incomes for enterprises which have been allocated the appropriate rights. Clientelist payoffs can be bargained for both from enterprises and the state, and the rights which underlie this are the subject of section 6.2. The rights which generate clientelist payoffs are then contrasted with those which underlie rent-seeking behaviour in section 6.3.

The last column in figure 6.1 shows the components of the aggregate surplus in our simple model at any given time. Adding together similar categories of incomes, we get the following expression:

\[
\text{Aggregate Surplus} = \text{Enterprise Profits} + \text{Clientelist Payoffs} + \text{Rents}, \quad \text{where} \\
\text{Enterprise Profit} = \text{Net Profits from Asset Ownership} + \text{State Generated Enterprise Profits},
\]

All of the aggregate surplus is not and cannot be invested, and the part which is invested is variable. Moreover, what is invested is not necessarily invested
in the most efficient way. The next few sections will first develop the point that it is possible to identify the rights which are necessary for certain categories of income flows to exist. What this implies is that the defence of a given structure of incomes is really the defence of a particular structure of rights. This will help us to analyse the size and allocation of the investible surplus. The investible surplus is the investment fund after the consumption of agents with rights over the fund. If the aggregate surplus is a product of a specific structure of rights, the size and allocation of the investible surplus depends on the nature of these rights. Those possessing such rights may consume more or less of the potential investment fund. Moreover the structure of rights over the aggregate surplus also defines the incentives and opportunities of agents making decisions about investment allocation. These issues will be further examined in Chapter Seven.

§ 6.1 Profits from Asset Ownership

In his game theoretic exposition of capitalist exploitation, John Roemer shows that surplus appropriation under capitalism can be attributed to the rights capitalists have over the means of production. Roemer is however concerned with an ethical critique of exploitation rather than with an investment-oriented analysis of surplus appropriation. He aims to show that i) a structure of rights over assets produces definite categories of income flows and ii) if an egalitarian reallocation of rights over a particular asset can be shown to result in gains for one coalition and losses for another then the first coalition was exploited by the second under the inequalitarian structure of rights over the particular asset. Under capitalism the restricted set of rights is over the means of production. If workers could withdraw with their per capita share of the means of production they would be better off and capitalists worse off. This, Roemer argues, defines the nature of capitalist exploitation and also the conditions under which it ends.
We agree with Roemer in that an appropriate (in the simplest case egalitarian) distribution of rights over the means of production can always be defined which would cause profits for a class of capitalists to disappear. However we do not agree that workers will necessarily be better off, except under a further set of assumptions which need to be specified. In fact, if a long enough time span is considered, what matters is the rate of growth of output. In the language of Chapter Five, workers will only be better off under the new structure of rights if the latter is also superior in terms of efficiency conditions. This criticism is not damaging for Roemer's first proposition that a structure of capitalist property rights are necessary for generating profits. It is however damaging for the second, which says that capitalist property rights always lead to a welfare loss for workers compared to the egalitarian option. This does not follow unless the rights underlying production in the alternative society are carefully specified.

Consider a snapshot picture of a simple competitive economy where the means of production are owned by a narrow group of people: the capitalists. Ownership and management are separate or separable so that the costs of management are accountable as wages. Labour productivity is higher using the means of production so capitalists can bargain for a product wage which is higher than workers could produce on their own but lower than the output per labour using machines. If workers do not have the means to subsist, machines are not necessary to produce this result. Any wage would be better than the alternative. In such an economy, the means of production would be the wage fund. Capitalist profit can then be shown to be the outcome of restricted property rights over the means of production. To see this, let us now assume that rights over the means of production are subsequently equally distributed across all members of society. What happens to total output and the consumption of workers depends on the assumptions we make about the nature of
technology and the objective functions of workers. But profit, the net enterprise revenue accruing to the owners of capital disappears.

In the simplest case assume that technology is such that capital is perfectly divisible, there are no economies of scale and no additional transaction costs of small scale production. Roemer considers two alternative objective functions for workers. In the first, workers minimize labour time subject to the constraint of producing their subsistence fund. Since technology is unchanged, workers now produce exactly as much as the wage fund under capitalism. Both the output which previously constituted profits, and profits as a category disappears. Note however, that workers will not be better off except in the short run unless capitalists were not investing any part of profits.

With the same assumptions about technology, a second possibility is that workers like capitalists are maximizers of net incomes. Production is now exactly the same as under capitalism. In neoclassical terms, the position on the production possibility frontier is unchanged since society's total stock of divisible capital and labour endowments remain the same. However, workers own all the revenue they produce, so profits do not exist. While total output is unchanged in a snapshot vision, it may not be unchanged over time compared to capitalism. That depends on future capital stocks and hence on investments. Workers can either increase their consumption or invest, and a comparison over time would require us to know the institutions governing the allocation of the investment fund in the capitalist and post-capitalist societies.

Now let us consider the more realistic case where technology is such that capital is indivisible, there are economies of scale, and transaction costs may increase with small scale production. Capital can no longer be physically divided, but rights over it can. Just as a capitalist stockholder owns a share of a company, coupons are issued entitling every individual to a per capita
share in society's capital stock. We assume that individuals make no attempt to realize the value of their coupons. A democratic process establishes the objective function for the managers of the indivisible stock of the means of production. Once again what happens to output depends on the objective function, for instance on whether workers wish to minimize work or maximize net revenues. As before, the objective function would determine the size of society's total output but once again capitalist profits disappear just as with divisible capital stock. Once again, workers are necessarily better off only in an instantaneous comparison. A comparison of future streams of income requires information on the institutions managing investment.

Moreover, profits in new forms may reappear. Even if rights over the means of production were equally distributed, as long as rights over them exist, profits need not disappear. Profits reappear for instance if some individuals contribute more labour than others and there were institutions for measuring labour contribution. If all individuals worked equally hard, or if effort was not measured, each individual would get a per capita share of society's output. In this case ownership of the means of production would not entail the generation of a separate flow of income. If however some individuals contribute less labour than others and institutions develop to ensure labour remuneration proportional to effort, income flows would have to take into account the fact that all individuals also owned an equal share of the means of production.

A possible solution would be to give all individuals a per capita share of the revenue of enterprises net of wages. Those who worked less would thus receive income flows quite similar to profits. Their total income composed of labour compensation and a per capita share of net enterprise earnings would be able to buy commodities with more embodied labour than they themselves contributed (ignoring any differences in the organic compositions of capital producing the relevant wage and output bundles). 'Lazy' or less skilled workers would thus
appropriate profits as defined by Marx. But for Roemer, they are not capitalist exploiters since diligent workers cannot improve their lot by withdrawing with their per capita share of the means of production - they already have that.

The paradoxical result actually shows that the maintenance of an egalitarian structure of rights over the means of production is nevertheless the protection of a particular pattern of rights. Profits, if they emerge in this case are related to the protection of that structure. Roemer correctly points out that a different allocation of rights over assets would again make profits impossible, if individuals were allocated their per labour share of the means of production. In other words, if more hard working or skilled workers had a proportionally greater share of the means of production. Roemer refrains from defining capitalist exploitation as the absence of profit-making on the grounds that the implicit alternative is not egalitarian, which is consistent with his ethical approach to exploitation. In contrast, whether or not we would identify the income flows accruing to workers contributing less labour in this society as part of the aggregate surplus would depend on institutional arrangements which may or may not exist to channel such resources for investment. What is critical is that in this case too, profits exist by virtue of a structure of property rights over physical assets, and if these profit-like income flows are to be analysed, the property rights on which they are based clearly need to be identified.

If we agree that capitalist profits in contemporary institutional contexts are part of the potential investment fund and that they are generated by the protection of rights over the means of production, we need to look at what the protection of capitalist rights entail. The simplest case is the type of capitalist economy considered by Marx in Capital, which models the competitive capitalism of Britain during the industrial revolution. Undoubtedly primitive accumulation even then required the state to transform particular pre-
capitalist rights, but by and large, the capitalist sector, once it had come into existence, did not require the selective direction of investible resources by the state to survive.

We may think of this as a model of capitalism with 'small scale technology'. The latter describes a technology which allows individual capitalists or groups of capitalists to own discrete units of production which are viable. The capital required for viable production must not only be relatively small, the neoclassical assumptions considered in Chapter One must also hold. There must be no pecuniary externalities, linkages or transaction costs preventing production being viable for individual capitalists. If technology is sufficiently simple and property rights well defined, these may not be unreasonable assumptions.

Even so, the state has some minimal functions. For capitalist surplus appropriation to continue, property rights over the means of production have to be protected. This assumes that the relatively narrow class of capitalists have enough economic and political power to ensure that the state does protect this assignment of rights, and secondly that the state has policing institutions to do this effectively. These assumptions are sufficient to ensure that capitalist surplus appropriation with small-scale technology can occur.

As the technology necessary for competitive production becomes increasingly large scale, the structure of existing property rights over the means of production can only be ensured by much more extensive state intervention. We introduce the analytical construct of 'large-scale' technology as a shorthand for the changes in the technological basis of capitalism which have made capitalist enterprises dependant on external institutions. The capital-intensity of competitive production is now so large that ownership by a single capitalist becomes less and less likely. The lumpiness of investments also
makes more pronounced the factors which prevent the viability of many important enterprises and sectors at market prices. The growth in the minimum efficient size of new investments and the pervasiveness of perceived market failures ensures that while property rights over the means of production are still restricted, economic intervention by the state is now necessary to sustain this pattern of ownership.

State allocation of investible resources, the undertaking of some economic activities by state owned enterprises or the maintenance of protective regulations are interventions which may be analytically interpreted as the provision of flows of resources by the state which complement those negotiated by private transactors. We defined these flows of resources as side-payments. While private institutional responses may overcome these constraints to some extent, with large scale technology, enterprises in different sectors and at different times need to be able to bargain side-payments with the state. One reason why they are able to do this (and we saw some of the evidence in Chapter Three) is because the state has an economic viability goal which compels it to aim for growth subject to political constraints. We thus make the following analytical generalization: the survival of capitalist property rights with 'large scale' technology is only assured if capitalist and state capitalist enterprises are able to selectively negotiate side-payments with the state. In figure 6.1 we see these flows as profits generated by state intervention. A snapshot picture of the capitalist economy with large scale technology would reveal that the existing structure of rights over the means of production is underwritten by an ubiquitous structure of side-payments.

So far we have looked at the minimum assumptions about rights which allow capitalist profits. These do not necessarily ensure the efficiency of capitalist outcomes. The competitive capitalism of early industrial capitalism is thus just as capitalist as the managed capitalism which has become the norm in the
post-war period: in both cases a large part of the aggregate surplus is produced as a consequence of the ownership of the means of production by capitalist and state capitalist enterprises. The industrial sector in developing countries is no different. What is often overlooked in arguments about what is capitalism is that the dynamics of different capitalisms may be very different.

The 'ahistorical' efficiency results of neoclassical analysis are actually premised on the assumption of 'small-scale' technology and a number of further assumptions about the structure of property rights over productive assets which enables the market to operate as a rational signalling mechanism. In Chapter Seven, we see that the model fails most dismally when capitalism with contemporary 'large scale' technology is considered. We argue that the efficiency of state managed capitalism requires an analysis of the efficiency with which the state has been able to manage the allocation of side-payments.

§ 6.2 Clientelist Surplus Appropriation

What are the constraints preventing a state from allocating resources to maximize growth in line with its perceptions of opportunities and costs? Or to put it differently, how do we explain the relatively large quantities of resources allocated by most developing country states to the ostensibly unproductive groups composed of state bureaucrats, professionals, political cadres and the 'educated class' in general through a range of subsidies and controls. This substantially large sub-group within the economically dominant classes in developing capitalist countries do not depend on their privileged ownership of the means of production to obtain incomes which are relatively large given the per capita output of the economy. The pressures which compel most developing country states to allocate substantial resources to these classes may explain why these states are also inefficient in allocating the resources which do get to industry. This question is particularly interesting
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Part II

Chapter Six

because a handful of states have, in contrast, demonstrated remarkable efficiency in their handling of side-payments, allocating benefits selectively and efficiently, and consequently attaining very high rates of growth.

What kind of rights and restricted 'asset ownership' could explain the appropriation by these primarily 'petty-bourgeois' classes of a part of the aggregate surplus of society as at least part of their income? Property rights over skill credentials are inadequate to explain why incomes of these lobbies are not driven down to the relatively low cost of production of their marketable skills. One of the striking features of most developing countries has been the remarkable tendency of credential-holding lobbies to grow, apparently with no systematic or apparently successful attempts by members to restrict entry.\(^6\) Moreover, rights over credentials, and a restrictive system of distribution of credentials would only succeed in extracting rents for holders if the services they provided were marketable and in excess demand.

To take account of the kind of evidence presented in Chapter Four, we define a clientelist mode of surplus appropriation. A substantial part of the incomes of organized coalitions seems to have been sustained by means of clientelist political pressure on existing asset holders and particularly on the state. If political pressure results in the generation of clientelist incomes, each side in the bargaining must gain given their initial possession of 'assets'. The agents who conceptually participate in this bargaining are the state, the coalition possessing rights over some assets which yields them an income flow, and the clientelist lobby. In Chapter Four we argued that clientelist bargaining becomes feasible if existing right-holders are uncertain of holding on to the rights which yield their incomes. If the probability of retaining effective rights is considerably lower than one, right-holders may be willing to make payoffs to challengers as a condition of holding on to their rights.
For a flow of resources to a clientelist organizer or lobby, we require that
1) existing right-holders should be willing to bargain payoffs to challengers,
and we have considered in Chapter Four some of the circumstances under which
existing right-holders will be particularly willing to bargain with clientelist
lobbies. These include a relatively low level of social acceptance or
legitimacy of the rights of existing right-holders and/or a relatively weak
policing capacity of the state. We also require ii) the existence of one or
more clientelist lobbies which can organize these challenges.

Let Y be the income over a single time period associated with a particular
assignment of a right. Let \( P \) be the probability that the existing assignee of
the right retains effective control over the asset and is able to realize the
potential income at the end of the time period. If this probability is less
than one, and if a clientelist lobby is responsible for organizing the
challenge, the payoff it can bargain for depends on the expected loss of the
existing right holder. The expected loss is clearly \( Y \cdot (1-P) \). This is the
maximum payoff the clientelist lobby can bargain for, and conversely, any
payoff less than this would increase the expected income for the existing
right-holder. From our discussion in Chapter Four, we can write the probability
of a particular right holder retaining effective control over the asset as a
function of a number of variables:

\[
P = f \left( + \text{Legitimacy of the Right Holder}, + \text{Policing Ability of the State},
- \text{Relative Organizational Power of Clientelist Lobby} \right) \ldots (6.1)
\]

The greater the perceived legitimacy of the right, or the greater the policing
ability of the state, the higher the probability of the existing right holder
retaining effective control over the asset. On the other hand, the greater the
relative organizational power of the challenging lobby, the lower this
probability. As a first approximation, organizational power can be measured by
the relative size of the lobby. If the total population is \( N_{\text{pop}} \), and the size of
the lobby is \( N \), \( N/N_{\text{pop}} \) is a measure of the organizational power of the lobby. If \( \text{OP} \) is the relative organizational power of a lobby, we can write:

\[
\text{OP} = g \left( \frac{N}{N_{\text{pop}}} \right), \quad \text{where} \quad 0 \leq \frac{N}{N_{\text{pop}}} \leq 1 \quad \ldots (6.2)
\]

For the sake of simplicity, we standardize the value of \( \text{OP} \) such that when \( \frac{N}{N_{\text{pop}}} = 0 \), \( \text{OP} = 0 \) and when \( \frac{N}{N_{\text{pop}}} = 1 \), \( \text{OP} = 1 \).

The income \( Y \) associated with an asset over a given time period is the income from asset ownership of the form described in Section 6.1 together with any direct or indirect state subsidies to the right holder. We can thus write:

\[
Y = \text{Income from Asset Ownership} + \text{State Subsidies to Right Holder} \quad \ldots (6.3)
\]

Then if \( P_{\text{max}} \) is the maximum payoff a clientelist lobby can bargain for,

\[
P_{\text{max}} = Y \cdot (1-\Pi) \quad \ldots (6.4)
\]

Figure 6.2 gives a plausible functional form for the payoff function.

**FIGURE 6.2: THE CLIENTELIST PAYOFF**

Given the income of an existing right holder, the perceived legitimacy of the assignment and the policing ability of the state, the maximum payoff a clientelist lobby could bargain for increases as its relative organizational
power increases. This is equivalent to a move along the X-Axis to the right. The maximum payoff would also increase as the income associated with a right increases, or the legitimacy of right-holders or policing power of the state decreases. This is shown in the figure as successively higher payoff curves, from $P_1$ to $P_3$. However, in explaining differences in the extent of clientelism in different contexts, we consider the relative organizational power of clientelist lobbies to be the significant variable.

One reason for this is that it is unlikely that the $P$-curve is ever so close to the X-Axis that a high level of organizational power of clientelist lobbies will not result in substantial clientelist payoffs. This is because it is unlikely that all the conditions which would lead to a very shallow $P$-curve are actually met in any particular case. Recalling our comparison of Bangladesh and South Korea in Chapter Four for instance, in the first case legitimacy and policing powers are low as are potential incomes from rights, while in the latter, legitimacy is low but both policing powers and potential incomes are higher. The difference in the payoff curves for the two cases may not therefore be very significant.

On the other hand, whatever the position of the $P$-curve, a lower level of organizational power for clientelist lobbies would lead to lower clientelist payoffs, and in the extreme case where clientelist lobbies have no organizational power at all, for instance because $N/N_{pop} = 0$, payoffs disappear because $\Pi \to 1$ as $OP \to 0$. Equally, as $N/N_{pop} \to 1$, $OP \to 1$, and in this case we would plausibly expect $\Pi \to 0$, since the right-holder would face an overwhelming challenge and $P_{max} \to Y$. It needs to be said though that the organizational power of the lobby is not necessarily an independent variable. If potential payoffs are high because of a high payoff curve, there are obvious incentives for organizing lobbies which can bargain for these payoffs.
So far we have looked at the conditions which determine the total potential payoff. By itself this does not tell us much about the likelihood that clientelist bargaining will actually take place or the resistance we can expect if attempts are made to change the size or distribution of clientelist payoffs. For this we need to know the per capita costs and benefits of organizers by taking into account the pyramidal nature of clientelist bargaining.

Lobbies are organized by organizers. The possession of organizational ability can be modelled as the possession of an asset. It is an ability which is in restricted supply and one whose possession is protected through a political process. The state clearly can and does put restrictions on political organization. As organizational ability becomes more equally distributed, the potential organizational power of lobbies increases as lobbies become larger, but at the same time the number of organizers also increase. It is therefore necessary to look at how the per capita payoff to organizers changes under plausible assumptions.

Consider the following simple model. The right-holder whose right is being challenged exists in a society of $N_{pop}$ individuals. The lobby organizes $N$ individuals, where $N < N_{pop}$. The lobby is organized by $n$ organizers, where $n < N$. As in equation 6.2, the organizational power of the lobby, $OP$, is a function of $N/N_{pop}$. As in equation 6.4, the maximum payoff the lobby can bargain for is given by $Y(1-N)$. The payoff is shared between the organizers and the organized in the lobby in the ratio $f:(1-f)$ where $f<1$. In most cases $f$ would be close to 1. The payoff per organizer $Y_o$ is then given by the following expression:

$$Y_o = \frac{[Y (1-N)]f}{n} \ldots (6.5)$$

For the sake of completeness, we can write the per capita clientelist payoff $Y_1$ for the non-organizers organized in the lobby as:

$$Y_1 = \frac{[Y (1-N)](1-f)}{(N-n)}.$$
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We can now examine the bargaining implications of changes in the distribution of organizational rights. For simplicity we assume that the opportunity cost per organizer remains constant and we look at how the per capita benefit of organizers changes with changes in the distribution of organizational rights. Starting from a position where the right to organize is totally absent, consider what happens as more and more individuals gain the right to organize, and as a consequence, more and more individuals are organized in lobbies.

With no rights of organization, \( n = 0 \) and \( N = 0 \). Consequently \( \frac{N}{N_{\text{pop}}} = 0 \). From equation 6.2, the organizational power of any particular lobby, \( OP = 0 \). From equation 6.1, and given the functional form for \( \Pi \) sketched in figure 6.2, when \( OP = 0 \), \( \Pi = 1 \). Finally, from equation 6.5, \( Y_o = 0 \).

As organizational rights spread, both \( n \) and \( N \) grow. What happens to the per capita income of organizers, \( Y_o \), depends on the rate of growth of \( n \) and \( N \) and the parameters of equations 6.1, 6.2 and 6.5. Looking at a particular lobby, the growth in \( N \) results in a growth in \( \frac{N}{N_{\text{pop}}} \). From equation 6.2, this results in a growth in organizational power \( OP \), and from equation 6.1, this reduces \( \Pi \), the probability of the right-holder being challenged maintaining effective control over a potential flow of income. From equation 6.4 we have the emergence of a positive and growing potential payoff \( P_{\text{max}} \) which can be bargained for as \( \frac{N}{N_{\text{pop}}} \) and thus \( OP \) increases. This is the function we plotted in figure 6.2. Assume that the parameters of equations 6.1 and 6.2 are such that the growth in \( \frac{N}{N_{\text{pop}}} \) traces out a maximum potential payoff \( P_{\text{max}} \) along the curve \( P_3 \).

However, the increasingly egalitarian distribution of organizational rights which leads to the growth in \( \frac{N}{N_{\text{pop}}} \), also results in a growth in \( n \), the number of organizers. Within lobbies the number of individuals claiming the larger, organizers' share of the payoff grows, so that \( n \to N \), and since \( N \to N_{\text{pop}} \), \( n \to N_{\text{pop}} \). Depending on the way in which organizational rights are being
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redistributed, the process results on the one hand in the growth in $N/N_{pop}$ which we looked at in the last paragraph and at the same time in a growth in $n$. We can now see from equation 6.5 why the change in the distribution of organizational rights traces out a definite per capita payoff for clientelist organizers. Figure 6.3 suggests a plausible functional form for the relationship between the growth in $n$ and the per capita payoff for the organizers, given that we know the associated growth in $N/N_{pop}$ and the payoff function giving $P_{max}$.

![Figure 6.3: Clientelist Bargaining and the Distribution of Organizational Rights](image)

Looking at figures 6.2 and 6.3 together, as the distribution of organizational rights becomes more egalitarian, $N/N_{pop}$ grows and we can read off from figure 6.2 the associated total payoff. Corresponding to the new distribution is a particular $n$ and figure 6.3 plots the per capita payoff for organizers associated with each value of $n$. From an initial per capita payoff of zero, there is first an increase in the per capita payoff to organizers as the maximum potential payoff becomes positive. How soon the per capita payoff for
clientelist organizers starts to decline depends on the rate of growth in $P_{\text{max}}$ and the growth in $n$ associated with the growth in $N/N_{\text{pop}}$. The growth in the number of organizers is likely to be much slower than the growth in the number of individuals organized, and consequently the per capita payoffs for organizers will increase for a time. How rapidly $P_{\text{max}}$ grows does of course matter, but we assume that the growth is rapid, along $P_\circ$ in figure 6.2. Eventually, however, the growth in $P_{\text{max}}$ flattens out as $n \to 0$ and $P_{\text{max}} \to Y$. On the other hand, the growth in $n$ accelerates as $n \to N_{\text{pop}}$. The per capita payoff for organizers thus eventually starts to decline and from equation 6.5 we see that $Y_\circ \to Y/N_{\text{pop}}$.

In a society where organizational abilities were perfectly equally distributed, any particular right which yielded an income to a specific individual could be challenged by a lobby composed of $N_{\text{pop}}-1$ individuals each of whom would have the status of organizer, and the potential per capita payoff would be very nearly $Y/N_{\text{pop}}$. Since a payoff of this magnitude would negate the point of having the right, such a payoff is equivalent to the right disappearing. Whether or not this happened would depend on the opportunity costs of organizers relative to the benefits, in other words on the Olsonian problems of organizing large groups. The per capita opportunity cost of organizers is shown in figure 6.3 as $C_\circ$. In figure 6.3, the right would not disappear with an egalitarian distribution of the right to organize, but clearly if the cost of organizing was lower, such that $Y/N_{\text{pop}} > C_\circ$, the right would disappear.

Just as profit may be defined as the incomes which accrue to particular agents by virtue of their ownership of alienable assets, we can now define clientelist surplus appropriation as the income flows which accrue to particular agents by virtue of their possession of organizational skills. As a first approximation clientelist surplus appropriation would end if all individuals in society were given their per capita share of organizational ability. The right-holder is
then either compelled to make a payoff which is equivalent to a loss of the right or the cost of organizing prevents a challenge being mounted. In either case, a periodic clientelist payoff from the right-holder to the lobby ceases.

But as in the case of capitalist profit, this is only a first approximation, because an equal distribution of organizational ability need not lead to the disappearance of payoffs which exist by virtue of such a distribution. For instance, if institutions exist to monitor economic performance and which allocate rights (for instance over net state revenues) to individuals on the basis of their perceived ability to augment growth, an egalitarian distribution of organizational abilities may prevent such allocations if successful collective challenges can be mounted against them. As in the case of the lazy workers in section 6.1, an egalitarian allocation of assets (in this case organizational ability) may lead to income flows (or prevent potential income flows) which can only be understood in terms of the (egalitarian) distribution of assets. In this case, the allocation which would end income flows which exist by virtue of a particular distribution of organizational ability would be one where the organizational ability of agents and coalitions was proportional to the incomes they have from rights allocated to them.

An attempt by the state to reduce either the total level of clientelist payoffs or to change the sectoral pattern of payoffs entails either changes in the distribution of organizational rights or overriding the pressures lobbies can exert. The likelihood of clientelist activity and the resistance of organizers is plausibly a function of the net gains for clientelist organizers. We can see from figure 6.3 that changes in the distribution of organizational rights could change these net benefits. However, whether inegalitarian or egalitarian changes work would depend on whether we were on the upward-sloping or downward-sloping segments of the Y curve. In most developing capitalist countries where the distribution of organizational rights and abilities is very
unequal, it would be plausible to believe that the upward sloping segment of the \( Y_o \) curve would be relevant, and that for a substantial range, the expansion of organizational rights would lead to an increased net benefit and thus likelihood of clientelist activity.

The second strategy for the state would be to override the existing distribution of organizational abilities by increased policing. In figure 6.2, this can be shown as a move to a lower P-curve, from say \( P_3 \) to \( P_2 \). With a given level of organizational ability for a lobby, an increase in policing will reduce the maximum potential clientelist payoff, and consequently in per capita payoffs for organizers in figure 6.3. Using the terminology of Chapter Five, the political consequences of either strategy would depend on the 'political settlement', the balance of political and organizational power in society. If the overall balance gave a lot of organizational power to intermediary organizations, attempts to restrict their income flows either by marginal changes in organizational rights or by attempts at increased policing would result in growing political opposition - a decline in stability conditions. On the other hand, for clientelist coalitions, the ability to maintain the income streams which they enjoy requires maintaining the existing balance of organizational abilities or changing them in the direction which increases net benefits, while resisting attempts at increased policing.

Clientelist surplus appropriation possibly occurs in every society to some extent. It is particularly important in developing capitalist countries where a material basis is provided by the financial, educational and consequently organizational inability of the vast majority of the population to participate in a 'democratic' economic and political system without the intervention of intermediaries. Ending clientelist surplus appropriation in such a context would clearly leave the petty bourgeoisie which supplies the bulk of organizers worse off and existing right-holders such as industrial capitalists better off.
Whether workers and peasants gain from clientelist surplus appropriation depends on how many of them participate in clientelist lobbies \( N/N_{\text{pop}} \), on the share of the payoff given to the non-organizing members of the lobby \((1-f)\) and the loss of real wages which comes about from the slower rate of growth as a consequence of clientelist activity. Under plausible assumptions for developing capitalist countries, ending clientelist surplus appropriation would also leave workers and peasants better off.

The distinction between 'class formations' and 'class structures' made by Erik Wright is a relevant one here. 'Class structures' refer to abstract theoretical constructions, of the type we have been looking at so far. In contrast, 'class formations' refer to historical descriptions, where classes-as-actors are composed of coalitions with some common and many conflicting interests. The analytical point is that each of these structures may be present coterminously in any actual social formation. The middle classes may thus have a contradictory location in the class structure, with some interests opposed to, and others in line with, those of the working class.⁹

The petty bourgeoisie in developing countries may thus analytically get part of their income through supplying labour power, another by participating in clientelist coalitions, and they may also have property rights over skill credentials. These observations allow us to place the petty-bourgeoisie and other groups comprising the non-capitalist sections of the economically dominant classes in contradictory class locations in the sense used by Wright. Conflicts of interest within this class should not, however, divert attention from the analytically similar basis of part of the incomes of all of this class, which can sometimes be the basis of united action.

Apart from the petty-bourgeoisie, privileged sections of the working class may also be participants in clientelist surplus appropriation. By its nature, the
clientelist coalition is a pyramidal one, each layer bargaining with the one above on the basis of the pressure of those below. To keep its legitimacy and credibility with those below, benefits, particularly jobs, have to be created. The pyramidal structure does mean that at the lowest levels, privileged sections of the working class make immediate if short-term gains in terms of income and jobs if they support political movements organized by the coalition. This is why it is often quite difficult to understand political movements in developing countries which involve the mobilization of workers and the petty bourgeoisie against the state in terms of conventional theories of surplus appropriation and class.

Our specification of clientelist exploitation does mean that this form of exploitation is not ostensibly the preserve of any particular class, in the classical definition of class in terms of property rights over physical assets. This anomaly becomes explicable if it is pointed out that clientelist surplus appropriation is only materially significant if the political and economic development of a particular society is 'out of step'. In a capitalist economy, with capitalists controlling the production process, clientelist exploitation would only be significant if this class was too politically weak to prevent the siphoning of resources by clientelist lobbies. In a socialist economy, clientelist exploitation would occur only if the working class was too politically weak to prevent alternative coalitions from exploiting a privileged access to resources directed by the state.

In classical writings, these cases were treated as 'transitional economies' and not much attention was given to economic processes in such systems. Evidence has however indicated a longevity of transitional systems much beyond that expected, bringing into question the usefulness of the term. The notion of clientelist exploitation may also be of use in studying the 'transitional' socialist economies. It points out the possibility of a politically-maintained
system of exploitation in these countries, which is not captured by Roemer's skill and status based socialist exploitation, or Wright's organization asset and skill credential based exploitation.

To the extent that organizational rights in transitional socialist countries allow some coalitions to use this 'asset' to negotiate payoffs through the state, part of the incomes of professionals, bureaucrats and party cadres could be modelled as clientelist exploitation under socialism. Perestroika may be seen as an attempt to counter socialist clientelism by attempting a more egalitarian distribution of organizational rights. Such a strategy might reduce the incentives for clientelist payoffs if the material development of the society was sufficiently advanced for organizational abilities to be potentially widely distributed. This would place the system on the downward-sloping part of the \( Y_o \) curve in figure 6.3, and given the per capita costs of organizing, democratization would reduce the net benefits of clientelism.

Finally, while clientelist exploitation is primarily a social phenomenon of 'transitional economies', economic processes quite similar to clientelist exploitation may be significant in primarily capitalist economies, where the capitalist class is politically dominant. In this case, the payoff curve in figure 6.2 would be low, for instance along \( P_r \), but it would still be possible for clientelist lobbies to bargain for payoffs. Moreover, politically powerful sections of the capitalist class (for instance groups engaged in war industries or agriculture), may be able to create political pressure to gain rights over side-payments which amount to a tax on capitalists in other sectors. The effects of such clientelism for economic performance even in predominantly capitalist economies may well be significant, since these privileged sectors could slow down or prevent structural transformation.
§ 6.3 Rents

The rights which give rise to the rents discussed in the now voluminous rent-seeking literature are quite different. Whereas clientelist payoffs are the outcome of weakly defined rights of existing right holders and a distribution of organizational rights which allows payoffs to be gainfully bargained by organizers, rents are the outcome of well-defined state-imposed restrictions on the market. Rents are the outcome of scarcity, where some right-holders obtain credentials which entitle them to absorb the difference between opportunity cost and market price. The difference is shown in figure 6.4 which looks at the market for the services of the respective surplus appropriating classes.

**Figure 6.4: 'Rent' Versus Clientelist Surplus**

![Figure 6.4](image)

(a) Credentialism  
(b) Clientelism

Figure 6.4 (a) examines the rights which give rise to rents for credential-holders. The demand and supply curves refer to the services of a particular sector taken as a whole. If there are no restrictions on entry the market equilibrium would be given by the intersection of the SS and DD curves. If supply is restricted by credentials (licenses, membership of clubs, parties or
unions and so on), to the level $Q_r$, the coalition possessing the credentials earns a rent equal to $P_rABC$.

In contrast, figure 6.4 (b) shows the equivalent partial equilibrium case of clientelist surplus appropriation. Here the source of the 'rent' is not a restriction of supply as a consequence of rights over credentials, but rather the ability of the coalition to generate an increase in the demand for its services through its ability to organize pressure against existing right-holders. $S_L$ is the long-run supply curve for clientelist services. If $D_C$ is the demand curve for the services of the coalition as a result of clientelist pressure, and $D_D$ is the demand curve if organizational ability is equalized and the clientelist coalition has no special ability to generate an increase in resources directed to it, we can say that $P_rX_rQ_rY_rP_r$ is the extent of clientelist surplus appropriation. This is the amount of resources gained by the clientelist coalition and lost by other coalitions as a result of clientelism. Clearly even if the long-run supply curve for clientelist services were perfectly elastic, the ability of those with rights over 'political voice' to maintain an inflated demand for their services would still result in clientelist surplus appropriation.

Clientelist surplus appropriation thus also depends on the access of some to 'skills', but it operates primarily through the direct bargaining of these skills (organizational ability) with existing right holders, rather than restricting the supply of specific skills in the market through protecting rights over credentials. A growth in the number of credential-holders would squeeze the surplus appropriated by each credential holder as well as the total 'rent' unless market demand grew rapidly enough to compensate for the increased supply. On the other hand, a rapid growth in the size of the clientelist coalition would normally increase the amount of resources diverted to the coalition, because the growth in its political power would shift the
demand curve in figure 6.4 (b) to the right. Even with a perfectly elastic long-run supply curve, this would increase the amount of resources appropriated by the coalition.

The per capita gain per organizer will of course eventually decline in the way we have seen. Thus the clientelist coalition cannot grow indefinitely, since paradoxically, if all members of society eventually gained equal possession of organizational ability, the possibility of using political mobilization for surplus appropriation would disappear. However, even in advanced countries, there is a considerable gap between the vast majority of the population and the relatively small minority who are articulate, in terms of their ability to mobilize around political demands. In the typical developing country context, it is fair to assume that an increase in the size of the clientelist coalition, and consequently in its ability to bargain with the state, will result in a corresponding growth in the resources the coalition can appropriate.

For the purposes of our subsequent argument, we only need to understand the nature of rights which have to be protected for rents to appear. Strictly speaking any set of well-defined rights can lead to rents if the individual with rights over the asset faces a downward-sloping demand curve for the services of the asset. This implies monopolistic competition, and in equilibrium, price will be greater than marginal cost, resulting in rents for the individual with rights over the asset. Another way of looking at this is to say that in figure 6.4(a), sectoral equilibrium at the intersection of the DD and SS curves is only possible if individuals face perfectly elastic demand curves. The restriction in effect results in downward-sloping demand curves for individuals with credentials.

Just as well-defined rights over a subsidy can result in the generation of rents for those with credentials over the subsidy, well-defined rights over a
machine which allows the owner to enjoy a downward-sloping demand curve for the output results no less in the generation of rents. In both cases, rent-seeking activity could lead to the withdrawal of resources from production with the well-known consequences discussed in the rent-seeking literature. It is important to note that both cases depend on the state maintaining well-defined rights over 'assets', and in both cases, rents and therefore rent-seeking would cease if 'state intervention' ended. Rent-seeking literature by and large ignores that just as rent-seeking for the rents associated with machinery can lead to creative Schumpeterian innovations, well-defined restrictions or allocations of side-payments imposed by the state may have the effect of overcoming particular types of 'market failure' whose benefits may outweigh the costs in terms of the losses to rent-seeking activities.

Before ending this chapter we note the possibility of different types of surplus appropriation systems interacting. Clientelist pressure may result not only in demand generation for the services of a lobby, it may also create new credentials which target the increased demand for the lobby. Conversely, the possession of credentials (for instance university degrees) may create a natural lobby which has an incentive to organize for clientelist payoffs. Capitalism and clientelism may also interact. Rowthorn's analysis of militarism is an example. Here demand creation by a politically powerful section of capitalists benefits capitalist surplus appropriation by creating political conditions under which capitalist property rights can be more effectively protected. Finally in Chapter Four we saw the possibility of a symbiosis of capitalism and clientelism. This is likely when technology is 'large-scale' and side-payments are extensively allocated by the state. It may often be difficult to distinguish between the allocation of subsidies to maximize growth in capitalist and state capitalist enterprises from allocations which respond to political pressures since enterprises too may participate in clientelist lobbies. The implications of this will be examined in the next chapter.
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3. Roemer (1982) and (1988). The game theoretic approach cannot 'reveal' the nature of surplus appropriation or exploitation. The latter requires further information which can only be provided by broader political-economic analysis of the ways in which groups have interacted over time. For instance, the game-theoretic approach can give trivial results without the additional condition of 'dominance' which ensures that the existing allocations are not just accidental and unrelated (as in the case of the two hypothetical and differently endowed islands), a point which Roemer credits Wright for raising Roemer (1982) p. 237n. On this issue, Wright takes the stand that exploitation has to be defined in terms of surplus transfers, in other words, the better position of exploiters has to depend on the production of the exploited and not simply on their accepting an inferior allocation. Wright (1965) p. 75. While we implicitly adopt a 'surplus approach', Roemer's approach does have powerful applications in modelling the rights necessary for particular types of surplus appropriation.

4. If a higher per capita income now entails a lower rate of growth of per capita income, workers will eventually be worse off. Przeworski analyses the possibility of class compromise on this basis. Workers have the option of accepting lower wages now and higher wages in the future if capitalist investment can be ensured. Przeworski (1987) pp. 171-203.


10. Rowthorn (1980) on the political economy of militarism argues that although Luxemburg made analytical errors in her discussion of the way in which militarism raises the rate of profit, her intuition may have been valid for the period she was writing for. Rowthorn suggests an alternative analytical explanation of the importance of militarism; by imposing a 'system of power' on workers and peasants, militarism directly shifts distribution in favour of capital. See pp. 250-69, particularly pp. 258-63.
Chapter Seven Efficiency and Rights

In this chapter we will look at alternative structures of rights and the systems of surplus appropriation they support, in terms of their implications for the dynamic performance of the economy. This will enable us in the next chapter to identify the nature of the 'tradeoff' between efficiency and stability conditions under alternative assumptions. We will argue that the characteristics of the 'tradeoff' define to a large extent the limits to the efficient intervention of the state. We shall see that if we can make reasonable assumptions about the efficiency and growth outcomes of certain changes in structures of rights, we can predict the nature of the 'tradeoff' between stability and efficiency under alternative assumptions regarding the initial position. Section 7.1 looks at how the composition of the aggregate surplus affects the size and allocation of the investible surplus. Subsequent sections examine the minimum conditions in terms of the rights which would be necessary for efficiency under successively more realistic assumptions about technology and the political balance of power.

§ 7.1 Clientelist Payoffs and Efficiency

From the simple model considered in figure 6.1, we can write the aggregate surplus, $AS$, as a sum of a number of components:

$$AS = \text{Net Profits from Asset Ownership} + \text{State Generated Profits} +$$
$$+ \text{Clientelist Payoffs} + \text{Rent Seeking Expenditures.}$$

It should be clear from figure 6.1 and the argument of Chapter Six that a change in the rights which underlie clientelist payoffs in ways which reduce such payoffs would have an immediate and offsetting effect on two of the other components of the aggregate surplus, net profits from asset ownership and state generated profits. In the very short run, if the changes simply offset each other there will be no change in the size of the aggregate surplus, but
even then, there may be a change in the size of the investible surplus. This can be seen if we write the investible surplus, $IS$, as:

$$IS = AS - \text{Consumption of Asset Owners} - \text{Consumption of Clientelist Organizers} - \text{Consumption of Rent Seekers}.$$ 

For instance, a growth in clientelist payoffs which led to an exactly equal decline in net enterprise profits would leave the aggregate surplus unchanged, but the investible surplus may decline if the decline in the consumption of asset owners, that is capitalists and managers of state capitalist enterprises, was less than the increased consumption of clientelist organizers. This would be quite a probable outcome if as we have argued, many of the members of the clientelist coalition have quite low incomes and therefore may be expected to have higher marginal propensities to consume. This argument holds even when the size of the aggregate surplus is growing, as it can be restated in terms of rates of growth. A rise in the rate of growth of clientelist payoffs now reduces the rate of growth of the investible surplus. We shall see that this makes employees and workers who have jobs as a result of participation in a clientelist coalition very much like the 'unproductive workers' in the classical marxist conception, although our theoretical basis for considering such employees as 'surplus consumers' is different.

Clientelist payoffs have a more serious implication in terms of the allocation of the investible surplus. By definition, enterprise investment in some sectors is deprived of resources. The surplus appropriated by the clientelist coalition is also more likely to be re-invested in ways which augment clientelist surplus appropriation, for instance in the employment and distribution of benefits to lower level clients, rather than in specifically productive ways. This lowers the rate of growth, and therefore the size of the aggregate surplus in the future. This argument is shown most simply in the context of a Harrod growth model with two sectors.
The incremental capital-output ratio in Sector 1, \( v_1 = \frac{\Delta K_1}{\Delta Y_1} \), is much higher than that in Sector 2, \( v_2 = \frac{\Delta K_2}{\Delta Y_2} \). A higher incremental capital-output ratio need not only refer to technical conditions, it is also a convenient way of distinguishing between more and less productive sectors, in terms of the output generated for a given allocation of investible resources.

The share of investible resources in total output, \( s = \frac{S}{Y} \) is fixed, and is divided between the two sectors such that \( s_1 = \frac{S_1}{Y} \) and \( s_2 = \frac{S_2}{Y} \), and \( s = s_1 + s_2 \). The rate of growth, \( r \), is then given by the following expression:

\[
\frac{\Delta Y_1 + \Delta Y_2}{Y} = \frac{\Delta Y_1}{S_1 Y} + \frac{\Delta Y_2}{S_2 Y} = \frac{s_1}{v_1} + \frac{s_2}{v_2}
\]

Assuming that \( v_1 = k v_2 \), where \( k > 1 \), and substituting for \( s_1 \),

\[
r = \frac{s + (k - 1)s_2}{kv_2}
\]

Thus even with \( s \) fixed, since \( (k - 1) > 0 \), an increase in surplus allocation to the faster growth generating sector, represented here by a growth in \( s_2 \), results in an increase in the rate of growth \( r \). In a neoclassical world, given the structure of demand, the equalization of the rate of profit would produce the fastest rate of growth consistent with the weights given to the output mix by consumer demand. If consumers are indifferent between the output of the two sectors, and there is no complementarity in their production, profit maximization would, in the absence of diminishing returns, tend to reduce \( s_1 \) to zero and increase \( s_2 \) till \( s_2 = s \), when the rate of growth is entirely dependent on Sector 2. However, if surplus appropriation by a clientelist coalition produces a positive allocation of surplus, \( s_1 \) to Sector 1, we have a range of possible growth outcomes depending on the allocative procedures built into the system which limit the allocation of greater quantities of resources to Sector 2. This is one way of modelling the growth implications of clientelist resistance to changes in allocations of the investible surplus.
This problem is independent of the type of production function which most appropriately describes the transformation of inputs into outputs in the two sectors. If a variable factor proportion function is preferred, the same results follow if separate production functions exist for each sector, and one sector has a larger total factor productivity growth rate than the other, however measured. Once again, if factor mobility responds to profit maximization signals, growth is maximized and we have an ideal-type capitalist system in operation.

The dynamic constraints set by clientelism are probably far more important than the static ones, and moreover, in the absence of convincing empirical work, the assumption of lower marginal consumption propensities of developing country capitalists is not likely to convince everyone. Nevertheless, conspicuous consumption notwithstanding, the marginal propensity of consumption argument is hard to discount.

§ 7.2 **Capitalism with Small Scale Technology**

Most of the robust analyses of efficiency outcomes under capitalism have assumed the existence of 'small-scale' technology and a relatively dispersed ownership of capital. If these conditions hold, an extensive market which allows for decentralized initiatives is 'efficient' in the sense that it provides signals which encourage, periodic crises notwithstanding, the movement of investible resources to areas where returns are highest. The importance of the assumption of 'small-scale' technology is that it rules out the necessity of state involvement in the capitalist economy. Analytically, the capitalist ownership form is now able on its own, to exploit all the relevant technological possibilities. The marxist or neoclassical analysis of efficiency in the competitive capitalist model makes at least two assumptions about the rights necessary for such outcomes. These may be re-stated as the minimum conditions on rights required for efficiency in this model:
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a) Rights over productive assets (the means of production) are comprehensively allocated to a class of right holders (the capitalist class), and

b) The discipline of the labour process is maintained by the state (for instance through the specification of the rights of workers or by interventions in favour of capitalists when discipline is threatened).

This set of conditions seems to be so minimalist that they appear to many economists to be 'natural'. In fact it assumes that i) the economic and political dominance of the capitalist class is sufficient to ensure that the state protects these rights, and that ii) the repressive apparatus of the state is sufficiently effective to enable it to perform its policing role. Both these assumptions refer to specific political and institutional conditions which do not 'naturally' exist.

Conditions a) and b) define a limiting case of state manipulation of rights, given a set of initial assumptions, which is necessary to achieve efficient dynamic allocation of resources. In this special case, the state's function is limited to the protection of a system of rights which allows capitalist surplus appropriation to continue. As long as workers cannot leave the system with their per capita share of productive assets, which is ensured by condition a), the possibility of autarkic production by owner-producers is ruled out. Production takes place through the capitalist labour process and the survival of productive assets is determined by the 'anarchic' rationality of the market.

Condition b) ensures that capitalists are collectively able to prevent the loss of their rights over productive assets through distributive struggles with labour. If a wage push is large enough, it not only squeezes profits, it can threaten the reproduction of capital and thus the collectively established
rights of capitalists over productive assets. The overall level of wages therefore has to be maintained within a range to allow the reproductive process to continue, if necessary through a process of crisis, destruction of capital, and unemployment. In equilibrium the full employment level of wages is competitively determined to allow the survival of only the most efficient set of productive units given technological possibilities, the structure of demand and the supply of labour-power.

The technological assumption of small-scale production allows us to assume a relatively dispersed ownership of the means of production. The costs of socially inefficient production can consequently be isolated at the point of production, so the movement of resources in line with the incentives created by changes in technology (and conceptually also in demand) could only be resisted if coalitions of capitalists could gain access to political side-payments from the state to protect their particular firm or sector. Depending on the process through which capitalist rights have been or are being established over the means of production, particular capitalists or sectors of capitalist production may from time to time enjoy such an access to the state. But there are no reasons for the state in this case being compelled to respond to such pressures in a general way.

Individual capitalists are therefore forced to operate close to the social average cost, in the way Marx analysed in Capital Volume One. Unit labour costs in particular are kept at their socially necessary level, since the survival of the enterprise depends on how efficiently this is done. If some enterprises fail, it is because they are technically unable to keep costs below or at the average level, or because the structure of demand has changed, making the existing use of resources unviable with given market signals.
Despite their methodological and terminological differences, classical marxists and the neoclassical economists have much in common when it comes to the analysis of the dynamic efficiency of capitalism with small-scale technology. This is because the implicit or explicit assumptions made by both about the structures of rights over assets in the economic system happen to coincide in the case of the capitalist economy with 'small-scale' technology. Both assume that rights are assigned such that the two conditions identified above are met to the fullest extent. But this implicit assumption means that the consequences of a partial fulfilment of the conditions is not considered, a possibility which assumes substantial importance in alternative social configurations. The initial assignment of rights assumed in this model, and the technology under which it is feasible is of course only one of a range of possible allocations of rights which may be described as capitalist.

The evolution of capitalism in response to the progressive extension of large-scale technology has left the competitive model inadequate for many analytical purposes. Our concern here is to question the adequacy with which it models the process of structural transformation. The analysis of allocation with large-scale technology proceeds in two parts. First we assume that the existing structure of rights only supports capitalist surplus appropriation and examine the minimum assumptions which will allow efficient dynamic allocation. We then allow for the existence of clientelist exploitation, and see in what ways the minimum assumptions have to be further modified.

§ 7.3 Capitalism with 'Large-Scale' Technology and Capitalism Dominant

Let us first assume that the capitalist surplus appropriation system is the only one which is supported by the existing structure of rights. The efficiency of dynamic resource allocation in this case depends not only on the anarchic rationality of the market, but also on the 'efficiency' of the state's allocation of side-payments. A productive unit or sector which may not have
survived on the basis of a market valuation of inputs and outputs, may do so under a system of side-payments. Since the availability of investible resources is still scarce, how net state revenues are allocated across sectors will have an impact on the overall growth rate.

There is a subjective element to this, in that the quality of the state’s perceptions of future growth possibilities clearly matters. On the other hand, there are objective limits to the quality of a state’s allocative process, since although it can in principle learn from its own and others’ experiences, it may not be free to change patterns of resource allocation in line even with the subjective perception of the ‘best’ allocation.

The efficiency of side-payment allocation to the industrial investor now comes to depend on the nature of the industrial capitalist class and the history of its evolution, and on the ability of the state to suppress the sectional interests both of workers and capitalists. If a state machinery is sufficiently detached from the capitalist class in pursuing its goal of maximizing economic viability, we could expect ceteris paribus, state allocative processes to be efficient in allocating net state revenues given the state’s policy perspectives. In addition, the state has to have the repressive ability to prevent sections of the work force, now much more politically powerful as a result of large-scale production, from impeding the re-allocation of resources. With these conditions, given the perception of possibilities by state decision-makers, the latter would have the ability to cut off funding for projects whose long-term growth prospects seemed poor, and vice versa.

In a bargaining context, however, no state is truly independent of the claims of politically sensitive constituencies. Paradoxically, the more responsive a particular state is to the sectional demands even of economically powerful groups (in the conventional marxist terminology, the more closely it reflects
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the class power in society), the more inefficient may be its intervention in the surplus allocating process with the advent of 'large-scale' technology. The efficient dynamic operation of the capitalist system now requires three further conditions on the structure of rights in addition to the two identified in the case of capitalism with small-scale technology:

c) The capitalist class is able to protect its rights over productive assets by negotiating rights over growth-augmenting side-payments from the state. Net state revenues are limited, and capitalists bargain for allocations solely on the basis of their ability to generate growth per unit allocation given the state's perception of viable sectoral strategies.
d) The repressive apparatus of the state is sufficiently effective to enable it to suppress sectional interests of workers, particularly when jobs are threatened by structural change, and
e) The state is sufficiently detached from sectional interests of capitalists to be able to overcome resistance from coalitions of capitalists particularly when structural change involves scrapping of capital stock.

Condition c) actually follows from the assumption of dominance for the capitalist surplus appropriation system, since with our technological assumption, a capitalist surplus appropriation system could not be dominant, or perhaps even exist without this assumption. The political dominance of the capitalist class, which we could expect given their economic dominance, would be sufficient to ensure that c) holds. The condition is explicitly identified because in the non-ideal case, it may not be met to the extent required for the growth of the capitalist sector.

This is not the only necessary condition for efficient allocation. While the market still exists, forcing the enterprise to operate at a socially necessary
level of costs, the range of variation allowed is now larger because to a certain extent, firms are now 'price-makers' rather than 'price-takers'. The economic analysis of efficiency under these conditions is in a sense indeterminate, but within a greater range of variation, firms still have to maintain control over technology and costs in the way we identified for the case with 'small-scale' technology. No commodity is absolutely unsubstitutable and in fixed demand, so that the market can define a maximum socially viable level of costs and the enterprise has to operate within this. The implications for the struggle over wages and employment, responses to technological changes, and autonomous changes in demand are therefore comparable to the small-scale case, with a greater margin of variation for monopolistic firms. But now there is also the possibility of a change in social resource use, (which is primarily a question of a change in the allocation of the investible surplus) being prevented by the sustained allocation of side-payments to enterprises or sectors beyond that justified in terms of their direct and indirect contribution to the economy. With a limited total quantity of potentially investible resources channelled through the state, the state has to be able to allocate side-payments on the basis of 'rational' criteria. In a dynamic and changing context, however, this rationality cannot be reduced to any simple rule such as the equalization of returns from all allocations at the margin. What is required is for the state to have the freedom to respond to the demands of sectors which it perceives to be the growth sectors of tomorrow, even at the cost of the established sectors of today.

The necessity of condition d) is to rule out the possibility of politically powerful coalitions of workers preventing the scrapping of their enterprises or sectors by making the withdrawal of resources too politically costly. Once again it may be argued that this follows from the assumption of capitalist
political domination, but in fact the question is the extent to which this condition is met.

The necessity of condition e) is to rule out the variant of clientelist surplus appropriation which is possible within the capitalist class, even when ostensibly the structure of rights exclusively supports a capitalist surplus appropriation process, and the capitalist class is politically dominant. How far condition e) would be valid for an actual economy depends quite a lot on the process through which capitalism has emerged. If some sectors have played a particularly vital political role in providing political and economic support for the state apparatus, the state may not be able to take a 'neutral' stand vis-a-vis the different sections of capital. Allocations to such sectors would be larger than was warranted by their potential contribution to growth and processes of restructuring would be successfully resisted by them.

No special assumptions are required in this case for the operation of public sector enterprises or about the rights enjoyed by bureaucrats. If a particular economic activity is undertaken by the public sector this is because private initiative is not forthcoming. This too amounts to the provision of side-payments to investors if the activity has externalities, or is sold as a subsidized input. Since capitalists are the political constituency the state has to satisfy, the objectives of public enterprises will be set accordingly, and analytically it is possible to conceive of managerial incentive structures which would be able to achieve such goals. The interests of the bureaucracy are similarly subordinated to the goal of contributing to the capitalist surplus appropriation process.

Clearly this argument is at the same level of abstraction as the analysis of the capitalist firm in a competitive market, but it does point out that there
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Chapter Seven

are no systematic or structural obstacles to the achievement of efficient dynamic resource use under these circumstances if the minimum conditions hold.

§ 7.4 Capitalism with 'Large-Scale' Technology and Clientelism Dominant

If we now assume that the structure of rights in the economy is such that the capitalist surplus appropriation system is no longer exclusively supported, the analysis of efficiency understandably becomes more complicated. The argument is conducted in several stages. First we ask why enterprises are at all able to bargain for side-payments when the political dominance of asset holders cannot be assumed. We then examine the obstacles to the state's direct involvement in productive processes and see that this is related to the first question. Finally, these results are used to identify a further set of conditions regarding the structure of property rights necessary for the efficient allocation of investible resources in a capitalist system with large-scale technology where clientelist surplus appropriation takes place.

Assuming the technical necessity of a structure of state support for enterprises, what enables enterprises to bargain for such side-payments when the capitalist class is politically weak? Asset holders, of whom industrial investors are a subset, are normally a politically weak group in the social context of most developing countries. Their access to side-payments from the state in terms of implicit and explicit subsidies, tax concessions, subsidized access to finance and so on, is therefore not based on political bargaining. Most developing countries do not even have political parties specifically representing the capitalist class.

The state provides side-payments to enterprises only to the extent that state decision-makers perceive that the economic viability of the system depends on them. The economic health of the system is constantly being communicated to the state apparatus through changing economic signals, such as inflation and
growth statistics, balance of payments figures and so on. Critical economic indicators in fact reflect economic processes which have consequences for social groups and classes. Below a socially tolerable limit for key indicators, the economic viability of the state becomes questionable. The emergence of a pattern of side-payments to potential capitalist investors may then be seen in neoclassical terms as a response of the state to the existence of substantial externalities in the way of purely market based accumulation and growth.

We may now turn to our second question and ask why, given the resources available to the state and its concern with economic viability, it does not directly enter production. After all enterprises could be either private or public sector, and if both are dependant on net state revenues, the support of a weak capitalist sector has to be explained. This could be due to constraints in a clientelist context on the effectivity of public sector enterprises and the bureaucratic control mechanism on the one hand, and on the other a comparative advantage of the capitalist ownership form for attaining the economic viability goals of the state. Private asset holders may also bring with them capital which augments the resources available for investment.

In practical terms, these considerations are probably more important from the point of view of the pressures on state decision-makers than any theoretical conception of market efficiency. Moreover, the question is not one of the relative innate talent of private versus public sector managers. There is no reason to disagree with Sobhan & Ahmad who pointed out in their discussion of the Awami League period of predominantly state-run industrial enterprises that a preference for private sector industrial management could not be supported on the grounds of the greater talent of private investors:

In terms of skill and entrepreneurial dynamism, the bureaucracy, public sector managers and professionals in state and private employment constituted a bigger and qualitatively superior pool of talent to run the economy than the class of opportunists who had risen
Part II

from the ranks of the petty bourgeois society to positions of affluence through state patronage.\textsuperscript{4}

Nevertheless, the Awami League's attempt to create a dominant role for the public sector must be judged to have failed. The reversal which followed cannot satisfactorily be explained purely in terms of an ideological counter-revolution or external pressure. What seems to be missing from Sobhan & Ahmad's analysis is an assessment of the merits and demerits of alternative ownership forms from the point of view of a particular kind of state. Ownership forms determine the structure of rights in the context of which decisions affecting the enterprise are made. In an economy where the market is the only effective control mechanism private asset ownership has a number of advantages from the point of view of the state.

In a capitalist enterprise, whatever the source of the fixed and working capital, rights to the surplus produced are technically not in question. They are determined by a fairly straightforward application of property rights which, apart from being relatively easily enforceable, are capable of being defended as legitimate. Control over the industrial surplus is thus assigned at a discrete number of points and although the state has no control over the subsequent use of these resources, it can influence allocation in investment by manipulating market signals and directing side-payments.

The ability to isolate right-holders in control of particular productive units not only allows the state to selectively direct resources, it potentially allows it to stand away from the consequences if necessary, for instance if better uses of investible resources previously allocated to a particular unit can be identified. But most important of all perhaps, it allows the state to devolve the struggle against clientelist dissipation of the industrial surplus to the enterprise level, where a specific 'owner' of the surplus can be legitimately
identified, who also has an interest in limiting the dissipation to clientelist coalitions working inside the enterprise. A state's attempts to support the rights of capitalists for economic or other reasons, is incidentally not minimalist as it involves actively interfering with established patterns of rights of other classes and coalitions, and providing what amounts to substantial side-payments to the industrialist.

In contrast, the ownership forms associated with public sector enterprises are much more susceptible to clientelist surplus appropriation. If the industrial sector is overwhelmingly in the public sector in a social context where clientelist pressure is substantial, the industrial surplus too is liable to become part of net state revenues which are the subject of clientelist lobbying. In addition, the pressures to absorb enterprise surpluses into the budget may further aid the application of dissipatory pressures. A growth in clientelist payoffs has consequences not just for the allocation of investible resources and the ability to change such allocations, but also for the total amount of investible resources available, as we have seen in section 7.1.

The resistance in this case to attempts to change allocations of side-payments no longer comes from a number of isolated points, but from a more nebulous set of coalitions or competing coalitions, and in the extreme case, from the clientelist coalition collectively. Attempts to change allocations can therefore be expected to be more difficult to manage. Since side-payments to a productive unit are not negotiated even in the ideal-type clientelist model on the basis of bargaining between managers and state decision-makers regarding the potential economic viability of the resource flow, the efficiency of dynamic allocation is clearly inferior.

To the extent that maximizing the investible surplus and efficiently allocating it over time is necessary for the economic viability of the state, this
constraint may be expected to influence decision makers at the higher levels of the state apparatus to favour the private sector in the interests of self-preservation. Hence even if the relationship between the state and capitalist investors was largely based on these sorts of considerations, condition c) would still partially hold, (capitalists would have access to growth-augmenting side-payments from the state), and this would be the material basis for the continued survival of the capitalist surplus appropriation system.

However, the prevalence of clientelist exploitation may be expected to affect even the operation of capitalist enterprises. We have seen that even with the dominance of capitalist surplus appropriation, the differential political power of sections of capitalists may result in clientelist allocations with the attendant inefficiency. When clientelism is a substantial social process, this possibility is qualitatively strengthened. We now have the possibility of sections of the capitalist class symbiotically participating in broader clientelist lobbies.

On the one hand, capitalists discover that retaining effective control over assets entails making payoffs to clientelist lobbies within and sometimes outside the enterprise. Viability then depends on passing on these costs to the state. On the other hand, they discover that even though they may have bargained for net state revenues on a growth-augmenting basis, the process can be facilitated by participating in broader coalitions putting political pressure on the state.

It thus becomes less likely that sectors or productive units more able to contribute to the growth of the economy will gain access to side-payments from the state. In fact the opposite is likely to be the case. Capitalists participating in clientelist lobbies will also typically be making substantial payoffs to those lower down the pyramid. The symbiosis of asset holders with
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participants in clientelist lobbies thus increases both the loss of resources and the potential resistance to changes in allocations. The presence of clientelism therefore means that while the difference between the private and the public sector may be important, it may only be one of degree.

Just as in the case where only the capitalist surplus appropriation system exists, the dynamic allocational efficiency of the capitalist sub-sector given the limits of variation allowed in this case by market conditions depends on the accuracy of the economic perceptions of the state (its ability to 'correctly' identify priorities), and the inability of sections of capitalists and workers to prevent changes in the allocation of side-payments. Improvements in the efficiency of dynamic resource allocation would in this case require stronger assumptions about the ability of the state to manipulate rights. In addition to the five conditions on assignments of rights already made, all of which still remain valid in the sense that extending their applicability would improve efficiency, two more now seem to be required:

f) the state is able to revoke rights which in general maintain clientelist payoffs, and in addition,

g) the state is able to revoke rights even over growth-augmenting side-payments, when these have been 'symbiotically' negotiated with clientelistically maintained side-payments.

Condition f) is required to rule out the diversion of investible resources to clientelist lobbies, which would prevent or lower the loss of investible resources or the resistance to changes in sectoral allocations which hampers rapid structural transformation, in the way discussed in section 7.1. Condition g) is required to rule out clientelist payoffs through the involvement of asset holders in lobbies. In a sense, condition g) is an extension of condition e), under conditions where clientelist exploitation is
dominant, which allows the isolation of enterprise viability decisions at discrete points. This is a critical requirement when the market is the principal control mechanism for the allocation of resources.

The minimum necessary conditions on rights for maximizing and efficiently allocating the investible surplus discussed in this chapter are summarized in Table 7.1.

### TABLE 7.1: NECESSARY CONDITIONS FOR EFFICIENT 'CAPITALIST' GROWTH

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Notes to Chapter Seven

1. Conspicuous consumption may have a function in a clientelist polity, since it is one way in which the privileged signal their ability to 'rule' in a system where their positions are not widely perceived as part of the natural order. Nevertheless, it does reduce the investible surplus.

2. Baran treats the provision of subsidies by the state to industrial capital as a general characteristic of capitalism, See Baran[1973] p.292, The quote he refers to from Capital Volume One is also interesting: "The minimum sum of value the individual possessor of money or commodities must command in order to metamorphose himself into a capitalist changes with the different stages of development of capitalist production, and is at given stages different in different spheres of production, according to their special technical conditions. Certain spheres, even at the beginnings of capitalist production, require a minimum of capital which is not yet to be found in the hands of single individuals. This situation gives rise partly to state subsidies to private persons, as in France in the time of Colbert and in some German states right into our own epoch, and partly to the formation of companies with a legally secured monopoly over the conduct of certain branches of industry and commerce - the forerunners of the modern joint-stock companies." Marx[1971] p.424. It is interesting that while Marx saw the necessity of state intervention even at an early stage of capitalist industrialization, he did not incorporate this in his economic theory (which was perhaps justified in his model based on the British case), but secondly, he seems to imply that the incidences of state intervention are 'randomly distributed', while we would argue that technical progress actually makes capitalist state intervention progressively more important.

3. Ever since the work of Joan Robinson and E.H. Chamberlin in the 1930s on imperfect and monopolistic competition, the literature on the subject has grown. It seems though that robust general equilibrium type results are difficult to derive in this case. With freedom of entry, the average rate of profit is equalized, but the neoclassical efficiency condition of Price = Marginal Cost in all sectors no longer holds. Price will in general be above long run marginal costs, in other words firms will tend to have excess capacity. While static neoclassical allocational efficiency may not hold, dynamic resource allocational efficiency still operates within a bounded range due to freedom of entry of substitutes and the equalization of the rate of profit, See Robinson[1933] and Chamberlin[1933]. Subsequent work at the microeconomic level, for instance Bain[1966], Sylas-Labini[1962] and Modigliani[1968] have stressed the importance of entry in determining the limits to technical progress set by 'oligopoly'. The qualitative changes brought by oligopoly thus depend more on characteristics which are strictly non-market, namely the ability of existing capitalists to prevent new entrants, given the efficient scale of production. In a very different tradition, this is also the assumption critical to Schumpeter's theory of creative destruction, and the successive allocation of resources to new sectors even in a context of monopoly, Schumpeter[1939] and also Schumpeter[1941] pp, 82-84. Evidence that competitive pressures force even new developers with very different factor proportions to adopt state of the art technology developed in the most advanced capitalist countries is now widely available, Pioneering work was done by Mehrav, see in particular Mehrav[1969] pp, 16-64.

Chapter Eight: The Stability-Efficiency Tradeoff

We can now draw together the analysis of the last few chapters to model the constraints facing the state under different assumptions. We assume given resource endowments and a political settlement describing the relative balance of political and organizational power between the major groups and classes involved in the economic process. If rights of various kinds are defined over different types of assets, then on the one hand there is associated with this a particular economic performance and on the other, depending on how consistent the allocation of rights is with the political settlement, a particular level of political opposition to the state. Consequently, it is possible to ordinally rank subsequent states of the economy after relatively small changes in the assignment of rights, in terms of the implications for stability and efficiency conditions.

Whether the new assignment of rights is ranked above or below the old in terms of stability conditions depends on how income flows of politically powerful groups changes as a consequence of the changes. If there are gains for politically dominant coalitions, stability may be expected to improve and vice versa. On the other hand, the ranking of the new assignment in terms of efficiency conditions depends on the implications for growth. Given resource endowments, we have identified in Chapter Seven a number of minimum conditions on rights necessary for achieving dynamic allocational efficiency. These have been summarized in Table 7.1. We now ask what happens to the ranking of the economy in terms of stability conditions, when the state attempts to improve efficiency conditions.

§ 8.1 Capitalism with Small-Scale Technology

This is the simplest case. We have seen that efficiency in dynamic resource allocation can be achieved here through the market mechanism provided two
minimum conditions on rights apply. Whether changes in rights in ways which help to achieve these conditions more fully and thereby improve the growth potential of the economy are better or worse in terms of their implications for stability depends on the nature of the initial political balance. This is a historical question but some observations may be made in a general vein.

Historically, capitalism with small-scale technology emerged from pre-capitalist pasts in the very early capitalist transitions. Initially, the establishment and protection of capitalist rights (which bring conditions (a) and (b) into existence though not necessarily to the fullest extent) could be expected to come into conflict with the rights on which pre-capitalist, and particularly feudal surplus appropriation was based. The stability implications of such moves would depend on the political power of the nobility in specific cases, the extent of feudal influence on the state, on how far the state apparatus was able to insulate itself from such pressures, on the intensity of economic and military pressures on the state apparatus to improve production, and of course on how quickly and effectively the growing capitalist class was able to organize itself politically. Such historical determinants of the stability implications would determine the ease with which particular societies were able to make the transition.

On the other hand, once the transition had been made, and a viable capitalist economy was operating with the capitalist class politically dominant, changes in the structure of rights which improve the growth potential of the economy could also be expected to improve the political stability of the system. For the capitalist system to have come into existence, a political balance of power must have been established which ensured the political dominance of the capitalist class over other classes. Historically, this would have been required to ensure that the assignment of rights over productive assets to a narrowly defined class could be defended.
In this case the assignment of rights which are necessary for surplus appropriation from (capitalist) asset ownership are also those which substantially correspond to the conditions defined in terms of assignments of rights necessary for efficient dynamic resource allocation. Given such an initial political settlement, and an initial assignment of rights, changes in rights which brings further productive assets within the capitalist sector or improve the discipline of the labour process would further the extent to which conditions (a) and (b) were fulfilled, and would therefore be superior assignments of rights both in terms of efficiency and stability conditions.

As an ahistorical but analytical possibility, we can speculate on the stability implications of changes in assignments of rights which extended the applicability of conditions (a) and (b) in the economy if the political settlement was such that the capitalist class did not have political dominance. Let us assume that the working class is sufficiently well organized so that an improvement in efficiency conditions resulted in organized resistance of such a magnitude that the political stability of the state deteriorated.

We could reasonably expect working class resistance particularly to attempts to strengthen condition (b), which directly affect the terms of the wage-bargaining procedure. In this case there would be a 'negative' tradeoff between alternative assignments of rights in terms of their implications for stability and efficiency conditions. This possibility may have been important for particular periods or phases of early capitalism, but in general, the very nature of the political settlement which allowed the emergence of the capitalist surplus appropriation system from pre-capitalist systems, would ensure that the tradeoff between stability and efficiency was a 'positive' one, (to distinguish it from the usual sense of tradeoff, which we term negative). That is, structures of rights which were better for growth, would in this
context also be better for the political viability of the state. This result is summarized in Table 8.1.

**TABLE 8.1: THE STABILITY-EFFICIENCY TRADEOFF: CAPITALISM WITH 'SMALL-SCALE' TECHNOLOGY.**

<table>
<thead>
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<tr>
<td>CONDITION a) +</td>
<td>+</td>
</tr>
<tr>
<td>CONDITION b) +</td>
<td>+</td>
</tr>
</tbody>
</table>

### 8.2 Capitalism with 'Large-Scale' Technology and Capitalism Dominant

More interesting possibilities emerge when capitalism has evolved to a technological stage which implies substantial centralization and concentration of capital and particularly the active involvement of the state in the economy. Not only does allocational efficiency now require us to make more restrictive assumptions about structures of rights conducive to growth, many capitalist economies now begin their social existences in this technological environment under a variety of pre-existing political and social contracts, and with the active involvement and guidance of the state.

If we assume that the capitalist surplus appropriation system is dominant, this implies the political dominance of the capitalist class and a political settlement with other classes which reflects this. Some of the assumptions we would have to make about the assignment of rights in this economy for dynamic resource allocational efficiency are already satisfied. To the extent that the capitalist surplus appropriation system was dominant, conditions (a) and (b), and condition (c) would, to some extent at least, be met. What is not specified by the existence of capitalist surplus appropriation alone, is how far conditions (d) and (e) are met.
Condition (b) is no longer assured, since the improvement of capitalist rights often directly affects the wage bargaining process. There are several reasons why worker ability to oppose indefinite improvements in the structures of rights which aid efficiency conditions may be expected to be qualitatively greater in this case. Larger units of capital result in the congregation of many workers in close proximity. Historically this has aided working class organization, and improved their ability to attack the stability of the state through votes, demonstrations and strikes.

Moreover, with large-scale technology, there is the possibility of sectional opposition from within the working class preventing the closure of specific enterprises and sectors. Efficiency in allocation therefore now requires condition (d). Whether attempts to increase the extent to which (d) holds results in a decline in stability conditions depends on the political power of these sectional interests. Nevertheless, the assumption in this case that capitalists are politically dominant means that as a result of improvements in conditions (b) and (d), a decline in stability is not the most likely or usual response.

Condition (e) refers to the necessity of assignments of rights over assets to be such that individual capitalists or coalitions of capitalists are not able to politically prevent the loss of their assets when economic criteria single them out for scrapping, or when the direction of existing side-payments is to be changed. This requires us to specify rights such that the negotiation procedure of asset holders with the state is likely to result in allocations of side-payments primarily on the basis of perceptions of economic possibilities. Attempts by the state to break up monopolies, prevent collusion, create institutions which can override sectional capitalist pressures, and in general, attempts to weaken the basis of its dependence on sectional capitalist interests would constitute movements in this direction.
Whether capitalist coalitions have the political basis to bargain for preferred treatment, in other words for clientelist side-payments from the state, depends on the initial position: the political settlement we start from. If a particular initial assignment gave capitalists in specific sectors rights over assets such that they acquired strategic significance in the economy, they may be able to bargain on this basis for preferred treatment. Whether such strategically powerful capitalist coalitions exist is clearly a historically specific question. If they do, and the state attempts to change the assignment of rights to weaken their power, to extend the applicability of condition (e), the political opposition of the capitalists involved may result in a worsening of the political stability of the state. These possibilities are summarized in Table 8.2.

Analytically, in the case of this type of capitalism, the attempt by the state to improve the dynamic efficiency of the economic system in any of the ways listed may result in a decline in stability, but there are good reasons to believe that under most circumstances, the effect would be an improvement in stability conditions. In Table 8.2 therefore, the possibility of '+' effects on stability are shown to have priority over the possibility of '-' effects.

**TABLE 8.2: THE STABILITY-EFFICIENCY TRADEOFF: CAPITALISM WITH 'LARGE-SCALE' TECHNOLOGY**

<table>
<thead>
<tr>
<th>CAPITALIST SURPLUS APPROPRIATION DOMINANT</th>
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<table>
<thead>
<tr>
<th>IMPROVEMENTS IN EFFICIENCY CONDITIONS IN TERMS OF THE CONDITIONS IDENTIFIED IN TABLE 7.1</th>
<th>NEW RANKING OF THE SYSTEM IN TERMS OF STABILITY CONDITIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>CONDITION a) +</td>
<td>+</td>
</tr>
<tr>
<td>CONDITION b) +</td>
<td>+ / -</td>
</tr>
<tr>
<td>CONDITION c) +</td>
<td>+</td>
</tr>
<tr>
<td>CONDITION d) +</td>
<td>+ / -</td>
</tr>
<tr>
<td>CONDITION e) +</td>
<td>+ / -</td>
</tr>
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</table>

We can now construct a political frontier for the state in terms of the economic growth paths it can select as a result of alternative manipulations...
of rights. Figure 8.1 is constructed on the assumption that the instability which can be created by privileged capitalist coalitions and organized labour, occurs only after substantial improvements in efficiency conditions, that is, only after substantial attacks on the rights of privileged capitalist sectors when they exist, and substantial improvements in the rights of capitalists generally, beyond which the implications for the wage negotiation process becomes unacceptable for workers. With the assumption of capitalist dominance in this case, the result is that changes in assignments of rights which improve efficiency conditions will also be successively superior in terms of a ranking according to stability conditions. For a substantial range of variation we therefore have the possibility of a positive 'stability-efficiency tradeoff'.

**Fig. 8.1**: The Stability – Efficiency Tradeoff with Large-Scale Technology Capitalist Surplus Appropriation Dominant.

\[ \text{Stability} \]

\[ \text{Efficiency} \]

\( \text{S}_0 \)

\( \text{T}_1 \)

\( \text{T}_2 \)

\( \text{A}_0 \)

\( \text{A}_0 \) and \( \text{S}_0 \) are the socially defined minimum viability limits for Efficiency and Stability Conditions respectively.

\( \text{T}_1 \) and \( \text{T}_2 \) refer to alternative tradeoffs, each with a particular initial assignment of rights or 'Political Settlement', and / or a different level of initial resource endowment.

On the other hand, for some ranges of improvements in efficiency conditions, we have the possibility of a negative tradeoff, because of the organized
political resistance to such changes from capitalists or workers in the ways identified. For simplicity, we have assumed in Figure 8.1 that these two processes of resistance to further efficiency-enhancing changes in rights occur simultaneously beyond a critical point. There is no analytical reason for this coincidence, so that separate sections of the curve may have a negative slope. Nor need the negative tradeoff section of the curve be situated at the end of the range, rather than say the beginning. The specific characteristics of the tradeoff will depend on the political settlement and the resource context from which the comparative analysis begins. All we can expect from our analysis is that a substantially important section of the tradeoff curve will have a positive slope.

The implications for the policy options of the state can now be schematized if we identify on the one hand, the minimum stability politically acceptable for the state apparatus to remain viable, and on the other hand the minimum dynamic resource allocational efficiency for the system from the point of view of the economic viability of the state. Since our ranking of alternative assignments of rights both in terms of stability and efficiency conditions is an ordinal ranking, the minimum acceptable limits for the state are not defined in terms of a cardinal measurement along the scales, but by identifying a particular assignment of rights (at the intersection of the axes So and Ao) which satisfy the minimum viability conditions. Assignments of rights better in terms of stability conditions are then ranked above the line So, while assignments which are better in terms of their implications for efficiency conditions are ranked to the right of line Ao.

Starting with a given resource endowment situation and an initial assignment of rights summarized as a political settlement, we can trace a tradeoff T1, which shows the implications of changes in assignments of rights which improve efficiency conditions, in terms of their effects on stability. In this
Part II

Chapter Eight

particular case, although for a substantial range of variation in rights, the minimum political and economic viability is not attained, there is nevertheless a range which falls in the north-east quadrant defined by the lines \( S_0 \) and \( A_0 \), which allow dynamic growth possibilities with the maintenance of political viability. Nevertheless, the subjective limitations of the state will be important in this case since the negotiation of assignments of rights which allow this possibility are unlikely to occur by chance.

This situation can be much improved if an alternative political settlement or initial resource endowment can be achieved which allows the state to operate along tradeoff \( T_2 \). For comparability with points along \( T_1 \), we need to assume that the relevant assignments of rights which we are interested in can still be ranked ordinally against the stability and efficiency ranking of assignments of rights in \( T_1 \). The new tradeoff could be achieved either on the basis of an improved resource endowment situation which improves growth possibilities (the efficiency conditions) at any given level of political viability, or the negotiation of a more favourable political settlement from the point of view of efficient capitalist allocational requirements, so that for any given level of growth potential, the political viability of the system (and thus its ranking in terms of stability conditions), is better. Along \( T_2 \), the state clearly has more room for manoeuvre, and states which lack the optimum institutional and organizational ability may also be able to learn from mistakes to attain a dynamic growth position in the north-east quadrant.

Finally, we can also see how a serious crisis may come about even in this favourable case where capitalist surplus appropriation is dominant. A dramatic political development which redefines the political settlement, or a significant decline in the efficiency conditions brought about by an economic crisis independently of changes in the assignment of rights, can bring about a steep shift of the tradeoff curve to the south-west, so that no changes within
the existing system can achieve the dual goal of political and economic viability. This unenviable position becomes much more of a possibility in the next case we will look at, which has a dominant role for clientelist surplus appropriation built into the political settlement on which it is based.

§ 8.3 Capitalism with 'Large-Scale' Technology and Clientelism Dominant

The dominance of clientelist surplus appropriation refers to a situation where clientelist lobbies are able to appropriate substantial payoffs, and we have seen that this is due to an inability of existing right-holders to effectively exercise property rights over assets. Dominance in this context refers to the fact that asset holders are unable to quell clientelist pressure. Given our analysis of the assignment of rights on which clientelist surplus appropriation is based, the capitalist class can no longer be assumed to have political dominance over the state. On the other hand, since capitalist surplus appropriation exists, the state is involved in the protection of the assignment of rights over physical assets which goes with it.

The stability implications of attempts to change the initial assignment of rights in ways which improve dynamic allocative efficiency can now be expected to be negative almost without exception. The outcomes clearly depend on the historically specific balance of power between the capitalist and clientelist groups, but some general comments can be made. Although capitalist surplus appropriation exists, since capitalists are not the only politically dominant class, attempts by the state to improve dynamic resource allocation by extending the capitalist sector, conditions (a) and (c), now have indeterminate effects as far as the stability implications of the new assignments of rights are concerned. Since capitalists did not have much political voice to start with, an extension of their rights is not necessarily going to improve the state's viability vis-a-vis political demands made by capitalists. On the other hand, if resources directed to the capitalist sector imply a withdrawal of
political side-payments from the clientelistically exploiting coalition, by assumption this group has sufficient political voice to affect the political viability conditions of the state.

As in the case where the capitalist surplus appropriation system is dominant, this may also result in political opposition from the organized working class. But now privileged sections of the working class may also be expected to be part of the clientelist coalition, even if they are situated at the bottom layer of the pyramid. Nevertheless, if the strengthening of capitalist rights involves an attack on the clientelist coalition, this may provoke an ostensible working class opposition because some jobs and privileges will be threatened. Workers in declining sectors are particularly likely to support clientelist political movements, because their jobs are entirely dependent on political pressure. Thus in this case, attempts to improve conditions (b) and (d), will on balance be more likely to result in a negative outcome in terms of stability.

Attempts to improve resource allocation by attacking privileged coalitions of capitalists, which we identified as condition (e), will as before result in possible opposition from these capitalists. As with the case where capitalist surplus appropriation was dominant, the effects of these attempts on stability are indeterminate and depend on the way the capitalist sectors have emerged, but in general, we can say that given the weakness of the capitalist class, moves in these directions are actually less likely to be negative in terms of stability than in the case where capitalism was dominant.

But the most important observation is that an improvement in the efficiency of dynamic resource allocation in this case requires a series of changes in the assignment of rights which directly challenge the bases of clientelist surplus appropriation. This happens when the state tries to achieve an improvement in
conditions (f) and (g). From Chapter Six, we know that reducing the incentives and therefore the likelihood of clientelist payoffs require either more inegalitarian distributions of organizational rights (assuming the upward sloping part of figure 6.3 is relevant) or greater policing which reduces the maximum potential payoff (figure 6.1). In either case, the threatened loss of income flows to organizationally powerful lobbies invariably results in a negative tradeoff with stability. How far state decision-makers can be pressured by poor economic performance to proceed along this road depends on how soon the minimum political stability conditions defined by $S_0$ are reached.

The political effects on the state in trying to attain conditions (f) and (g) also sharply distinguish clientelism from either corruption or nepotism. Attempts by the state to correct particular resource-misallocation effects of corruption or nepotism when they were perceived to be constraining economic viability would not necessarily have such a definite effect on the political stability of the state, since neither corruption nor nepotism in their non-clientelist forms are based on political and organizational pressure on current decision-makers.

### TABLE 8.3: THE STABILITY-EFFICIENCY TRADEOFF: CAPITALISM WITH 'LARGE-SCALE' TECHNOLOGY

<table>
<thead>
<tr>
<th>CLIENTELIST SURPLUS APPROPRIATION DOMINANT</th>
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<tbody>
<tr>
<td>IMPROVEMENTS IN EFFICIENCY CONDITIONS IN TERMS OF THE CONDITIONS IDENTIFIED IN TABLE 7,1</td>
</tr>
<tr>
<td>CONDITION a) +</td>
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<td>CONDITION b) +</td>
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<tr>
<td>CONDITION d) +</td>
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<tr>
<td>CONDITION e) +</td>
</tr>
<tr>
<td>CONDITION f) +</td>
</tr>
<tr>
<td>CONDITION g) +</td>
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</tbody>
</table>

These observations are summarized in Table 8.3. Taken together they imply that on the whole the tradeoff slope is likely to be negative over much of the
relevant range of variation of rights. The geometry of the stability-efficiency tradeoff frontier, sketched in Figure 8.2, is clearly very different in this case. Whether or not dynamic growth is possible through state intervention in such an economy depends on whether any section of the tradeoff lies in the north-eastern quadrant defined by the \( S_o \) and \( A_o \) axes, and whether state-decision makers are able to manipulate rights sufficiently for the economy to operate within this range.

**Fig. 8.2 : The Stability - Efficiency Tradeoff with Large-Scale Technology**

*Clientelist Surplus Appropriation Dominant.*

\[ \begin{align*}
\text{Stability} & \quad \text{Efficiency} \\
\mid & \quad \mid \\
S_o & \quad A_o
\end{align*} \]

\( A_o \) and \( S_o \) are the socially defined minimum viability limits for Efficiency and Stability Conditions respectively. \( T_3 \) and \( T_4 \) refer to alternative tradeoffs, each with a particular initial assignment of rights or 'Political Settlement', and / or a different level of initial resource endowment.

In the two cases shown in Figure 8.2, this possibility is attainable along a section of \( T_4 \) lying in the north-east quadrant defined by the minimum viability axes. But along \( T_3 \), we have a case where the political and economic system is doomed to perpetual crisis as long as the underlying conditions behind the tradeoff cannot be changed. Attempts by the state to intervene in the economy may be expected in such a case to alternate between attempts to
attain political and economic viability, but no manipulation of rights over assets and side-payments moves this economy to the north-east quadrant to attain dynamic growth with political stability.

Some assignments of rights along $T_3$ may still achieve satisfactory conditions for growth, but such attempts are short-lived as political pressure to incorporate alternative demands moves the economy back from attempts to reach positions to the right of $A_0$. Equally attempts to settle rights so that the economy is situated above the minimum stability frontier $S_0$ also fail, as this results very shortly in an economic crisis and possibly a change in the personnel running the state or in even more fundamental changes. Under the circumstances traced by $T_3$, or even along $T_4$, if state institutions fail to achieve an assignment of rights to reach the north-east quadrant, state intervention in the economy will be 'inefficient'.

Just as in the case where capitalist surplus appropriation was dominant, the concept of political and economic crisis in this case needs to take account of the possibility of changes either in the nature of the political settlement or in changes in economic flows independent of variations in the structure of rights, causing sudden changes in the tradeoff possible. A 'crisis' in this case, could for instance be a movement of the tradeoff curve from a relatively manageable position, say $T_4$, to an unmanageable position like $T_3$. This could happen because of a deterioration in the resource availability situation (for instance because of a decline in aid or foreign credit), or to a decline in the relative political power of the capitalist sector as a result of increased political mobilizations on the part of clientelist coalitions. In the latter case, this would amount to a change in the political settlement, and for any given allocation of rights supporting efficient capitalist surplus appropriation, the state would have to cope with a reduced level of political stability.
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On the other hand, an improvement in resource availability, or a shift in the balance of political power which changed the balance of power in favour of coalitions of capitalists to the detriment of clientelist coalitions, (within the overall context of clientelist domination), would shift the tradeoff curve to the northeast, allowing the state a more favourable political frontier if it wanted to negotiate a move to a higher growth path. Conceptually, if the shift in the balance of political power between capitalists on the one hand and clientelist coalitions on the other continued far enough, the 'political frontier' or tradeoff curve facing the state would not only shift upwards and to the right, it would also change its characteristics and eventually become upward sloping, as in Figure 8.1. Conversely, if clientelist coalitions gained in strength in capitalist dominated economies, the political frontier would not only shift downwards, it would eventually become downward sloping, but this is a much less likely possibility.

Like all models, ours makes simplifying abstractions to exaggerate a particular aspect of economic reality. Whether the model assists us in understanding and explaining aspects of the economic problem in developing countries will be tested in subsequent chapters. We will use it to explain the constraints on the state in Bangladesh, which have conditioned the persistent interventions of the state in this economy, and prevented it from achieving either efficient economic growth or tolerable political stability.

8.4 The Political Economy of Stagnation

The reader is probably in no doubt by now that the constraints examined in Figure 8.2 are the ones thought to be relevant for the study of developing capitalist countries like Bangladesh. We will try to identify the features specific to some developing countries which makes the pursuit of overall viability by the state result in frequent and wasteful tradeoffs between efficiency and stability. The recent political experience of Bangladesh with
its non-optimal but lasting combination of political instability and economic crisis shows that attempts to improve the viability of the state in either way can be very costly in terms of the other viability goal. The political history of such economies suggests that the state is forced to accept low levels of political and economic viability simply because attempting improvements in one direction takes the system below the minimum tolerable limit of the other.\textsuperscript{1}

Efficiency and stability are clearly central concerns for the state in any commoditized economy. The advanced capitalist countries, however, which were by and large uncolonized or colonized by settlers, have been different in this respect that classes within these societies developed in line with the changes in internal productive organization. As a result, the political development of classes was \textit{relatively} much more in line with the development of the internal organization of production. In contrast, in India as in many other colonized countries, economic and political evolution created special problems for the state as the 'middle classes' were to a large extent the product of the administrative and political needs of the imperial power.\textsuperscript{2} The growth of these classes depended at least as much on the growth of organizational rights enshrined in colonial law as on the development of productive forces. These developments were the basis for the subsequent dominance of clientelism.

This has meant that the social conflicts which have been of critical significance in some developing countries have generally been of secondary importance in the advanced ones. In the latter, the \textit{predominant} economic struggle is between labour and capital, as the size of the surplus and therefore a critical aspect of the conditions of production for both the individual and the collective capitalist depends on this. But this conflict, to the extent that it tends to be resolved in favour of capital, weakens the political power of organized labour and re-establishes the political dominance of capital. The state can respond to this periodically reasserted political
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balance by consistently asserting its defence of the rights of capital. To this extent, and this is of course a stylized picture, efficiency and stability conditions in the advanced capitalist economy are not contradictory from the point of view of the state.

Conflicts between stability and efficiency are not a necessary characteristic of the political economy of the state in developing (ex-colonial) countries. But class and economic developments in these societies confront developing country states with a much more exacting task of fine-tuning political and economic conflicts. It is worthwhile reminding ourselves that few developing countries have been able to avoid dictatorial regimes (in whatever constitutional form), leave alone achieve fast growth without them - and that much of the repression of these regimes have been directed to resolving conflicts within the middle classes.

Finally, the institutions and traditions of the state are also important. The perception of the causes of what may appear as a fiscal or monetary problem by decision-making individuals within the state apparatus, and the conventionally accepted legitimate range of powers they can wield, conditions the freedom of action of particular states. This is particularly important because states can and do take pre-emptive action, strengthening or attacking groups and classes in line with a political vision of future threats to its viability. The leadership and vision of even a few individuals can have far-reaching consequences.

Our next two chapters look at some of the analytical problems raised in the literature on the economics of state intervention. We find that some of these problems can be effectively addressed within our framework, and this serves as the starting point for our historical and empirical work.
Notes to Chapter Eight

1. An enduring political instability together with a virtually permanent state of economic crisis has been one of the hallmarks of contemporary Bangladesh. Conflicts within the economically dominant urban classes have failed to resolve the impasse. See for example, my article entitled 'Bangladesh Opposition in Disarray', in Inside Asia No. 7, Feb-Mar 1986. The model presented is one way of understanding the difficulties which lie in the way of a successful resolution, which can be traced to the nature of the political settlement and ultimately the distribution of organizational rights in society.

2. B.B. Misra(1961) was the first to trace the history of the Indian middle classes. See in particular p. v and the Introduction.
Chapter Nine Some Marxist Problems Reconsidered

An interest in the 'class nature of the state' within marxist economics and historiography, together with a methodology which stresses the interaction of politics and economics makes the marxist research paradigm particularly appropriate for looking at the state and the efficiency of its economic intervention. On the other hand, the tradition has suffered from a formalism which for instance accounts for the lack of attention given to the microeconomic basis of many of its macroeconomic generalizations. A concern with the internal consistency of theories rather than the diversity of historical experience led to the 'structuralism' of Poulantzas, Hindess & Hirst and others. Analytical elegance was awarded priority over flexible theoretical responses which could cope with the transformations taking place for instance in the developing countries. At the same time, some within the marxist tradition raised important questions and provided interesting answers.

§ 9.1 State as Superstructure

The relegation of the state as a consequence of the base-superstructure causal hierarchy may not be an adequate summary of the analytical framework used by Marx and Engels, but it is nevertheless a popular interpretation of their method. This 'orthodox' marxist tradition of keeping the analysis of the capitalist state distinct from an analysis of the economy (the base-superstructure distinction), derives from the methodology of Grundrisse and Capital, and scattered statements, like the famous Manifesto quotation which said that the executive arm of the state was nothing but a committee for managing the affairs of the whole bourgeoisie. The tendency to regard the state as an unproblematic and unitary entity which 'reflects' the dominant class interest was one of the factors which hindered a better understanding of the dynamics of state policy formulation and surplus use.
Marx's own writings on the state were to a large extent political, aimed at assessing political programmes and explaining concrete historical developments. In his analytical work, his initial plan for the structure of *Capital* involved six volumes, the fourth being devoted to an analysis of the state. If this volume had been written, it is quite likely that the historical specificity of the model of capitalist development outlined in *Capital* would have become much more explicit.

The economic model of *Capital* was based on the experience of nineteenth century Britain. Here growth had been led by wage goods for which demand was created by the growth of capitalism in agriculture, and production proliferated in relatively small-scale and labour-intensive units. The analysis of *Capital* thus reflected the primacy of decentralized initiatives in the process of capitalist transformation. With its favourable conjuncture of technological possibilities, class formation and the structure of demand, the British case was almost unique. It was a good historical case for analysing the role of the market and competition in the generation of capitalist accumulation, but not for the analysis of the role of the state.

This was apparent by the time of the German industrialization experience, since by that time the scale of technology was already sufficiently large to rule out purely decentralized responses. The class structure too, with the rapprochement of liberal and Junker interests following the Revolution of 1848, required a centralized, interventionist and mediatory state if industrial growth was to proceed. The consolidation of the Bismarckian state was not caused by the functional requirements of growth nor can it be assumed beforehand that appropriate institutional responses will be forthcoming in each and every case. An explanation of German industrialization would therefore be incomplete unless it identified not only the role and the motivations of the
contemporary German state, but also the social conditions which allowed the state to sanction the allocations of resources for industrialization.

Equally, looking at a period prior to the industrial revolution in Britain, Fernand Braudel identified five parallel sets of social organization or 'hierarchies' which critically affected the subsequent transformations in European feudal society. These were the seigniorial society proper, relating landlord and peasant, the Roman church, the emerging territorial state, the structure of feudal lords or feudalism proper, and the towns. Dynamic accumulation by merchant capitalists took place in Western Europe in the context of a very specific historical configuration. Economic conflicts at the apex of the social structure, the political space allowing aspiring accumulators to climb to the status of the nobility, and emerging territorial states forced by competitive wars to adopt mercantilist policies were some of the key elements of this configuration. The state, represented initially by the royal bureaucracy, was in a variety of ways delinked from the pursuit of purely feudal interests. Even within this picture, the outcome in each country and the responses chosen to the same economic and political problem varied greatly. Braudel's historical analysis thus pointed out the specificity of the combination of economic pressures in a favourable political environment which allowed and induced the early capitalist states to protect and support the development of capitalist rights.

Nevertheless, despite its rather special characteristics, the British case implicitly remained the basis for marxist economic theory. The Dobb-Sweezy debate, for instance, regarding the transition to capitalism in Europe, by its concentration on the relative primacy of 'internal' versus 'external' factors, gave remarkably little attention to the role of the state. This was unfortunate because the way the states in Western Europe emerged and evolved, admittedly in response to social pressures, was historically and geographically
specific to the region. Moreover, these states developed specific institutional responses to these pressures, which are crucial for understanding the transition to capitalism in this region.

In the case of the countries of the 'orient' at a similar historical period, the historical significance of the oriental states made it more difficult to ignore them in subsequent marxist analysis. The relative performance of China and Japan, for instance, immediately brought to the fore the crucial role of the institutions constituting the state. Marx's response to the oriental state has been particularly unhelpful. To cope with the histories of continents and epochs where the state had played a dominant role, he simply formulated a distinct pre-capitalist mode of production with unique characteristics. For this special case, the base-superstructure methodology was temporarily suspended. This was the Asiatic mode, where the state owned all the land and collected taxes from resolutely unchangeable villages with static technology. In one conventional marxist view, China was a case where the model of the Asiatic mode of production was appropriately applied. As the theoretical structure and analytical problems of the Asiatic mode construct are well known, we need not repeat the analysis here. In contrast, Japan was seen to be more akin to the feudalism if not of Britain and France, then of Prussia. The transition in Japan was persuasively presented within this tradition as being similar to the Prussian model, feudal power not being defeated in, but rather being incorporated by, the state.

Although analyses of this type did incorporate a role for the state, they were still quite inadequate for addressing the question of differences in economic performance between 'similar' countries. By rooting historical analysis of the state within the analytical framework of a limited number of modes of production, with the economic dynamics of each mode being fairly well defined, this variety of marxist research had the advantage of a powerful lever in
examining epochal transitions. As against this, there was a tendency to ignore, or of being unable to cope with the significant differences that did exist within social formations broadly corresponding to the same mode.

The limitations set by this methodology emerged time and again, for instance during the Indian Mode of Production Debate where much of the discussion was over whether particular features of the specific type of capitalism described in the three volumes of *Capital* were to be observed in contemporary India, rather than about the way in which the Indian economy actually operated. Many of the useful insights which emerged during this debate, did so in a sense in spite of the methodology adopted.

§ 9.2 Institutional Empiricism

One of the departures from this orthodox marxist view has stressed the institutional specificities of different countries and directed attention to the empirical study of how institutions actually operated. Miliband, who is particularly associated with this strand of analysis for the advanced capitalist countries pointed out that

"the state" is not a thing... it does not, as such, exist. What "the state" stands for is a number of particular institutions which, together, constitute its reality, and which interact as parts of what may be called the state system."

Writing about the advanced capitalist context, where the structure of property rights and production relations is relatively stable, Miliband argues that here both civil servants and politicians are able to define the national interest in terms congruent with the interests of growth, or in other words, the interests of capitalist accumulation. While Miliband introduces the empirical study of institutions in marxist research, his aim in exploring these institutional linkages is to understand how, in a diversity of national situations, the state acts in the interests of the dominant class, despite its apparent neutrality.
However the work of Glyn and Rowthorn, for instance, shows that even in the advanced capitalist countries, the responses of states, say to the profitability crisis of the seventies, or the growth of unemployment in the seventies and eighties has varied in line with differences in domestic political possibilities and the perceptions and capabilities of the state.\textsuperscript{12} Miliband's analysis does not indicate how such variations can be accommodated.

In developing countries the analytical problem is not so much the semblance of neutrality in the actions of state decision-makers, which often does not exist. It is rather to understand the consequences of the interaction between state and society in a context where the composition and organization of the economically dominant group is relatively fluid, and the state itself is involved in processes of class formation. Nevertheless, the historical approach implied by the institutionalists is relevant because the diversity of possible outcomes rules out the possibility of 'general theories' of the state.

The historical antecedents of modern states, and the ways in which they emerged out of the ancient imperial systems is consequently of considerable importance in understanding some of the differences which exist between countries in the institutions which evolved, and the range of their interventions in the economy. The ways in which the state perceives and reacts to economic and political signals also depends on the history of how the state was formed. Historical work within the marxist tradition supports this view.

Frances Moulder in her comparative study of Japan and China pointed out the importance of the process through which the state identified and implemented policies encouraging merchant capitalists at a crucial transitional stage in history, policies which later came to be known as 'mercantilist'. She persuasively argues that the transition to these policies constituted a significant jump from the 'provisioning' policies aimed at sustaining a stable
surplus-consuming class within a self-sufficient economy, characteristic of the
pre-mercantile feudal and imperial states.13

In Europe, where this first happened, favourable conditions for perceiving this
need had been created by a period of nationalist rivalry between a number of
states at manageably similar levels of technological sophistication. A further
prerequisite for this, as Moulder points out in her comparison of China and
Japan, was the evolution of a 'national bureaucracy', characterized by its
financial dependence on the centre and an enforced structure of rules. This is
distinguished from the 'imperial bureaucracy', where incumbents while not
necessarily more powerful, are more arbitrary and depend on the opportunities
for plunder provided by the job for their livelihood.

Moulder is not clear about how national bureaucracies and economic growth are
related, but it would be reasonable to expect a state with an 'imperial
bureaucracy' to be worse equipped as an institution through which emerging
progressive forces in the broader society (in this case merchants) can either
express their interests at the apex of political power, or implement them once
they have been legitimized. A possible explanation behind this inability could
be that 'imperial bureaucrats' were engaged in a surplus appropriation process
which conflicted with the assertion of property rights over productive assets
by capitalists. This would be analogous to the opposition to changes in the
rights underlying clientelist surplus appropriation in our analysis, but we
would clearly expect the 'property basis' of surplus appropriation by state
bureaucrats to be quite different in imperial China.

An analysis based on the evolution of rights in the face of specific political
balances of power and economic possibilities, is more likely to be fruitful
than those which suggest a one-way causality between the venality of the state
on the one hand, and economic sloth on the other. France, for instance, in the
sixteenth and seventeenth centuries, was marked by an exceptionally venal bureaucracy which nevertheless did not prevent the evolution of forces which could successfully challenge it in the eighteenth.¹⁴

Moulder's analysis of Japan's relative success in developing a national bureaucracy and nationalist economic policies emphasizes the importance of the differences in the nature of the external impact in each case. China, with its raw materials and markets, was too attractive to the Western powers to be allowed to develop an independent state—a series of wars and unequal treaties, and continuous intervention in the administration made this certain. Japan's relative poverty, geographical situation and the international balance when the time came to turn to Japan, ensured that attempts to do the same here were at best half-hearted.

The case does seem to point out the strategic importance of the time afforded to Japanese society after the Western impact. This was critical for an internal resolution of the anarchic conflicts of the Tokugawa era and gave new forces the compulsion and legitimacy to carry out rationalizations. However, in arguing against conventional marxist analyses in which the supposed Asiatic mode of production in China and a 'feudal' form in Japan are the sole basis of the explanation, Moulder goes much further in drawing out the similarities in the social basis of the societies than is necessary for her case. While her critique of these approaches is surely valid, as is the importance she gives to the nature of the incorporation into the 'world economy', the latter by itself must be inadequate as a complete explanation of the differences between non-European states. What is missing in her analysis of the relative efficiencies of their bureaucracies is an analysis of the internal forces which obstructed, no doubt with foreign connivance, the emergence of a national bureaucracy and nationalist policies in pre-revolutionary China.
The continuing importance of 'nationalist' responses to economic problems has been underlined by Bienefeld and others who have looked at recent industrial performance in a number of countries including non-European ones. These empirical examinations have looked at the appropriateness of 'national responses in a changing international context'. Differences in the nature of the economic problem in different contexts, together with continuous changes in technology and in international market conditions have meant that success has been limited to countries which have been able to perceive and implement national strategies which allowed rapid accumulation and market expansion. The state clearly is the only forum where such national strategies can be realistically formulated in the modern world. Although these studies do not use the terminology we have developed, implicitly the factors which influence the perception and flexibility of response of national institutions on the one hand and the political frontier which allows their implementation on the other are of crucial economic significance.

One implication of our argument is that while the institutional capabilities of the state may be quite important, this has to be seen in the context of the feasible set of options which are available to it. This can be seen using the tradeoff frontier developed in the last chapter, when the clientelist coalition is politically dominant, which is the typical situation in many developing capitalist countries. This is reproduced as figure 9.1. Assuming that the more favourable tradeoff, $T_4$ holds, the feasible subset of choices available to the state is shown by the shaded area $FS$. Within this subset, whether the fastest politically viable rate of industrial growth is chosen by a particular state, that is whether it chooses to allocate rights to reach point $G$ in the diagram, depends on the institutional efficacy of the state and the preferences of its decision-makers.
The continuing importance of 'nationalist' responses to economic problems has been underlined by Bienefeld and others who have looked at recent industrial performance in a number of countries including non-European ones. These empirical examinations have looked at the appropriateness of 'national responses in a changing international context'\(^1\). Differences in the nature of the economic problem in different contexts, together with continuous changes in technology and in international market conditions have meant that success has been limited to countries which have been able to perceive and implement national strategies which allowed rapid accumulation and market expansion. The state clearly is the only forum where such national strategies can be realistically formulated in the modern world. Although these studies do not use the terminology we have developed, implicitly the factors which influence the perception and flexibility of response of national institutions on the one hand and the political frontier which allows their implementation on the other are of crucial economic significance.

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FIGURE 9.1: THE FEASIBLE SET OF STATE INTERVENTIONS

\[ \begin{align*}
\text{Stability} & \\
\text{Efficiency} & \\
S_0 & \\
T_3 & \\
T_4 & \\
A_0 & \\
Y & \\
A & \\
B & \\
G & \\
\end{align*} \]

\( A_0 \) and \( S_0 \) are the socially defined minimum viability limits for Efficiency and Stability Conditions respectively. \( T_3 \) and \( T_4 \) refer to alternative tradeoffs, each with a particular initial assignment of rights or 'Political Settlement', and / or a different level of initial resource endowment.

The economics and politics of the institutional sluggishness of the Indian state has been given a lot of attention in recent literature. Jha points out the tremendous growth in public sector employment in the sixties and seventies, largely in the lower (Class III and Class IV) echelons. At the same time, he concludes from an analysis of the implementation of Industrial Licensing Policy, Tariff Policy, Price Controls and Excise Duties, that the systematic failure of policies cannot be attributed to inadvertence. Jha's explanation of the motivations of the state, however, are not very robust. His analytical framework is derived from Kalecki's intermediate regime concept. He defines an 'intermediate class' composed of state bureaucrats, small producers, professionals and surplus farmers, united not in the classical marxist sense of sharing a similar position in a surplus appropriation process, but rather in being net beneficiaries of a scarcity economy characterized by inflation.

This powerful alliance, according to Jha, \text{controls} the state and has a vested interest in perpetuating the scarcity which enables them to engage in lucrative
rent-seeking. This framework, however, effectively presents the 'state' as a unified entity, an instrument in the hands of a coalition intent on preserving scarcity. It does not allow an analysis of conflicts between viability goals of the state, and consequently of conflicts of interest within the state bureaucracy.

A characterization of the Indian state which would fit in with the stylized facts would be to say that the set of feasible choices facing the state in its attempts to increase the rate of industrial growth, (the space $FS$) is quite small in India, but we would expect it to be non-empty. The growth of public sector employees would be an indication of the growth in the strength of the clientelist coalition and if this was a growth in relative power, it could well result in a less favourable tradeoff. But the inability of the Indian state to choose the best option from within the available set would be a conceptually separate problem.

§ 9.3 The Relative Autonomy of the State

Another departure, also rooted in the writings of Marx and Engels maintains the materialist emphasis on production and class but brings in the state in a dialectical relationship. To get around the base-superstructure controversy, it tries to establish the 'relative autonomy' of the state based on several observations of Marx and Engels such as the following quote from the latter:

> The reaction of the state power upon economic development can be one of three kinds: it can run in the same direction, and then development is more rapid; it can oppose the line of development in which case nowadays state power in every great nation will go to pieces in the long run; or it can cut off the economic development from certain paths, and impose on it certain others. This case ultimately reduces itself to one of the two previous ones.  

Anupam Sen, for instance, in his analysis of the Indian state, challenges the structuralism of Poulantzas, and argues that there is a lot of evidence that
Marx and Engels, under certain circumstances, gave primacy to the perceptions, interests and actions of the state. He argues that the Mughal state system, from which the modern Indian state is derived was an example of the Asiatic mode of production. It is characterized even now by the desire of its officials to maintain their hegemony over the two economically dominant classes: the bourgeoisie and the petit-bourgeoisie, neither of which are strong enough to impose their dominance on the state.

A range of economic policies, from the growth of the public sector to the support given to small-scale technology is explained with reference to the desire to balance the bourgeoisie with the petty-bourgeoisie. However, we are entitled to ask why the Indian state should want to perpetuate this costly balance to retain its hegemony, and why it is so ineffective, compared to some other Asian states, even in performing the functions it explicitly sets out for itself. After all, it would be difficult to argue that Japanese, South Korean or Taiwanese state officials are less powerful or economically less rewarded than their Indian counterparts.

Much of the analysis of 'relative autonomy' of states in the Indian subcontinent is associated with the pioneering work of Hamza Alavi, and like all pioneering works, Alavi’s concepts and interpretations of history have been the subject of extensive criticism in the literature. Starting with Marx and Engels’ analysis of the Bonapartist state, Alavi argued that the state in postcolonial society was relatively autonomous of the three dominant classes: the indigenous bourgeoisie, the metropolitan bourgeoisie, and the landed classes, in the sense that no class singly had control over the military-bureaucratic oligarchy which constituted the state apparatus. This was partly rooted in history; the colonial power had created a state ‘overdeveloped’ in relation to its indigenous social basis, and this was used to engineer social
change from above. Autonomy subsequently became economic as the state began to appropriate and dispose of a substantial part of the social surplus.

While Alavi continues to have critics, this only underlines his success in bringing the state into the discussion of the political economy of the subcontinent. Moreover, while it is possible to criticize Alavi's choice of the three constituent dominant classes or his particular formulation of autonomy from within any of a number of marxist paradigms, it is hard to argue against the historical facts, some of which Alavi himself presents, which show the economically dominant groups in Pakistan and Bangladesh to be structurally diverse, with the state adopting policies, which at least ostensibly, do not reveal sustained or systematic preferences. This is a fact which has to be explained and incorporated in any analysis of the economic system. In fact, the weak aspect of Alavi's analysis which does need to be pointed out is his treatment of the economics of the state: the motivations of the participants and the limitations of their actions.

Alavi always maintained that the state's autonomy was relative, since it was determined 'within the matrix of a class society', where all three dominant classes were interested in preserving the system based on private property. This was elaborated in a later work in the concept of the 'structural imperative' of the state.

The role of the state in civil society is secured by the 'structural imperative' of peripheral capitalism, a concept we put forward as a key concept for understanding the inter-relationship of the state and civil society and the mode of operation of the state in class-based societies... Structural conditions do not determine the actions of social agents but rather, the outcomes of their actions, which in turn become points of departure for subsequent conscious and purposive actions designed to secure their objectives... The 'structural imperative' is, therefore, the logic of the functioning of a capitalist economy and society (peripheral or otherwise). It refers to the objective requirements of the processes of capitalist development and capital accumulation, the conditions of profitable economic behaviour and allocation of resources that delineate
'efficient' from 'inefficient' allocations and draws a line between solvency and insolvency."'

This formulation is somewhat unsatisfactory as it stands. That the economy sets limits to the state's actions is plausible enough, but the economy itself is to be explained. Apart from the concession that the decision-makers' perception of objective conditions may not coincide with reality in the short run, Alavi hints that time and experience will tend to bring the two into line. Like the theory of rational expectations, this actually requires an independent specification of the 'economy'. However, as soon as we try to define the dynamics of 'peripheral capitalism' in this way, (say with the aid of dependency theorists from whom the phrase is borrowed), we are back to unidirectional causality and the state paradoxically diminishes in importance.

This is possibly why, these comments notwithstanding, Alavi does not proceed further with an economic analysis. Nevertheless, the concept of the structural imperative can be a powerful analytical tool if it is seen not as an indicator of the actual functioning of the state (or even as a tendency), but rather as a heuristic description of how the state would behave in an ideal world to generate the fastest accumulation and growth in a specific class context. This may help us to understand and thus explain why, in fact, the state in many countries does not and is not able to do so. The sustained nature of 'state failures', despite the extremely costly economic signals of this failure, suggests that the explanations have to go beyond false perceptions.

The concept of relative autonomy can thus be re-interpreted. In the context of the political frontier defined by the tradeoff curve T₄ in figure 9.1, the state is indeed 'autonomous' in the sense that the personnel in charge of decision-making do have to make 'choices' within a defined set of options, FS. The limits to these options are set by the social and economic context in which
the state operates. The state can even decide to go outside the bounds of FS if
decision-makers are prepared or forced to pay the price. What we have argued
is that it is not at all necessary that resource availability, the balance of
political power and the institutional abilities of the state will be such that
every capitalist developing country will automatically experience dynamic
growth. Some capitalist countries, indeed, may face very poor prospects.

Figure 9.1 suggests another and perhaps more important way in which the state
can be autonomous. In developing capitalist countries, the frontier facing the
state is often extremely unfavourable, T3 shows an example of this, with no
politically feasible allocations of rights leading to even the minimum economic
performance. In such cases, the state, if it wants to survive, is compelled to
engage in the 'class struggle', in other words, in the social engagement which
defines what we have called the political settlement. On the one hand, the
organizational ability of capitalists is weak compared to that of the
clientelist coalition. On the other hand, the state includes institutions like
the army which are relatively well organized, armed, and can be used for, or
sometimes take their own initiative in, blocking the political voice of
clientelist coalitions. Survival may require the state to 'autonomously' engage
in a political struggle which results in a more favourable political frontier.
This amounts to the state being 'responsible' for a new political settlement,
and for shifting the political frontier to a more feasible position such as T4.

Generals in developing countries may be more or less sympathetic to the
philosophy of democracy than their counterparts in advanced countries, but the
conditions which encourage them to pursue their personal ambitions by engaging
in a struggle against 'democracy' is too systematic a phenomenon to ignore. At
a general level, it needs to be stressed that the state is not compelled to
engage in the social struggle because it is autonomous, rather the state is
compelled to act in 'autonomous' ways as part of its overall strategy of
maintaining at least the minimum viability conditions. How far it succeeds depends not only on the organizational capabilities of the state, but also on the nature of the political balance it attempts to change.

With a political frontier such as $T_3$, the decision-makers of the state have two options, they can either do nothing and hope the system will readjust with lower political and/or economic tolerance levels ($S_0$ and $A_0$), or they can engage the institutions of the state in the conflict between sections of the economically dominant classes in favour of the capitalist class. If the former option is chosen and fails, the personnel in charge of the state are quite likely to be replaced by members of the armed forces who take advantage of the crisis (no doubt in pursuit of their own interests), who feel they can 'run the country' better.

The critical question then becomes, whether the new leadership can consciously or unconsciously intervene in politics in ways which do indeed move the tradeoff curve to the northeast. This is by no means always assured. We have referred to the pyramidal structure of the clientelist coalition and this gives it substantial tenacity. There is a real possibility that the 'dictatorship' may be the only major social force against the clientelist coalition. But the dictatorship is itself often a part of a state structure which is deeply involved in clientelism.

This gives rise to the curious political phenomenon so common in developing capitalist countries of multi-class 'populist' alliances fighting each other in the name of 'social discipline' and 'military rule' on the one hand and 'democracy' and often 'socialism' on the other. The only significant difference between them may be the extent of clientelism they are willing to support. These two reasons, the strength of the clientelist coalition and the weakness of the mobilization against it, imply that dictatorships do not always succeed.
in generating capitalist growth. If the clientelist coalition is strong enough to resist the efforts of the 'dictatorship', the attempts of the authoritarian state may simply move the system down a stationary tradeoff curve, with rapidly declining political viability.

§ 9.4 The State and Class Structure

A third kind of departure from the orthodox perception of the state emphasizes distinct patterns of interaction between the state and the class structure of the society attempting industrialization. Despite the considerable variety in patterns of class evolution across societies, economic analyses typically avoid this issue. Nevertheless they are not free of implicit and often inappropriate assumptions. In his study of Latin America, Weaver points out that

to formulate a theory of historical and contemporary economic development from the few variables that conventional theory includes, necessarily involves using, explicitly or not, one of the following types of assumptions about the institutions and culture in which economic aspects of social life are embedded: i) the social structure that goes with liberal capitalism or else a powerful state insulated from social pressures (as in the case of development planning literature) already exists, or ii) economic change will easily and automatically lead to accommodating changes in the social order.22

Weaver's concern was to show how the nature of capitalism and the capitalist state had evolved in response to a) changes in the nature of technology, and b) differences in the class structure of the societies attempting industrialization. Three stages of capitalism are identified. The first, competitive capitalism, produced primarily wage goods using decentralized, labour-intensive technology and depended on the markets of wage workers and foreign consumers. The capitalism of Britain and the United States till the third quarter of the nineteenth century approximated to this model.

Finance capitalism, the second stage, was technologically defined by the leading role played by intermediate and capital goods sectors, and the
consequent concentration and centralization of capital. Demand was now primarily from the state (railways and armaments) and foreign investments. This kind of state required a stable class balance behind it, a balance which was achieved in late nineteenth century Prussia through the alliance of junkers and industrialists. In contrast, such a balance failed to materialize in early twentieth century Russia as a result of a decline in the social and economic power of the nobility in the last third of the nineteenth century, which together with the predominance of foreign capital in Russian industry ensured that a stable class alliance behind an industrializing state was missing.

The final stage, monopoly capitalism, is said to characterize contemporary Latin American capitalism. Here production is led by capital-intensive consumer goods, the market for which is provided by a politically powerful middle class and the state. The success of the state now depends on how well it can manage the provision of subsidies to the middle class to sustain demand.

Although Weaver's analysis introduces to the analysis the problem of managing the political constraints to industrialization, the adequacy of the consumer goods oriented monopoly-capitalist construct for describing the range of capitalist responses in contemporary industrializing and semi-industrialized countries may be questioned. A more important weakness in Weaver's detailed historical analysis is that the economic problem is defined in terms of managing the demand corresponding to a particular type of technology, and not primarily as a problem of production and accumulation. Many developing countries do indeed suffer from chronic problems of inadequate demand, low levels of capacity utilization and grindingly low rates of growth of output. But an appropriate structure of investment would create the 'home market', while no amount of demand management can of itself overcome the barriers to efficient production and accumulation. As Terry Byres put it, writing about the 'structural stasis' of Indian industrialization,
... if tomorrow, the 'home market problem' were to disappear - let us say through the sudden emergence of limitless export markets - the roots of India's accumulation crisis would remain undisturbed. Indian industry, if we may revert to the passage from Marx with which we started, continues to come up against formidable barriers which are logically prior to 'those presented by the availability of ... sales outlets'.

This brings us to another set of analyses of the Indian state in the context of the so-called deceleration debate referring to Indian industrial growth. This was based on a comparison of industrial performance during 1967-1982 with that of 1957-1966 and generated a range of possible explanations for the observed slowdown. The constraints set by conflicting class demands on the state were brought into the debate by a number of contributors, tangentially by Desai and more directly by Bardhan. For Bardhan, the most convincing explanation of the industrial slowdown is in terms of the slowdown in public investments. This introduces the question of the state and the nature of the pressures which resulted in the slowdown in public investments. The analysis also draws on the theoretical tradition which developed the concepts of 'relative autonomy' and the 'overdeveloped state'.

Bardhan identifies three dominant proprietary classes: the industrial bourgeoisie, the rich farmers and what he calls the professionals, both civil and military. 'Log-Rolling' within this motley collection of interests to carve up the resources available to the state is what accounts for the trend fall in public investments:

When diverse elements of the loose and uneasy coalition of the dominant proprietary classes pull in different directions and when none of them is individually strong enough to dominate the process of resource allocation, one predictable outcome is the proliferation of subsidies and grants to placate all of them, with the consequent reduction in available surplus for public capital formation.

The desire of the state apparatus (which in India seems to virtually incorporate the Congress Party) to consolidate its political viability, is
implicitly behind this process of wheeling and dealing. But the necessary conditions behind this, in other words the factors which prevent a similar phenomenon in all capitalist countries are not examined by Bardhan. Moreover, it is perhaps because of India's experience of a qualitatively greater political and economic stability that Bardhan gives very little attention to the conflicts between economic and political viability goals. The publicly proclaimed commitment against corruption and public sector inefficiency in the Rajiv era, together with India's increasing exposure to international borrowing and trade may well serve over the coming years to make the conflict between viability goals more obvious. In such situations, an analysis of the nature of the conflict facing the state would be necessary to understand what Bardhan calls 'the political economy of development'.

Bardhan sees two possible choices for the dominant coalition: to close ranks and intensify the exploitation of those below, or to strike coalitions with subordinate classes to enable the system to somehow muddle through. The possibility of a conflict between efficiency and stability goals, a consequence of contradictory systems of rights protected by the state, opens up a third and perhaps more likely possibility. If such a conflict threatens to take the system below its tolerance limit of either political or economic viability, the actions of the state might provoke mobilizations and counter-mobilizations within the dominant coalition, making the state the centre of increasingly bitter struggles.

In terms of the analysis of Chapter Eight, the industrialization process in both India and Bangladesh suffers from the presence of a substantial clientelist coalition. The difference may be conceptualized in terms of the relatively more favourable balance of political power and resource endowments in India. Indian capitalists attained a relatively more satisfactory political settlement at the time of independence due partly to their more substantial
economic and numerical presence and partly to their financial and political role in the Indian Congress during the independence struggle. India moreover enjoys a much more favourable resource endowment situation. The tradeoff between Stability and Efficiency may therefore be expected to be normally more favourable in India, along $T_A$ say, in Figure 9.1, rather than $T_3$, allowing the possibility of dynamic growth with careful state management.

However, an economic crisis or a change in the political balance of power as new coalitions attempt to join the existing clientelist lobbies (typically in the case of India through sub-national or regional struggles for greater autonomy) could conceivably result in a much less favourable tradeoff for the Indian state. The initial (and already largely unsuccessful) moves of the Rajiv regime against some manifestations of clientelist activity suggests that this problem is becoming more and more severe.

In Bangladesh, the most substantial empirical and analytical contributions on the nature of the relationship between class structure, the state and economic performance have come from Rehman Sobhan and Muzaffar Ahmad. They have concentrated on the question of the performance of public sector enterprises in Bangladesh and have put forward a persuasive argument that this cannot be evaluated without an understanding of the political context, and in particular, of the class character and stability of the state. The point of departure for both these authors is to point out the variety of outcomes of the process of decolonization. If a stable state structure is to result, it is asserted that one of the three possible classes must be able to exert its dominance over the state: the bourgeoisie, the petty bourgeoisie, or the peasant-worker masses.

In each case, the dominant class has a vested interest in improving the performance of public sector enterprises, though the size and constitution of the sector may vary. Since output, pricing, employment, and other policy
decisions are made in the context of the objectives set by the state, the 'performance' of the public enterprise sector has to be judged with respect to these objectives. It is in the intermediary cases, where the state, and particularly public sector enterprises become the arena for struggles over the distribution of the surplus, that performance deteriorates. Moreover, in the case where the petty-bourgeoisie is dominant, the stability for the public enterprise sector is short-lived as the surplus created here is increasingly diverted to party-building and to the pockets of cadres.

Sobhan carries the argument further and offers an empirical analysis of public enterprise performance in the critical years of the Awami League experiment of the early seventies. His argument has two principal facets. The first defines the enterprise performance criterion as its ability to generate surplus, defined as value added minus employee compensation. Thus direct and indirect tax deductions, and depreciation are added on to profitability figures to get a measure of surplus produced. Sobhan provides empirical evidence from South Asian countries including Bangladesh, showing that public sector enterprises have, over the relevant period, continued to generate substantial surpluses.

The second part of the argument says that the profitability figures were much poorer because of the various ways in which surplus generated was lost by the enterprise, either directly to the state, or indirectly to other classes, as a result of policies they could impose through the state.\textsuperscript{30} The principal cause of this, it is argued, was the instability accompanying a conflict between the bourgeoisie and the petty-bourgeoisie over the state, a process in which a section of the latter was also differentiating itself through surplus appropriation and becoming a part of the bourgeoisie proper. As a result of this struggle, the public enterprises lost control of the surplus they produced, so that their post-tax performance was uniformly poor.\textsuperscript{31} The implicit and perhaps misleading implication of their analysis is that the
public enterprises performed quite well under the Mujib regime, if only we look at their technical performance separately from their profitability performance.

The line of argument is as follows: Political Instability / Unstable States → Loss of Enterprise Autonomy → Loss of Enterprise Surplus → Apparent but Misleading Decline in Enterprise Performance. Let us look at each of the components of the argument in turn. We accept for the moment the appropriateness of pre-tax profitability as a criterion for measuring enterprise performance, although we will later argue that this measure has serious problems in the context of developing countries. Political instability is neither a necessary nor a sufficient condition for loss of enterprise autonomy. A state with a stable class basis may intervene heavily in the affairs of the enterprise while a period of instability may allow firms to enjoy de facto autonomy.

Secondly, enterprise autonomy is neither necessary nor sufficient for the retention of surplus by the firm, particularly in the typical context, where many firms are heavily dependent on explicit or implicit state subsidies. It is possible, for instance, for prices to be such (manipulated perhaps by a stable state), that a substantial part of the 'surplus' leaves the firm even while it is fully autonomous in its day to day running. Equally, a firm suffering from periodic political interventions in its decision-making may nevertheless enjoy a net injection of resources.

Finally, the retention or otherwise of the enterprise surplus does not say much about the conditions which force enterprise and state decision-makers to systematically make efficient choices about dynamic resource allocation. It is quite possible for decision-makers in autonomous public sector firms in a stable state to be uninterested in efficiency, accumulation or investment even when they have full retention of the surplus.
In other words, where market distortions and cross-subsidies are the norm, whether or not an enterprise 'produces' a surplus, the growth implications, and hence ultimately our evaluation of performance, clearly depend on the use which is made of it. The link in the argument between a stable state and observed public enterprise performance (measured in terms of its post-tax profitability) is not satisfactorily established, (why should public enterprises in stable states be more 'autonomous' and more able to retain surplus?) and the nature of the link between enterprise performance in terms of post-tax profitability or surplus retention and enterprise performance in terms of growth, is not examined, (why should enterprises with more autonomy and hence more retained surplus be judged better performers?).

Even if it could be accurately measured, surplus leaving the public sector enterprise is not necessarily lost for investment and indeed Sobhan looks at these deductions as potential contributions to the development effort. The fact that public sector enterprises may be generating a surplus, or indeed the simple availability of surplus at any level of the economy, thus does not say anything definitive about efficiency conditions as defined in Chapter Five. Growth requires an appropriate investment of investible resources, so to meaningfully assess performance, it is inappropriate to separate enterprise surplus generation from enterprise investment or investment of its surplus elsewhere. (Long-term profitability trends would ceteris paribus reveal the appropriateness of investments, but this is pre-empted because of the short period for which the Mujib government survived). Investment decisions are made in an integrated framework of conflict and compromise of which the enterprise management is a part, implying that an evaluation of the performance of public sector enterprises must involve other institutions and processes which together describe the way decisions are made regarding surplus distribution both to and from the enterprise.
Many contemporary reports of the economic crisis gripping the economy, but particularly the public sector, during the latter part of the Mujib regime also suggest that the economic problem was not so much the non-availability of surplus, as its diversion by groups who had acquired new 'rights'. This is the very phenomenon Sobhan incorporates as the mechanism through which enterprise surplus is lost as a result of class conflict and the consequent loss of enterprise autonomy. What we would stress is that this 'dissipation' was not caused by class conflicts as such, although this period was marked by such conflicts, but rather by an emerging pattern of economic operation that integrally involved the public sector in an evolving pattern of organizational rights which required substantial and systematic clientelist payoffs. In other words, if the class and political conflicts of this period had been resolved in favour of the emerging groups which were beginning to assert the new patterns of rights, there is good reason to believe that the 'dissipation' would have continued rather than stopped as a result of the new stability.

There is evidence, which we will look at later, that the economic involvement of the state, including its performance in the public enterprise sector, became substantially less 'efficient', measured not in terms of profitability, but in its ability to manage growth-enhancing allocations of resources. The political turmoil of the period was, in this interpretation, more the effect rather than the root cause of the economic crisis. Mujib's response to the decline in economic viability was to attempt to change the political settlement. This was the so-called Second Revolution of 1974-5, which set up a one-party state and sought to impose serious restrictions on organizational rights. Whether this move could have succeeded in moving the system to a more favourable tradeoff frontier is questionable given the fact that the Awami League was a party dominated by the petty-bourgeoisie whose interests were most threatened by restrictions on clientelism. The coup of August 1975 made this a moot question. The subsequent period of military government has shown however,
that it is extremely difficult to improve efficiency conditions in Bangladesh, because of the way in which the middle classes have evolved. Attempts by military regimes to restrict organizational rights have met with quite successful political opposition.

Some of Rehman Sobhan's recent writings have been dedicated to showing that the post-1975 denationalized enterprises have not performed significantly better than the enterprises still left within the public sector. There is some evidence that the denationalization strategy of the post-1975 military and quasi-military regimes was a part of their overall attempt to attack what we have called clientelism. If we look at the evidence from the public and the private sectors, we see that in both sectors, military governments attempted to curtail overmanning. The ultimate failure of these attempts, exemplified both in the statistics of manning levels, and in the growth of the 'democratic movement' over 1984-87, affects both sectors, though not necessarily equally.

If public enterprise autonomy, that is the retention by each enterprise of the surplus generated by it, was greater under 'stable' states, and this was a necessary condition for increasing the direction of resources to growth generating areas (Sobhan does not explicitly argue that this is so, and I am not convinced that this is either necessary or even one of the more important conditions), then in the terminology developed in Chapter Two, it may be argued that the implicit causality proposed by Sobhan is of the form:

Improvements in Stability Conditions \rightarrow Improvements in Efficiency Conditions.

With a downward sloping frontier, this could occur if greater stability improved the tradeoff over time, so that choosing points such as X rather than Y along \( T_3 \) in figure 9.1, would result in the frontier moving to a position such as \( T_4 \), allowing viable improvements in efficiency conditions.
The possibility of such cumulative interactions between stability and efficiency conditions is an important and interesting possibility, but should not obscure the essentially distinct processes which are involved. Historically, the stability imposed through the state by a dominant class has often been the pre-requisite for a period of accumulation and growth. But adequate stability conditions may not necessarily imply favourable efficiency conditions, and in fact, it is not difficult to find historical examples of countries which have managed to step up accumulation during, and indeed by means of, intensifying the class struggle between surplus accumulating and surplus consuming classes.

§ 9.5 Productive and Unproductive Sectors

The allocation of the social surplus has been at the centre of a venerable debate within classical economics on the demarcation of productive and unproductive sectors. The output of productive sectors were a net addition to the social product but unproductive sectors essentially redistributed the social product already produced, perhaps transforming it in the process, but without adding to it. In his Tableau Economique, Francois Quesnay initiated the debate as long ago as the eighteenth century, identifying agriculture as the only productive sector. But it was perhaps Adam Smith's dual analysis of the distinction between productive and unproductive labour, on the one hand in terms of whether the activity added value, and on the other equating this with a distinction between goods and services, which specifically induced Marx to contribute to the debate. Already in Smith, the condition of surplus creation is implied by the notion of productive labour according to the first of the two criteria suggested. The second however, does not quite correspond with the first since it rules out services from the domain of productive labour.

Marx's contribution was to point out that in the capitalist surplus appropriation system, a definition of productive labour should be consistent
with the objective productive requirements of the system. Productive labour was therefore labour which produced surplus value. Clearly, unproductive labour was a drain on the dynamic possibilities of the capitalist sector, since whatever the use value it produced, it did not augment the surplus in the capitalist sector. This simplicity is lost, however, when a detailed specification of productive and unproductive labour is attempted, and Marx's own sometimes conflicting observations have not helped to resolve the problem.\textsuperscript{35}

The argument in \textit{The Theories of Surplus Value}, Part I, looks at the demarcation from the point of view of the individual capitalist. At this level, the problem is relatively simple. All labour sold to capitalists is engaged in the production of surplus value and is therefore productive.\textsuperscript{36} In his more considered analysis in \textit{Capital Volumes Two and Three}, Marx modifies this position by looking at the problem from the point of view of the capitalist class as a whole. Now, even though labour may 'produce' a surplus for the individual capitalist, it may not contribute to the increase in the total surplus. In other words the activity may be simply redistributing the surplus already produced without augmenting it. Activities like stock market trading readily come to mind, but Marx demarcated a whole range of capitalist labour employment which were 'unproductive' in this sense. Included in the unproductive category was the circulation and exchange sector covering banking and trade,\textsuperscript{37} and activities which cover the protection of rights, such as legal proceedings, contractual agreements and so on.\textsuperscript{38}

The logic behind Marx's sharp distinction between the production sector and the circulation sector is that the expenditure on the realization of commodities, or the protection of property, while a necessary expenditure in this social context, is nevertheless a deduction from the surplus produced. Workers employed in this sector do not produce any more surplus, even though the market may give capitalists operating in these sectors an average rate of
return on their capital, including the variable capital advanced. The flaw in this logic is that in a general equilibrium context, and the analysis of the three volumes of *Capital* clearly refers to a competitive determination of prices and quantities, it becomes almost meaningless to distinguish between the necessary and the direct costs of producing surplus.

Let us take the case of retailing or security services, two sectors argued to be unproductive. If we assume that the price and quantity supplied of both these services are determined in the market, the price and quantity supplied of all other goods and services would be interactively determined in equilibrium, as would the total social surplus produced. It is not as if a social surplus is first produced in a specifically productive sector, and the indirect necessary costs of production (given the specific social context), like retailing and advertising are then met from it.

Whether the resources for the 'unproductive' sectors are provided temporally prior to the production of the surplus, (from 'capital') or subsequent to the production of the social surplus, (from 'revenue') and therefore constituting a deduction from the surplus, is an analytical problem created by Marx's conception of the production of the social surplus. The capitalist surplus is undoubtedly produced, but it is produced in a generalized value form and not all of it is produced in factories. Marx actually frequently switched between the factory based conception of surplus production, and the socially integrated conception of surplus production, a tension which also surfaces in the conflict between his embodied labour version of the law of value and the socially necessary labour time conception of value. It seems to me that the controversy over productive and unproductive labour has been to a large extent created by Marx's implicit use of the factory-based conception of the production of surplus value in this case. The result is that he would have no problem in
including luxury goods (or armaments) in the productive sector, but banks and accountancy firms created conceptual problems for him.40

Our critique of the marxist distinction between productive and unproductive labour does not imply that the sectoral allocation of the social surplus is not important for the volume of social surplus produced. What is being said is that the dichotomy between productive sectors on the one hand and unproductive sectors on the other is not very helpful, and the analytical basis on which Marx made the particular distinction between production and circulation is internally flawed. Different patterns of surplus allocation may quite reasonably be expected to have quite different implications for output and surplus production within the capitalist sector, and consequently for the subsequent growth of the capitalist sector. The question is really about analytical frameworks appropriate for the analysis of these differences.

Instead of a dichotomy of sectors, we identified a range of outcomes in terms of alternative assignments of rights over assets and their implications for dynamic surplus allocation. All capitalist societies have retail sectors, police forces and insurance firms. The dynamic implications of the relative size of the 'unproductive' sector in different capitalist countries is not simply deducible as a 'drain' from the productive surplus because of the analytical problems with this approach: the implications for domestic surplus production would depend on the necessity of these activities, that is on whether production could be increased with a different allocation of resources. The question would then be to look at the factors which prevented this more efficient allocation of resources from coming about.

Our analysis suggests that countries with similarly large 'unproductive' sectors defined in the classical way may perform very differently, in terms of surplus generation over time, given differences in the assignment of rights
over assets, and particularly the kinds of surplus appropriation processes they support. We have also seen that some patterns of employment generation may also result in a reduction of the investible surplus, if they are part of clientelistically exploiting coalitions. In terms of the effects on surplus generation, if not in its analytical basis, this type of employment may be termed 'unproductive' in the marxist sense.

The developing capitalist countries in fact became a subject for marxist research following the application of a surplus allocation approach to the problems of development in the work of Paul Baran. Baran's innovation of the 'Actual' and 'Potential' Surplus allowed him to distinguish between two different conceptions of what we have called the Investible Surplus. The Actual Surplus roughly corresponds to the Investible Surplus after current wasteful deductions of surplus (corresponding in our case to the deductions of the clientelistic coalition), while the Potential Surplus could be interpreted as the Investible Surplus without such deductions. The development problem was that the Actual Surplus was small, though the Potential Surplus was large relative to output. The structure of Baran's argument is thus quite similar to ours, since he is also concerned with explaining why growth maximizing allocations of surplus do not come about.

The details of Baran's study are however quite different, but unfortunately, his conclusions and generalizations have been much more influential than his methodology. In Baran's argument the Actual Surplus was small because a coalition of feudalists, compradore merchants and monopoly capitalists controlled the state and were engaged in unproductive consumption and surplus export. The crux of the analysis is the assertion that this coalition had 'nothing to hope for from the rise of industrial capitalism which would dislodge it from its positions of privilege and power'. It has been pointed out that such a coalition was also in control in what are now the
industrialized countries at a similar stage of development but did not and could not prevent the transition to industrial capitalism. The distinctive features of developing countries which could explain the qualitatively greater hold this coalition could be the role of foreign enterprises or the much weaker support offered by the state to domestic industrial capital. Baran makes much of the first possibility, but it is not convincing that foreign enterprises could be held entirely, or even largely accountable for domestic surplus misallocation.

This leads to the question of the anti-industrial state, which is probably the weakest part of Baran's analysis. The state in the ex-colonies is said to be controlled by a compradore coalition, and even in the case of what Baran calls the 'New Deal' governments, composed of alliances of the progressive bourgeoisie, workers, peasants and intellectuals which come to power as a result of an anti-imperialist struggle, the threat of revolution drives the progressive bourgeoisie into the hands of the compradores and their foreign benefactors. This essentially instrumentalist conception of the state cannot explain why industrialization should not be crucial for the economic viability of even the most compradore state.

Historical evidence of the post-war period, which was of course unavailable to Baran, has shown that all 'compradore states' have, at least in their policy declarations, recognized the critical importance of industrialization in promoting the economic viability of the system. It is true that the success different compradore states have achieved with industrialization has varied from case to case, but it is precisely this which has to be explained, particularly since some of the successful cases included compradore states par excellence, such as Taiwan's KMT regime, expelled from mainland China by Mao's anti-compradore alliance. Most of Baran's successors, for instance those in the 'dependency' and 'unequal exchange' traditions have however dedicated
themselves to the demonstration of the general characteristics of neo-colonial imperialism. We will not discuss these arguments further since their limitations have been extensively discussed in the literature.44

Some contemporary analyses of surplus allocation have avoided the problem of the state altogether, attempting to revert to the classical marxist definition of 'productive' and 'unproductive' sectors. A case in point is Wolff's empirical analysis of the post-war productivity slowdown in the American economy.45 Although the work deals with an advanced capitalist country, the problem he addresses is very similar to ours: why did a particular economy, in this case the American, perform less well in terms of productivity growth than many of its competitors. The solution too bears a resemblance, because the answer is sought in the pattern of allocation of the surplus in the American economy.

All 'circulation' activities and activities protecting and transferring claims on the social product are classified as unproductive. On the basis of this definition, Wolff decomposes eighty-seven-sector input-output tables for the American economy into productive and unproductive sectors, and all product flows are classified by subscripts showing the character of the input and output sector. This decomposition is also done for the other components of the standard Leontief framework: the matrix of value added flows showing sectoral income generation by type of income, the final demand matrix, the employment vector and the capital vector. The object is to quantify the resources and labour directly used in the productive sector, which is understood as the sector which alone contributes to the creation of value and surplus value.

The most striking feature about the empirical results is that the share of unproductive activities in the economy remains more or less stable, particularly after 1958, and does not show any correlation with the productivity trend, particularly the dip in the total productivity growth rate.
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after 1967. To reconcile the empirical observations with the structure of the theory, Wolff has to derive the result from a constant-returns-to-scale Solow growth model for the productive sector. Labour and capital used in the unproductive sector are set at fixed shares of the output of the productive sector. With a constant and exogenously given rate of growth of total labour supply and a constant savings share, it is shown that the total factor productivity growth rate of the productive sector tends to zero. This analytical result clearly depends less on the insights provided by Marx's analysis of productive and unproductive labour, and rather more on the specification of the Constant Returns Cobb-Douglas growth model, a possibility Wolff quite explicitly recognizes.

It is quite possible that part of the poorer productivity performance of the U.S. economy relative to West Germany and Japan was due to a greater degree of inefficiency in the allocation of the social surplus, but our analysis suggests that this need not be 'revealed' by the absolute or relative size of the circulation sector in the United States. It could be that the state in the United States is less able to allocate resources efficiently, due to say its relationship with specific sectors, which hampered dynamic efficiency in resource allocation. The possibilities available to the U.S. state need, however, to be examined historically, and unfortunately are not immediately amenable to rigorous mathematics.
Notes to Chapter Nine

1. See for instance the famous passage relating the specific form of the state to the 'direct relationship of the owners of the conditions of production to the immediate producers', Marx [1981], Capital Vol. III p. 927.

2. See K. Marx, Correspondence to Engels of 2nd April 1858, in Selected Correspondence.


6. The initial work by Dobb is in Dobb [1963] with the more important contributions collected in Hilton [1984a].

7. See for example Melott [1982] for a sympathetic resurrection, and in particular pp. 105-13 on China. The concept clearly has severe theoretical problems with its internal logic, within the framework of marxist class analysis. Despite the excessive formalism of their own approach, Hindess & Hirst [1975], give a good theoretical critique of the AMP. Its rejection by Perry Anderson on the basis of a historical comparison of China and the Islamic world is, if anything, more damaging. Anderson argues that the differences between the societies, including those in the structure of landownership, the organization of towns, the structure of the state bureaucracies, the relative role of secular and religious morality, the dynamism of indigenous technology, and the importance of hydraulic works, is so great, that a common analytical framework is misleading. In fact, one of the only things they had in common was that neither had egalitarian villages, Anderson [1979] pp. 462-549.


9. The key works were Rudra, Majid & Talib [1969], Rudra [1970b], Rudra [1971], Utsa Patnaik [1971a], U. Patnaik [1971b], U. Patnaik [1972a], U. Patnaik [1972b, c], Paresh Chattopadhyay [1972a] and P. Chattopadhyay [1972b]. The definitional problems partly resulted from being unable to decide whether the farm, sector, national, or world economy was the appropriate unit of analysis. But the main problem was that the existing framework afforded little opportunity to break out of the abstract feudai-capitalist dichotomy and that also as the concepts had been developed in the marxist classics a century ago. Attempts to break out of these restrictions had already produced the departures in Latin American dependency theory with its emphasis on world economy. Blomstrom & Hettne [1984] provides a useful summary of the range of contributions, but for the limitations of the approach despite its achievements, see for example Patnaik [1981]. In India, the major innovation was the 'Colonial Mode of Production', developed in Panneers [1972], Ali [1975] and Ali [1982], which despite its theoretical inadequacies; (nobody pointed out, for instance, what the specificity of the 'colonial' forces of production were,) did point out some of the specificities of capitalism in the third world. The real problem
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with the latter works is that while they are historically rooted, they are all too brief to satisfactorily present a view on the question of epochal transformations which is their chosen subject, a point made by Terry Byres, in Byres(1985) p. 12.


15. Bienefeld(1982) presents a collection of article covering national responses over a range of countries.


18. Anupam Sen(1982) In explaining the obstructions to industrial growth in India, Sen argues that the state consciously limits the growth and power of the industrial bourgeoisie to maintain the historical autonomy which the Indian state enjoys. The historical evolution of a relatively autonomous state may be accepted, but it is not clear why the state should take such pains to maintain its hegemony over the two contending classes, the bourgeoisie and the petty-bourgeoisie, (ibid, p. 124). One possible interpretation of the historical record would be to point out the state’s motivation to maintain its political viability, With India’s relatively much more developed industrial bourgeoisie and industrial production, the potential threat to accumulation conditions was less readily apparent. It was also a price which the sophisticated Indian industrial bourgeoisie were for a time prepared to pay.

19. Alavi has developed his ideas on the state and economy over a series of articles: Alavi(1973), Alavi(1976), Alavi(1979), Alavi(1980), Alavi(1982a), Alavi(1982b), and Alavi(1983). The concept of the ‘overdeveloped state’ clearly emphasizes some aspects of the post-colonial state and not others, and has been criticized for instance in Levy(1976). Anupam Sen has pointed out, in Sen(1982), that to some extent, imbalances within the Indian state structure and its relative autonomy preceded the colonial impact, which makes the pre-colonial history also relevant to the analysis of the present. The importance of Alavi’s historical approach is paradoxically underlined by some of his theoretical critics. One example is Ziemann & Lanzendörfer(1977), who argue that because the economic base is now the world market, it is inappropriate to separate the post-colonial superstructure as a unit of analysis, without recognizing this fact. Their argument is, however, at a high level of abstraction. They correctly point out the fragmented nature of classes, such that “the consequence is
with the latter works is that while they are historically rooted, they are all too brief to satisfactorily present a view on the question of epochal transformations which is their chosen subject, a point made by Terry Byres, in Byres[1983] p. 12.


12. See for instance Rowthorn & Gilv[1987].


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that interests are realised and accommodated less and less within the social process and are mediated more and more by the state. Thus the state becomes the actual forum of class struggle and class relations." p. 162. But because the argument is at a high level of abstraction, it is impossible to proceed to ask why some states and societies fare better than others in identifying and implementing growth-oriented policies.


24. The deceleration debate, while it raised many important and interesting issues about the Indian economy, unnecessarily exposed itself to statistical criticism by focussing on and trying to explain selective figures of economic growth. For a critique of its statistical basis, see for instance K.N.Rai(1984). This could have been partially avoided by a greater use of inter-country studies. For a good survey of the issues raised, see Nayyar(1981), and also Ragchi(1981) and Rangarajan(1982a).

25. Ashok V. Desai(1981) argues that the two conventional arguments explaining the low rate of industrial growth; namely that terms of trade had moved against industry and that income distribution had worsened demand, were statistically unsustainable. He sees the proximate cause in rising capital-output ratios, which he explains by reference to the politically irrepressible demands for jobs by what he calls the strongest political class in the country: the 'petty-bourgeois haute-proletarian with a little education and less property'. Ibid p. 390.


28. Bardhan's thesis was extensively discussed at a conference held at the MIT in 1983 whose subject was the political economy of slow industrial growth in India. One criticism, made by A.K.Sen, was that such class conflicts were also a feature of societies like S.Korea which had not suffered. A.Kohli went further, arguing that the problem was not intra-elite class conflicts, but democracy, which exposed the state to wasteful pressures. This understandably raised the objection from other participants that not all dictatorships had performed well either. The conference, summarised in Varsanney(1984), also points out the need to extend the framework proposed by Bardhan.


33. In what turned out to be an extremely perceptive article, Umar predicted the destruction of the Awami League by the state in 'The Anti-State Awami League', reprinted in Umar[1980] pp, 76-8: "...there has now developed a contradiction between the forces which want to get rich by plunder and smuggling and the forces which want to organize the exploitation of the people through production. The traditional coercive machineries and the bureaucracy normally remain on the side of the latter... A situation will finally reach when this contradiction between the two will become quite irreconcilable and this state, in order to preserve itself, will have to make an attack on the Awami League as a ruling political organization and substitute it by something else."

34. See for instance Sobhan & Ahsan[1983] and Sobhan & Mahmood[1986].


36. This is the interpretation adopted in Theories of Surplus Value, Chapter IV, but even here there are contradictions in Marx's interpretation, as pointed out by Mandel in his Footnote 43 on p, 40 of the introduction to Marx[1978], Capital Vol, II.

37. The interpretation presented in Chapter 6 of Capital Volume II, and Chapters 16 and 17 of Capital Vol, III.


39. Chapter 17 of Volume III of Capital is dedicated to showing how this is possible.

40. Marx's contradictory approach surfaces in the 'Results', cited above, where after discussing unproductive labour, he discusses the transformation of the worker into the collective worker as a consequence of the social nature of production, pp, 1052-5. In Capital Vol, III after discussing in Chapter 16 why the pure form of commercial capital does not add to surplus value, Marx ends the chapter discussing how it can; by reducing
turnover time or expanding markets, it is not really clear why the 'pure' component of realization activities is not also seen as an integral part of production since it creates both use value and exchange value.

41. Baran[1973].


44. See for instance Chilcot[1974], Seers[1981], and Brewer[1980].

45. Wolff[1987].

46. For the productivity trend figure see Wolff[1987] p. 89. The decomposition results for the share of unproductive labour and capital in the total are presented in a number of tables, but particularly Table 5.1 on p. 105 and Table 5.9 on p. 117.


In recent years, analysts within the neoclassical tradition have also turned their attention to the state. In common with most neoclassical analysis, the level of development of the economy studied rarely enters the analysis explicitly, so that much of the work on 'rights' in fact claims generality in its applicability to a variety of social contexts. Work in this tradition has concentrated on the analysis of the micro-efficiency of different structures of rights. The implications of neoclassical economics for an analysis of the state has been summarised elsewhere, we will only look at some contributions which are relevant for our discussion of the state.

§ 10.1 The State and Market Failure

Neoclassical interest in the state derived from the analysis of property rights. In a seminal article, R.H. Coase showed that under certain restrictive conditions, in particular zero transaction costs, externalities would not affect the competitive (ie Pareto optimal) equilibrium being reached. Compensating payments would be competitively arranged, irrespective of the institutions, in the sense of rules of compensation, which were available. It needs to be stressed that while 'institutions' in the marxist or Keynesian frameworks refer primarily to arrangements which create or maintain a particular distribution of assets, in the neoclassical model, they refer only to specific 'rules' for the exchange of assets whose user is not immediately obvious. For instance, a factory compensating villagers for smoke damage, and villagers paying the factory to limit output constitute different 'rules'. In fact, however, we shall see that rules cannot be seen independently of the rights which underpin them.

At its simplest, conventional neoclassical analysis would be concerned to show that unconstrained bargaining would be optimal irrespective of the rules. In other words, it does not matter whether the imposer of previously non-
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commoditized costs is persuaded to compensate the pre-bargaining loser, or cut back the offensive activity in return for some compensation from the loser. If the resulting arrangement is competitively arrived at, and there are no legal restrictions to the bargaining, the outcome is bound to equalize revenues and costs at the margin. Coase's argument is really only an extension of the neoclassical analysis, with the difference that property rights are defined over costs and benefits which are not normally traded. The outcome is then in a sense definitional, since if property rights over externalities exist, they cease to be externalities.

Coase's work however, provided a framework for raising the question of institutions within neoclassical theory. First, if one or more of the restrictive assumptions of the neoclassical framework are relaxed, externalities may no longer be overcome by simple compensatory arrangements, and the market outcome, in the absence of adequate offsetting institutional arrangements, would be suboptimal. The most obvious case would be one where transaction costs were significant. State activities are then seen as a rational response to 'market failure'. This has generated a largely normative literature for assessing state intervention. The problem with any concept of market failure is that it necessarily incorporates some notion of what markets ought to achieve. If all costs, including costs of transacting, forming new institutions or breaking up monopolies and cartels were correctly imputed, all competitive outcomes would be definitionally optimal. Thus if some competitive outcomes are argued to be sub-optimal, the observer is implicitly making judgements about the 'data' of the model: the prior distribution of assets and preferences.

Transaction costs have nevertheless been innovatively used to study institutional developments, particularly in the work of Douglass North. An incomplete specification of property rights (externalities) and measurement
costs leads to free-rider problems and a loss in terms of allocational efficiency. Institutions which overcome free-rider problems would thus improve allocational efficiency. The legitimacy of property rights aids efficiency by overcoming free-rider problems and thus lowering the transaction costs associated with the enforcement of contracts. The link between legitimacy and efficiency in this model may be compared with the analysis of legitimacy in Chapter Six. There we saw that an increased legitimacy enjoyed by existing asset-holders would lower the probability of clientelist payoffs, and from Chapter Eight we could expect this to result in a more favourable tradeoff which would in turn allow more efficient interventions by the state.

The neoclassical model does not make distinctions between different categories of rights, primarily because efficiency is defined in terms of static allocation and not in terms of the generation and allocation of the potential investment fund. Our analysis points out that strengthening certain types of rights, or ideologies which overcome certain categories of free-riders may have negative consequences for dynamic efficiency. For instance, if organizational rights are unequally distributed, reducing the costs of enforcing such rights would help rather than hinder clientelist surplus appropriation which would in turn lower dynamic efficiency. Similarly ideologies which overcame free-rider problems for the clientelist coalition, for instance by legitimizing opposition to existing right-holders, would aid clientelist lobbies by reducing the transaction costs of organizing pressure. Such ideologies would also be self-perpetuating once they came into existence because their viability would be demonstrated in terms of increased payoffs.

§ 10.2 The State and Side Payments

A second point of departure from Coase's analysis is to ask whether, even if all the restrictive conditions held, our assessment of the efficiency of bargaining outcomes could really be entirely independent of specific
compensatory institutions (or rules) being applied. Rules may not necessarily be fair or consistent with the rationality assumptions implicit in neoclassical analysis. For instance, a rule which allowed sufferers from pollution to bargain for compensation with the factory concerned would be immediately perceived as rational, but a rule which allowed someone unconnected with the production of the factory to gain 'compensation' would not.

This is because the compensatory arrangements or rules really reflect rights. The right to clean air is implicitly recognized, an infringement of which is a cost, and for the Coasean outcome to work, smoke has to be recognized as the 'property' of the factory. On the other hand, we normally do not recognize the rights of persons unconnected with production to bargain for a share of the product. The bargaining process behind the formation of rights and consequently of rules, is thus important, bringing up the question of further bargaining counters which may be relevant to this prior outcome.

Institutions in the neoclassical world are clearly only rules for making 'side payments'. The parties engaged in the exchange of conventional assets, also engage in bargaining over externalities, non-divisible commodities and so on, over which rights have been established. Instead of just being concerned with the exchange of apples and oranges, we are now also concerned with the exchange of 'the right to fresh air' and 'the right to produce smoke', both of which are 'owned'. Either of these rights, 'the right to fresh air' or 'the right to produce smoke' can be partly 'purchased' by the other side by the payment of a compensation, (the side payment) and the outcome is shown not to depend on the 'rule'. The outcome clearly would be different if one or both of the parties did not possess the right in question. The state enters the picture by enforcing both rules for making side-payments and the side-payments which are negotiated.
Questions can now be raised about the effects of specific rules on the bargaining outcome or the confidence agents have in such rules for 'side-payments'. Institutional distortions may well be more important than market imperfections in explaining notional 'misallocations' in developing countries. This is the point made by Lipton in a paper analysing why developing countries tend to stay away from efficient Coasean outcomes:

Studies of one after another LDC market - credit, labour, sale of farm products - reveal few signs of 'market failure'. What they reveal is far worse. Market success produces slow growth, and limits the benefits of such growth largely to better-off, less risk-averse, less present-time-preferring transactors. Such transactors tend to be from bigger, more capital- (and import-) intensive firms, who use their power to persuade State agents to set prices, roads, market conditions, research priorities, etc, in ways that favour size and capital-intensity.

These developments introduced into neoclassical analysis the economic significance of politics and the state. If rights over resources are defined to their fullest extent, then given the initial distribution, exchange produces the most efficient static allocation. But in the case of institutional arrangements, it sometimes appeared to neoclassical economists that rights are more often 'attenuated', or restricted in their extent, often because of specific political decisions. This is really only a recognition that rights by their nature, including rights over physical assets, imply that the state can be mobilized to deny this right to others. This may not be directly obvious in the case of physical assets, because the owner is in possession, and this particular right is not really contended except in exceptional circumstances.

The problem arises in the case of assets which are not directly in the possession of the claimant, such as subsidies or other side-payments, where, because the neoclassical economist (inconsistently) adopts an egalitarian rationality, the structure of rights appears to be 'attenuated'. In fact this case may be seen to be symmetrical with the conventional physical asset one.
In both cases, some groups and classes are able to persuade the state that their rights over specific physical and non-physical assets needs to be sustained. There does not seem to have been a clear recognition within the neoclassical tradition that this is an analytically prior and historically specific 'bargaining' process, which clearly has important consequences for the subsequent bargaining outcomes in the ways which are being increasingly recognized. Nevertheless, there has at least been a realization that a theory of property rights cannot be truly complete without a theory of the state.  

The incompleteness of the neoclassical argument, in terms of its own logic, lies in its treatment of the state, and the way in which these prior rights have come about. What these institutional arrangements reflect are distributions of bargaining power vis-a-vis the rule-making body: the state. Conceptually, the basis for the clearly unequal access to the state enjoyed by different classes and groups may be seen in terms of an analytically prior bargaining outcome. In neoclassical terms, we can model the determination of a range of rights in terms of a 'trade': a number of groups possessing specific 'assets' which are perceived to be important by the state are able to use these as the basis of a trade with the state in which the latter is persuaded to formulate rights and rules for side-payments, of which the protection of conventional property is just one example. But the 'assets' being traded in this conceptual representation of a historical process are not ordinary economic assets, since there is no explicit market for them; they may only be conceived of as the contributions which specific classes or groups are potentially able to make to the social process describing the viability conditions of the state.

Such assets are therefore to some extent dependent on the subjective perceptions of the state, but primarily depend on the historical interactions of different classes with the state. In developing countries, the state may
well be persuaded of the externalities which lie in the way of industrial development and consequently agree to subsidize industrial development in its own perception of interests. Distinct from any short-term inducements they may offer state decision-makers, industrialists are arguably trading their potential to improve the long-term economic viability of the system for such favoured treatment. Other groups such as the educated middle classes are also able to gain concessions from the state simply because they can bargain with their ability to disrupt the political stability of the state. In this case, the asset which allows a particular class to bargain for a set of side-payments is clearly quite different.

It has long been recognized that any particular competitive outcome is specific to the initial distribution of assets and preferences. What also needs to be understood is that the distribution of assets, both physical assets and such assets as organizational rights, comes about through a process of bargaining and struggle which is historically specific. The outcomes which are arrived at, however, are not only of fundamental importance for the subsequent exchange outcome of neoclassical economics, but also, as we have argued, for the growth prospects of the economy.

In the context of his analysis of 'Coasean' versus 'Prisoner's Dilemma' outcomes, Lipton suggests that democracy may be one way of encouraging Coasean outcomes. This is because Coasean outcomes require participants to have confidence in laws about side-payments, which in turn requires a sense that such laws are equitable. Democracy may help create that sense. It is also argued that the kind of local-level participatory and issue-specific democracy which may be vital for avoiding wasteful Prisoner's Dilemma situations, may in turn need the formal, multi-issue and centralized democracy, which is often at issue, as a protective device. This is an analytical argument, Lipton does not
attempt to provide evidence that formal democracy at the centre has facilitated cooperative, participatory, Coasean outcomes at the local level.

Lipton's conclusion depends on neoclassical analysis being neutral on the question of surplus appropriation. Allocations of assets which support quite different surplus appropriation processes are not distinguishable. Any bargaining outcome which is competitively arrived at, when ancillary conditions like confidence in and ability to contract side-payments are satisfactory, is as good as any other competitive outcome in terms of static efficiency. The ancillary conditions which promote the attainment of static efficiency are improved under democracy. Hence democracy results in better outcomes. The prevalence of dictatorship in most developing countries (in one form or another), can then be seen as an irrational imposition of brute force, and additionally as one which encourages Prisoner's Dilemma wastefulness.

The analysis of clientelism in Chapter Six suggests that democracy may have important implications for the distribution of organizational rights and thus for the per capita clientelist payoff per organizer. The very unequal distribution of organizational rights in developing countries explains why with a given level of policing ability and legitimacy, attempts by the state to reduce the likelihood of clientelist payoffs lead to restrictions on organizational rights. In figure 6.3, this is shown as the upward sloping segment of the payoff per organizer curve. Of course if democracy actually led to such a widespread distribution of organizational rights that the downward sloping segment of figure 6.3 became relevant, further extensions of democracy would be efficient. In practice, given the distribution of material and educational abilities, the downward sloping segment of the curve is not attainable in most developing countries where a qualitative organizational gap exists between the vast majority of the population and the five to fifteen percent who organize, lead and benefit most from democratic movements.
The implication is that the process of democratization in poor countries is a more problematic process than neoclassical analysis suggests. Since democracy is a desirable process, this directs our attention to strategies which can either combine the spread of organizational rights with changes which lead to a lower maximum payoff function (figure 6.2), for instance through increased policing, or strategies which can rapidly take us from the upward sloping to the downward sloping sections of figure 6.3, for instance by ensuring that the spread of organizational rights (in terms of the relative growth of organizers, the organized and the number of countervailing groups) is such.

§ 10.3 Institutional Adaptation to Partial Markets

'Attenuation' of rights, or the absence of a full specification of rights over all assets relevant to production and consumption need not necessarily be an outcome of the interaction of classes with the state. It could also be the result of an underdeveloped or simply somewhat different history of institutional adaptation. Interest in the structures of communication in exchange processes has resulted in the study of institutional arrangements which appear to be suboptimal but nevertheless continue to exist. One example is Geertz's study of clientelism in the 'bazaar economy'.

To avoid terminological confusion, it should be pointed out that Geertz's clientelism is defined as a sustained pairing of buyer and seller over a series of trades, and is to be clearly distinguished from our clientelist exploitation. Geertz argues that because control over information is not just a problem but also a source of profit, the development of clientelist structures is a rational response to the absence of a market in information. Competition here is intensive, the investment in search being concentrated in a few intersections to achieve the best possible package deal, rather than extensive, with search over a large number of agents concentrating only on the price specification. Nevertheless, competition and even price competition is here no
less aggressive than in 'market economies'. Thus clientelism, which is usually perceived as a monopolistic arrangement which survives precisely because of the underdevelopment of markets and competition, thrives in a highly competitive environment and reproduces itself only because it is able to exploit this environment so well.

The case of partial markets is actually not very different from that of partial rights, because the former is ultimately reducible to the latter. If rights over information were better defined, a market would appear. What is different in this case is that the 'right' to information does not seem to be specifically protected or denied by the state, though there is presumably some social mechanism which gives some agents a privileged access to this scarce resource. Geertz does not speculate on the social basis of partial rights and the possibility of conflicts between 'market' and 'bazaar'. The clientelist context described by Geertz would also make particular sense when production is underdeveloped and the commodities exchanged have not been produced with commodities largely or entirely originating from within the system. This would enforce an objective limit on the range of prices over which production would be profitable, and reduce the scope for discretionary behaviour.

§ 10.4 Bureaucracies and Rent Seeking

The shift of emphasis away from firms and consumers towards a more general consideration of rights has also enabled neoclassical economics to approach the modelling of bureaucracies. Most of the models developed are, however, based on specific assumptions whose transferability is limited even within the advanced countries. Niskanen's work which influenced most of the subsequent research assumed a budget maximizing bureaucracy, financed by budget rather than sale of output and with monopoly powers vis-a-vis the legislature. Within this tradition, the work of Breton and Wintrobe is the most interesting from a developing country perspective.
They start from the observation that given a particular formal structure, the bargaining power of bureaucrats derives from their ability to supply informal services (which can be either efficient or inefficient in terms of the outcome), as demanded by others in the hierarchy. However, since these exchanges are not, and cannot be, supported by a structure of enforceable property rights, Breton and Wintrobe develop a theory of the production and accumulation of 'trust'. Trust in this model is an objective variable which may be accumulated by an individual vis-a-vis another by the foregoing of opportunities now, in the hope of being able to use this as the basis of trade later. This is an interesting analogue, at the intra-institutional level of the two-stage bargaining outcome we referred to above.

The supply price of informal services is a function of trust; and individuals, networks of individuals and entire bureaus compete in the market for informal services, allowing the model to derive testable comparative static results. One result, for example, is that an increase in competition within bureaus, as demand increases to enter particular networks, may actually increase the ability of bureaus to selectively offer informal services, which implies an overall decrease in efficiency if inefficient informal services are being provided. This particular result obtains because although competition reduces rents accruing to individuals in networks, the increase in demand increases the total supply of informal services, producing a result which is ostensibly counter-intuitive. In contrast to most others, this model is of greater relevance in a developing country context, where the discretionary powers of many bureaucracies are far greater, while the attractiveness of informal returns is greater because even monetary payoffs can be quite openly bargained and exchanged within bureaus. What Breton and Wintrobe do not discuss is the question of the constraints on the bargains engaged in by the bureaucracy as a whole, in its dealings with the outside world.
The important question of how bureaucracies and the outside world interact has been the subject of neoclassical work on corruption and rent seeking. Corruption is a phenomenon which involves the simultaneous analysis of bureaucracies, institutional adaptation, and economic outcomes. A concise market-based definition of corruption is provided by Robert Tilman:

Corruption involves a shift from a mandatory pricing model to a free-market model. The centralized allocative mechanism, which is the ideal of modern bureaucracy, may break down in the face of serious disequilibrium between supply and demand. Clients may decide that it is worthwhile to risk the known sanctions and pay the higher costs in order to be assured of receiving the desired benefits. When this happens bureaucracy ceases to be patterned after the mandatory market and takes on characteristics of the free market.

Two important questions arise: when do some bureaucracies act in a corrupt way, and how does it matter? Weber's name is associated with one of the classic answers to the first question. He puts the transition in a historical framework, identifying the non-corrupt characteristics with a 'bureaucratic' state, which evolves from a pre-bureaucratic system. In the latter, office-holding is legally and actually considered to be a source of income (which we may interpret as a specific kind of property right), whereas in bureaucratic systems, the office-holder accepts a specific duty in return for a secure existence. The transition was seen as a historical process of state formation as the feudal states in Western Europe were impelled towards greater rationality in revenue collection and use.

Although he uses the construct as an 'ideal-type', Weber is careful not to imply any automatic economic consequences of the 'rational bureaucracy'. For instance, he considered the relatively 'moral' German bureaucracy, in the state guided contemporary system, to be less useful for economic efficiency than relatively less moral alternative bureaucratic structures which could better cooperate with private capital. This would also be implied by a neoclassical analysis which saw corruption as a response to disequilibrium. However, like
all second-best outcomes, the allocational efficiency of a corrupt bureaucratic system would in general, remain indeterminate within neoclassical analysis.

To get determinate results in this analytical tradition, specific assumptions have to be made. One example was Breton and Wintrobe's analysis which examines the equilibrium supply of bureaucratic services, but does not address the problem of identifying the conditions under which efficient or inefficient informal services will be traded. Another neoclassical response has been the development of the literature on 'Rent-Seeking'. Rent-seeking is defined as activity and resources devoted to capturing potential rents created by quantitative restrictions imposed by the state. Rent-seeking can take the form of bribery, smuggling, black-markets, or even an excess supply of candidates for state-sector jobs.

Different contributors have used a number of tools in elaborating the consequences of rent seeking. The core idea is that state intervention results in rents as described in our section 6.3. Resources are then withdrawn from productive uses as competitors seek to gain access to such rents. Since the analyses have much in common, we will look at one of pioneering works, that of Anne Krueger, who uses a production function approach. Krueger argues that competitive rent-seeking involves a withdrawal of resources from domestic production and in fact results in lower domestic output and lower welfare than a similar quantitative restriction without competitive rent-seeking. This strong result, however, is entirely dependent on the restrictive assumptions behind her analysis.

There are two sectors in her model, with one factor of production. In the agricultural sector, there is a well-behaved production function with diminishing marginal product of labour. In the 'distribution' sector, output is physically exactly equal to imports, and labour required here is a linear
function of output. The terms of trade are unity but a domestic markup on imports sets the price of distribution sector output. Krueger distinguishes between three possible cases. The first is the free trade outcome where output is optimal in the neoclassical framework. An import restriction is the second case; labour demand is reduced in the distribution sector as imports fall, and agricultural output is increased as the agricultural wage falls. Distributors now earn a rent in the sense that their wages are higher. Production is sub-optimal because the economy is on a lower indifference curve, but it is still situated on the production possibility frontier. In the third case of competitive rent-seeking, labour is withdrawn from agriculture till the return in the two sectors is equalized. Since there is no need for more labour in the distribution sector with fixed imports, this labour is purely engaged in rent seeking. Production is therefore now inside the production possibility frontier and the results follow.

The critical difference between Krueger's analysis and the possibility of efficient corruption noted by Weber lies in Krueger's assumption that rent-seeking activity can be adequately defined as a withdrawal of labour (or factors of production in the general case) from production, to equalize returns across sectors. Her result follows directly from this assumption. The weakness of this analysis is that the state is not at all in the picture, so the response of the state to economic pressures is ignored. What the state tries to achieve with its import restriction is immaterial for this analysis because rent-seeking and corruption in this case has no effect on the imposition of the import restriction. The bureaucracy is not only not analysed, it is not really corrupt because there is no change in the enforcement of the import restriction.

Although Krueger presents this as an analysis of the effects of bribery and corruption, it is strictly an analysis of the failure of corruption.
Equalization of rents is brought about not by corruption but by queuing, the enforcement of the import barrier is resolutely maintained. Officials may receive bribes, but since their services are inelastic in aggregate, those already in the distribution sector will be willing to pay bribes as much as those queuing, and it is not clear why there should be a redistribution of licences.

If the import restriction or other state intervention was not simply a 'mistake' which made production suboptimal (the criterion of the competitive market as the optimal outcome is central to the argument), but was a part of the state's industrial policy, the question would be how effectively the state chose the protected sector and how efficiently it could move out of it. The dynamic gains would have to be compared with the static allocational costs. In the case shown by Krueger, the state's choice of sector or its imposition of the control is unaffected by rent-seeking, and therefore in a comparative dynamic context, this could well be a very efficient state. Krueger's analysis does not approach the real questions of allocational inefficiency which plague some developing countries, and it would therefore be misleading to draw general conclusions about the efficiency implications of corruption in developing societies from her argument.

Micro-analyses of bureaucratic supply indicate that bureaucracies are best seen neither as ideal-type Weberian organizations staffed by neutral individuals nor as the unendearing monopolies of the von Mises - von Hayek tradition. An analysis of the effects of corruption even in terms of neoclassical efficiency criteria, requires a specification of the objective functions and the constraints on the activity of the bureaucracy and the state, and their reactions to economic and political pressures. The real question is, does the resultant activity direct resources in ways which improve or worsen efficiency, however measured. It should be remembered that in a dynamic setting where
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State intervention was an essential part of market-based industrialization, any state activity would be subject to some amount of rent-seeking.

Corruption which has an impact on the enforcement of a resource flow the state is trying to ensure is more difficult to evaluate. The efficiency of the outcome would depend on whether the intervention was efficient (growth-enhancing) in the first place, and if it was not, on whether the operation of corruption allowed resources to be claimed by more dynamic sectors, even though at a price. Given a pattern of state intervention, efficiency in resource allocation could thus increase, decrease or be unchanged as a result of corruption. The latter would be the case if the state extracted a lump sum tax from successful candidates, say for a loan, but which had no effect on the state's choice across sectors. The evaluation of the efficiency effects of corruption is therefore likely to be quite specific, a conclusion which would not have surprised Weber at all. This conclusion is also consistent with the observation of 'corruption' even in very efficient states.

Our analysis has substantial implications for the neoclassical policy conclusion that reducing the level of state intervention would improve dynamic performance by reducing rent-seeking losses. If clientelist pressures were the cause of state inefficiency, reducing state intervention would only have an indirect effect through reducing the maximum payoffs potential organizers could bargain for (figure 6.2). This would shift the tradeoff curve say in figure 9.1 marginally upwards but it would also mean moving leftwards along the tradeoff curve as the state abandoned protection of efficiency enhancing rights. Given the critical role of most modern states in maintaining the conditions for rapid growth, the net effect would probably be a lower set of efficiency conditions. This suggests that if clientelism has to be tackled, other ways of lowering the likelihood of successful clientelist pressure have to be devised.
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§ 10.5 Organizations and Externalities

A very different approach to the economic constraints set by organizations has been developed in the context of the advanced capitalist countries by Mancur Olson. Based on his earlier work on the 'Logic of Collective Action', Olson argues that while small groups are much easier to organize, they are also less likely to 'internalize' the externalities of their activities. Based on this, in his recent work on the political economy of growth he has argued that long periods of political stability in advanced capitalist countries encourage the growth of special interest groups. These groups campaign to further the interest of their members primarily by restricting entry. While this has immediate effects on static allocational efficiency, it also lowers the rate of growth because it prevents the most efficient re-allocation of resources as prices and incomes change in line with productivity growth.17

Olson argues that the 'national government' is the most 'encompassing' group in society, and if freed from the pressures of sectional interest groups, it would have the greatest incentive for promoting efficiency and growth. Two conclusions immediately follow from this hypothesis: where upheavals like revolutions and military occupations have destroyed the organization of special interest groups, the 'national government' can be expected to be stronger and growth will be faster. The longer the period of stability enjoyed by a society, the lower will be the ability of the 'national government' to ignore the interests of special interest groups. Hence societies which have been settled longer will have lower growth. Secondly, the more 'encompassing' the groups within a society, the more efficient will be the allocation of resources.

These results are meant to apply to the typical advanced capitalist country, where we can assume capitalists are politically dominant. Although Olson's analysis of efficiency loss is different from our own (he is primarily interested in restrictive practices without distinguishing between the nature
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of the rights which the claims aim to protect), we can try to look at his propositions in terms of our analysis. In figure 10.1 we reproduce the tradeoff curve facing the state when capitalism is dominant.

**FIGURE 10.1: THE TRADEOFF WITH ENCOMPASSING ORGANIZATIONS**

![Diagram showing tradeoff curve]

$A_o$ and $S_o$ are the socially defined minimum viability limits for Efficiency and Stability Conditions respectively. $T_1$ and $T_2$ refer to alternative tradeoffs, each with a particular initial assignment of rights or 'Political Settlement', and/or a different level of initial resource endowment.

The first of Olson's two major propositions may be conceptualized as follows. If a long period of stability resulted in the growth of narrowly based interest groups and in the growth of their political power over the state, this would amount to a growth in the power of the clientelist coalition within capitalism, and result in a movement of the political frontier down from a position such as $T_2$ to one such as $T_1$. Under the new political conditions, the state would have to accept inferior stability conditions, for any given level of economic efficiency. This would happen because the state would have to pay a higher political price in allocating resources independently of the demands of capitalist sub-coalitions and sectional working class interests, (conditions (d) and (e) of Table 7.1). Olson's direction of causality, Instability →
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Improvements in Efficiency Conditions, thus refers to dynamic interactions between efficiency and stability conditions which affect trend shifts in the tradeoff frontier, and may be compared to the similar but opposite kind of interaction suggested by Sobhan, where instability leads to a decline in economic performance.

Olson's second proposition is more problematic. If more 'encompassing' organizations are to be more efficient, it matters very much which interests are being encompassed and the terms under which the group is organized. If capitalists are politically dominant, and encompassing organizations of workers and capitalists exist, it is possible to see how more efficient outcomes could result in this context. We have argued that even with capitalists dominant, the state may face political opposition from workers and capitalists if it attempted to improve efficiency conditions. Particularly when major structural changes are necessary, the state may find itself on the declining part of a tradeoff curve like T1, say. In such a situation, if organizations existed which could collectively negotiate for workers and capitalists, the sectional opposition of losers could be reduced by compensatory payments from the others, negotiated through the state. As a result, political opposition to the improvement of some of these conditions, particularly (d) and (e) could be reduced, and the state could operate along the more favourable tradeoff T2.

But it is not always necessary that corporatist organizational forms will produce this result. For corporatism to work, it is necessary that the 'conditions of production' are sufficiently favourable for it to be worth the while of the majority of surviving capitalists to pay for the costs of a smooth transition. It is also necessary that the corporatist organization does not itself become a clientelist one. This could be ensured if for instance capitalists are politically dominant and can prevent clientelist coalitions.
from using the corporatist framework for sectional surplus appropriation. Another possibility is that the structure of the organization in terms of the relative number of organizers and organized is such that the payoff per organizer is below the costs per organizer (see figure 6.3). If these conditions held, the externalities of slow growth could be internalized by an encompassing organization.

On the other hand, if the state was facing a declining section of the tradeoff because of the strength of clientelist sectionalism within capitalists or workers, the introduction of corporatist organizational forms may well make the situation worse from the point of view of overall efficiency, if it gave politically powerful but deadweight sectors the opportunity to effectively exercise their collective voice. If greater political stability was achieved at the cost of resource allocation to more efficient sectors, this would be a move up the declining section of a stationary political frontier, say from Y to X along T1, rather than a move from T1 to T2.

In developing capitalist countries, the clientelist coalition is usually politically dominant because of its numerical and organizational superiority. In this context, represented in figure 9.1, corporatism is quite likely to have exactly the opposite effect from that suggested by Olson. If the interests of the clientelist coalition were 'encompassed' in a single organization, we would not expect the organization to have a greater ability to meet the conditions for dynamic allocation at any given level of political stability. Rather, we would expect the new organization to greatly enhance the political power of the clientelist coalition, or a particular section of it, by giving the coalition a unified and monopolistic organizational form for expressing its organizational rights, which is ultimately the source of its ability to bargain with the state. In other words, the coalition could then not only force the state to select more favourable points on the tradeoff curve from its point of
view, (say a move from B to A along T₄ in figure 9.1), it would be quite reasonable to expect that with the greater organizational power of the encompassing organization, the tradeoff curve would shift to a less favourable position, say from T₄ to T₃, reflecting a new 'political settlement'.

**Conclusion**

The model developed in Part II aims to direct attention to the political and economic constraints on the efficient allocation of investible resources through the state. Since a substantial part of total investible resources in capitalist countries are allocated by or through the state, or through processes which require the intervention of the state in defending or legitimating rights, these constraints play a critical role in our understanding of the differences between more and less efficient states.

The model directs our attention to the nature of the political settlement which defines the context in which the stability implications of changes in assignments of rights have to be assessed, and the 'exogenous' elements of the efficiency conditions, in particular resource availability. Taken together, they define the position of a conceptual tradeoff curve in relation to the minimum political and economic requirements. Depending on how favourable the tradeoff was, a state in such an economy would either be able to 'manage' rights to allow efficient intervention in the economy, or in the worst conceptual case, it would be doomed to alternate between interventions which resulted in cycles of economic and political crisis.

Our subsequent investigation of the industrialization experience of Bangladesh, and the role played by the state in creating or limiting growth opportunities, will be structured in line with the pointers provided by this model.
Notes to Chapter Ten

1. For a recent though partial guide, see Whynes & Bowles[1981].

2. Coase[1960]. For a review and analysis of the 'rights' literature, see Furubotn & Pejovich[1972].


6. Furubotn & Pejovich[1972] p. 1140. Thus for example, the state may institute inefficient property rights (eg a monopoly) to patronise a group or for revenue, Furubotn and Pejovich observe that a satisfactory theory of the state has yet to be developed within the neoclassical tradition. Ibid.


8. Geertz[1984].


11. Breton & Wintrobe[1982].


15. Krueger[1974]

16. Weber of course only thought of bureaucracies in this idealized way as a model with the same correspondence to reality as the Austrian concept of markets. His own knowledge of corruption and incompetence in actual bureaucracies points to this. See Jackson[1984] pp. 169-70.

17. Olson[1965], Olson[1982], and Mueller[1983].
PART THREE. INDUSTRIAL GROWTH IN BANGLADESH:
POLITICAL SETTLEMENTS AND THE STATE

Chapter Eleven The Colonial Era

Introduction

In this part of the work we try to understand the nature of, and changes in, 'political settlements' in Bengal and the consequences for state policy-makers. It follows from our discussion so far that the options open to the state may change over time. This makes the elements of historical continuity extremely useful for highlighting the aspects of change. We find it useful to identify a series of settlements between groups and classes in economic contention. The political settlement is simply a shorthand to describe the political balance which constitutes the alignments and mobilizations behind an existing structure of economic rights. Political struggles may or may not succeed in establishing a new balance or settlement. Once however a major political settlement is arrived at, the rights it supports are not infinitely variable, though as we have seen marginal changes can and are attempted.

We may expect the transfer to a new settlement to be accompanied by demonstrable shifts in the power of the groups or classes in contention, so much so that ground is conceded and a new set of relative entitlements gains political recognition and legitimacy. Such a change does not necessarily mean that a new class is dominant. A change in the relative power of classes would also constitute a new settlement. A decisive electoral outcome, the defeat of a political movement, the decision to begin or end a war, or concessions won as a result of a mass mobilization may be specific events which serve to fix a particular settlement in the popular consciousness, and give the rights negotiated under it the recognition of 'legitimacy'. A settlement, and the period for which it remains valid, is therefore a product of the political mobilization of different groups and classes. Clearly, what constitutes a new
'phase' is to some extent an arbitrary assessment on the part of the observer, but nevertheless, one which I feel it is sufficiently important to make even if only to engage further assessment.

The history of state-industry relationships in Bangladesh suggests at least three distinct periods, the colonial, the Pakistani, and the Bangladeshi, which are successively examined in Chapters Eleven, Twelve and Thirteen. On the other hand, there have also been substantially important shifts in political mobilizations within any of these broadly defined periods. Over the last three decades, we can further distinguish between three different political phases or cycles in the contemporary history of the country. A longer time-frame allows us to place these contemporary cycles in the context of much more enduring processes of social mobilization and class mobility. It also serves to point out that social conflicts which emerge in the industrial sector in developing countries often have their roots in the history of agrarian evolution, and are therefore much more difficult to 'disrupt' than might appear at first sight.

The first of the contemporary cycles began barely a decade after the departure of the British in 1947, with the imposition of martial law in 1958. This period is examined in Chapter Twelve. We will argue that the most important consequence of the 'coup' from the point of view of the industrial sector was that it ensured the limitation of organizational rights. Under the praetorian direction of the state, much more of the available social surplus was directed to a statistically minute privileged class which possessed a potential ability to invest in industry. For a number of reasons, this balance of power could not be sustained against the growing demands of the wider middle classes, whose established mode of upward social mobility had been disrupted.

To incorporate some of these demands, the regime had to accommodate in the first place, a 'civilianization' of the military government during the sixties,
which allowed previously isolated constituencies to get access to the surplus directed by the state. Secondly, particularly in the latter half of the sixties, a glaring disparity emerged in the class balance of power within the middle classes in the two halves of the country. The state's belated attempts to accommodate the much more powerful voice of the non-industrial East Pakistani middle classes came to an end in 1971 with the overthrow of military rule and the break-up of Pakistan.

Chapter Thirteen looks at the post-1971 Bangladesh period where we identify two further phases. The Awami League democracy marked the legitimation of a new political settlement. The war of independence established the dominance of the long disenfranchised non-industrial middle classes whom we loosely describe as the petty-bourgeoisie. The nationalization of industry in the context of the new distribution of organizational rights created predictable strains on the allocation of net state revenues. Although the government was short-lived, it made a number of increasingly desperate manoeuvres to attain economic viability in the context of the constraints set by growing clientelist surplus appropriation. These included an attempt to restrict organizational rights through the institution of a one-party state.

The popularly elected government was overthrown by the intervention of a group within the armed forces amidst a bloody series of assassinations of the President and his associates in 1975. This kind of intervention by the armed forces to enforce a radically new settlement has by no means been limited to Bangladesh. Quite a few developing countries have gone through, and are going through, cycles of 'democracy' and 'dictatorship' quite similar to the Bangladesh experience.

Finally we have a third phase from 1975 of military governments, each starting with the imposition of martial law, progressing to a managed democracy through
a process of 'civilianization', but facing the growth of increasingly serious political opposition. The first post-1975 quasi-military government of President Zia began to reverse some of the gains made by petty-bourgeois coalitions. Industrialists were singled out for more favoured subsidies, nationalizations were reversed and political dissent suppressed more effectively (but compared to the Awami League, not necessarily more violently). Zia too, was not isolated from social pressures, and the state's freedom of action was rapidly diluted as the result of civilianization and the formation of the Bangladesh Nationalist Party in 1978. The government was eventually overthrown as a result of internal dissent within the army which culminated with the assassination of President Zia.

The second quasi-military government of President Ershad continued the general thrust of the policies of its predecessor. More industries were denationalized, and the institutional bases of middle class demands were also attacked by a process of administrative decentralization which would disperse 'political voice' away from the cities and towards the tens of thousands of villages. However, as under previous regimes, the state faced a growing political constraint in its attempts to improve its economic viability conditions. The systematic concessions to, and the eventual participation of the government in clientelist processes was demonstrated most clearly in the political manoeuvres through which the new Jatiyo Party was formed.

The experience of countries like Bangladesh may be contrasted to say that of South Korea, where the accession of the military in 1961, and the eventual coming to power of the government of Park Chung Hee, established a much more lasting political balance, a balance which has only recently been challenged by the middle and working classes.
§ 11.1 Company Rule

At least since the eighteenth century, the history of industrial growth in Bangladesh has always been intimately linked with that of the state. The decline on the one hand of the Mughal system of land rights and revenue collection and on the other the growth of long-distance trade in the course of that century led to growing conflicts of interests within the group of merchants, financiers and nobility, who comprised the 'ruling class'. These conflicts were in turn increasingly expressed in political intrigues within the state apparatus of the last independent ruler of Bengal, Nawab Siraj-ud-Daula.

They led directly to a calamitous dénouement with the military disaster of 1757 at the Battle of Polashi (Plessey), where intrigue, deception and betrayal on the part of the nawab's main financiers and generals led to a pre-arranged 'victory' for the English against much superior forces. The new balance of physical power enabled the East India Company to install and remove subservient nawabs at the provincial capital Murshidabad, till in 1772, Warren Hastings brought the unnecessary facade of dual government to an end. An English council under a governor took over the administration and shifted the capital to Calcutta, which eventually became the capital of British India.

Before the colonial impact, Bengal was ironically a relatively prosperous and food surplus province of the disintegrating Mughal Empire and appeared to be an especially promising region for the indigenous development of manufactures. From the late seventeenth century onwards, there were indeed signs that this was taking place. The artisan sector, particularly textiles, was well-established and was the basis of a thriving long-distance trade organized by Indian merchant capital. The agricultural surplus was large enough to maintain substantial urban populations, particularly at Dhaka and Murshidabad, even when the Mughal capital at Delhi could enforce the full payment of taxes to the central authority.
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The tottering Mughal imperial system was overthrown not by a civic challenge from the emerging merchant class, but by a tiny group of marauding English traders, who in the space of 'a brief startling score of years', found themselves transformed from supplicants to the Moghul into the new masters of India.¹ Bengal, the province first brought under 'Company Rule', suffered the greatest from the early depredations of colonialism. The merchants of the East India Company had no difficulty in understanding the connection between political power and the 'gains from trade'. Bengal's textiles had undoubtedly attracted the English traders, but the way in which textiles were 'exported', ensured the destruction rather than the development of the artisan economy. The company and its servants acquired the right to move goods in the interior duty-free, depriving the nawab's treasury of revenue, and destroying local merchant capital through this process of 'exchange', since local merchants, unlike the expatriate traders, were forced to pay domestic tolls and duties.

In 1763, Nawab Mir Kasim made a final attempt to save the local economy by declaring that since the English enjoyed free trade, his treasury would henceforth absolve Indian merchants too from paying any duty. The English reaction was swift and unequivocal: the head of the company's factory at Patna attacked the city, and in the ensuing two and a half month war, the nawab's depleted army was defeated in six successive battles. Mir Jafar, the general who had betrayed Siraj-ud-Daula took over once again as nawab and the company's privileges were preserved by maintaining duties for indigenous merchants. This symbolic but rather feeble effort was in effect the last 'nationalist' stand of the fractious indigenous ruling elite.²

Artisans too were destroyed by the company trade. Prior to the English, civil and military administration had been in the hands of a tax-collecting nobility, the Indian equivalent of a 'feudal elite', who constituted an effective check on the merchants and usurers operating in the 'interstices of the economy'. It was
not in the interest of the nobility to either accumulate inordinately or kill
the geese which laid the golden eggs, both of which would attract the
unwelcome attention of higher-level administrators. This balance had allowed
the growth of a substantial artisan sector, which despite technical
backwardness produced commodities which were in high demand throughout the
world. Many artisans were directly settled in cities supplying the demands of
the administrative and military elite. According to one estimate, the home
market for luxury handicrafts alone amounted to about five per cent of Mughal
national income, with an export market accounting for another one and a half
per cent before the English takeover.6

The victory of the company changed this particular social balance. The
company's servants and gomastabs (local agents) now had unbridled power to
underpay the artisan, and the mood of the times made them prefer a vast
premium on today's trade even if that meant the artisan would be dead
tomorrow. William Bolts, a contemporary English merchant has left a graphic
account of the system of fines, floggings, imprisonments and forced bonds
which enabled them to do this.7 Furthermore, the destruction of the mughal
elite destroyed a substantial part of the domestic demand for luxury
handicrafts. As much as three quarters of domestic demand disappeared
according to one estimate.8

In less than a century, the thriving artisan manufacturing sector had been
virtually squeezed out, with all its implications for the dynamic growth of
indigenous skills, technology and entrepreneurship. The vast urban settlements
which visitors from Europe had once marvelled at, all but disappeared. Writing
about Dhaka, Sir Charles Trevelyan reported in 1840:

The peculiar kind of silky cotton formerly grown in Bengal, from which the fine Dacca
muslins used to be made, is hardly ever seen; the population of the town of Dacca has
fallen from 150,000 to 30,000 or 40,000, and the jungle and malaria are fast encroaching
upon the town... Dacca, which was the Manchester of India, has fallen off from a very flourishing town to a very poor and small one; the distress there has been very great indeed.\textsuperscript{9}

\section*{11.2 The Social Balances of the Raj}

In the century from the eighteen fifties onwards, the administrative and physical infrastructure which developed in Calcutta, did enable the province to take advantage of the possibility of modern jute manufacture and export. During that century, in terms of absolute size, Bengal developed the largest industrial sector in British India. According to one estimate, with 15.5 per cent of India's population in 1939, Bengal accounted for 28.7 per cent of industrial workers. At the close of the year 1935/6, 49.6 per cent of Indian joint stock companies were based in Bengal, accounting for 44.2 per cent of total Indian paid up capital.\textsuperscript{10}

The historically \textit{prior} destruction of handloom textiles meant, however, a somewhat different social trajectory in Bengal from the 'classic' transformation from artisan to factory production as it had happened in Britain, where indigenous producers were absorbed into more efficient units. The early industrial sector in Bengal was in contrast an isolated and largely foreign-owned and foreign-controlled modern economy centred around Calcutta in the western half of the province, while the eastern half, where much of the older handloom textile industry was situated, in terms of some available indicators, actually experienced 'de-industrialization'.\textsuperscript{11}

At the same time as exposure to the world market was restructuring the domestic economy, the political imperative of maintaining power in a vast country with primarily indigenous troops led the raj to develop a series of political settlements with domestic classes who were perceived to be most suitable to act as intermediaries. The changes in the productive structure of
the economy on the one hand, and the new assignments of rights which were being created by the colonial state on the other, were eventually to have profound effects on the social history of East Bengal.

The needs of the colonial administration were to leave an indelible stamp on both the structures and motivations of the state and the composition of the new urban elite. There were important differences in the character of the new middle classes which emerged in different parts of British India, and in the pace and extent of industrial development. Class evolution depended not only on pre-existing structures of land rights and the organization of merchant and usury capital, in which there were important differences, but also on historical accidents. The colonial strategy the British tried to implement underwent evolution and were themselves the subject of internal conflicts both in India and in Britain. Much depended on when a province was annexed and the particular experiments being tried. Non-political accidents, like regional variations in the availability of raw materials and in the fertility of the soil, were also of importance.

In an analytical survey of the changing role of law in colonial India, David Washbrook differentiates three phases of the colonial state. He terms the first phase, which lasted from the very early period of colonial power in the late eighteenth century to the mid-nineteenth century, the period of the 'mercantilist state'. The colonial power at this stage was interested primarily in maximizing revenue from the land, and this was achieved by making the pre-existing Mughal and Nawabi land-tax collection system more efficient. This assessment tallies with quite a lot of recent historical work on the impact of early colonialism.

The mughal state used to collect land-tax by appointing a chain of intermediaries, who though they had no right to the land they ultimately
collected from, had quite a well-defined and often inheritable and transferrable set of rights to their revenue collecting positions. The evidence also suggests that while the disintegration of the Mughal Empire from the late seventeenth century onwards made some difference to the relative power of different levels of this hierarchy, the structure itself remained more or less intact. The Mughal subahdar of Bengal, Murshid Quli Khan, virtually declared independence in 1707 by stopping revenue payments to the centre, but within Bengal he rationalized the revenue collection system and attempted to exert greater pressure on the higher level revenue collectors, the zamindars.

The most significant act of the 'mercantilist' colonial state was to enact the so-called Permanent Settlement of 1793. This gave revenue collectors at a particular point in the hierarchy, the zamindars, clearly defined rights to buy and sell their revenue collecting right, in exchange for a perpetually fixed rental paid to the state. Historical consensus has now shifted away from the opinion that the Permanent Settlement created 'capitalist' property rights in land, to the more tenable one, that the pre-existing structure was made more efficient by making one set of revenue collectors directly accountable to the state. The zamindar had an incentive to pay the rent on time as his zamindari would otherwise be auctioned, but as Ratnalekha and Rajat Ray have persuasively argued, it did not give the zamindars control over the land.

Under the Permanent Settlement, as before, bargaining power over the distribution of the agrarian surplus at a critical point in the hierarchy, between the peasant producers and the higher level rent-collectors, remained to a substantial extent with an ubiquitous class of village level petty landlords and rent collectors. Despite substantial regional variations in the precise mix of rent collecting and land-holding, Ray finds this class to have enough in common to be collectively identified as a common group: the jotedar class. Because of their close proximity to the production process, their relationship
with the direct producers, though it was exploitative, was not usually perceived as such by the peasants. The village elite were the intermediaries between them and the outside world, and moreover they shared in the disasters which struck the village from time to time.

If anything, the Permanent Settlement weakened the zamindari nobility, by destroying the political and administrative structures on which their authority was based, as Hussain Zillur Rahman points out in his analysis of the effects of colonial law during this period. The zamindari was not primarily an economic unit, but rather a political unit, with the zamindar performing a control function, which the raj deliberately but unsuccessfully tried to replace with a formal structure of paid functionaries. Rahman's analysis suggests that the colonial state thus served to destroy the zamindars and might well have resulted in a destabilization of the structures of social control in rural Bengal, with consequences which are still being felt.\footnote{18}

Largely as a result of the social engineering inflicted by the raj on the administrative and political structures of agrarian surplus appropriation, the political tasks of the imperial power also began to change. The transition coincided not only with a much greater need to preserve the social balance as investments and vested interests grew, but also with a radically different identification of the groups which were likely to be the organizers and representatives of mass discontent. Washbrook terms this the phase of the 'High Colonial State'. The apparent conservativism and concern with the 'peasant' in the legislation of the raj in this phase, which lasted into the twentieth century, thus becomes explicable. As Washbrook points out,

the policy documents of the period... make it plain that the raj saw the agrarian problem much more in political than in immediately economic terms. Its policies of social conservation and peasant protection flowed from the fear that if competitive capitalist
relations were allowed freedom to take over the countryside, the resulting conflict would destroy the raj’s own institutions of government and political security.¹⁹

The peasants in question were emphatically not the vast majority who were "poor and dispossessed", but rather, the erstwhile dominant local-level elements in the mercantile revenue based political structure through which the ancien regime and its company variant had operated. It was the village community brotherhoods, mirasidars, inamidars, vatanidars, pedda ryots and petty zamindars whose disaffection the British feared and which they tried to avoid.²⁰

In short, they were none other than the group which in the context of Bengal, Ray identified as the jotedar class. The search for stability led the raj to create new agrarian rights for this constituency, exemplified by the Rent Act of 1859 and the Tenancy Act of 1885.²¹ Increasingly, however, two factors compelled the state to respond directly to the economic demands of this constituency. The first was the gradual disappearance of non-agricultural investment opportunities in the Bengal countryside, largely due to the sudden and precipitous collapse of the artisan sector. The second was a much less coherent collection of reasons which together militated against attempts to organize investment in an agricultural sector characterized by a hierarchical pattern of revenue rights.²²

In this particular economic context, by choosing to be responsive to the demands of its village level intermediaries, indeed often encouraging them to voice demands which would balance the pretensions of the zamindars or pre-empt the mobilization of those even further below, the raj was compelled to concede ground to the economic demands for urban privileges the jotedar was soon to make. By the 1870s, this petty proprietor group was the basis of much of the rapid expansion in the urban 'middle classes', and comprised most of the successful professionals in law, journalism, medicine, teaching, and the judicial and civil services.²³
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It was this class which was behind the formation of the Indian Association in 1876, which split from the old British Indian Association dominated by the big zamindars. It was also this class which was soon to become the organizational backbone of the Indian National Congress and the Muslim League, and in Bengal, would come to have its own party, the Krishok-Proja (or Peasant) Party. Lord Curzon's enquiry found that whereas in 1875 there were no Indians in the hallowed Indian Civil Service, by 1903, there were 16,000 Indians at relatively senior levels with salaries above seventy five rupees.

A turning point for the new middle class came in 1892 with the passage of the Indian Councils Act. Under the act, the Legislative Council of Bengal was to have twenty members, admittedly in an advisory capacity, of whom not more than ten were to be officials. Of the rest, seven were to be nominated by the Lieutenant Governor from panels suggested by the Calcutta Corporation, municipal and district boards, the senate of the Calcutta University, the Bengal Chamber of Commerce and the Trades Association. Only one of the remaining three was 'ordinarily' to be a zamindar, a numerical balance which reveals the shifting political balance in the broader society.

Part of the growth of the urban 'middle class' was undoubtedly the result of the modernization of the economy. But the evidence put forward by economic historians looking at the growth of the middle classes suggests that the 'push' of political mobilization from the countryside was much more important than the 'pull' from new demands for services generated by a growing modern sector. The most enduring effect of the set of representative institutions introduced by the raj, and the political culture that developed around them, was to legitimize a pattern of upward mobility for the vast class of rural petty-landowners who were perceived to be such a potential threat. Washbrook is probably right in describing the responses of the raj as 'paranoid', but
given the rather limited domestic tasks the 'High Colonial State' had set for itself, there was no immediate conflict with any other objectives.

Industrialization was not one of the objectives of the early raj. Tariffs which had been allowed in Canada, Australia and South Africa, and which had played a crucial role in the development of industry in those countries, were expressly disallowed in India on the grounds of the 'Open Door' policy. In the 1880s Indian customs revenues were only 2.2 per cent of the trade turnover, compared to say 21 per cent for Brazil at the same period. However, from the early twentieth century onwards, and particularly after the First World War and the growing penetration of India by Japanese textiles, the pressures of expatriate British capitalist interests in India finally began to succeed in getting the vital state support for industry. This came in the form of tariffs, state contracts, infrastructural services and interventions in commodity and labour markets, without which Indian industry had no chance of 'taking off'. By 1925, the average level of tariffs rose to around 14 per cent from a pre-war level of 5 per cent.

The growth in the importance of industry and urban politics brought about yet another change in the overall political context. This period coincides with the third and last phase of the colonial state, a period Washbrook describes as that of the 'Incipient Nation State', which lasted from the early twentieth century till the transfer of power in 1947. The stable balance of forces which had characterized the previous era came to an end. The new balance which the raj had to politically manage included the landed petty proprietors as before, but instead of the zamindari and mercantile interests, it was now the emerging domestic industrial capitalism which was making demands on the state.

Washbrook's analysis of the conflicts inherent in this new context needs to be re-considered. On the one hand, the evidence does support his claim that a
growing pressure from the nationalist and expatriate industrialists, and a growing net financial dependence of the state on industry was pushing the raj towards an interventionist policy which amounted to selective subsidies for industry. On the other hand, the growing political and economic tensions of this period are not adequately explained in terms of the state having to continue with its policies of social conservation in the village, strengthening the village-level landlords and giving them enhanced opportunities for economic gain.

The essentially rural political mobilization the raj had supported had by then created an urban middle class as successful intermediaries migrated to the towns to take up professional jobs. Populist politics and the mobilization of ever growing sections of the stagnant rural society swelled the numbers of those who came to the towns, such as Calcutta, to seek education and a share in the surplus of the state. The attempt by the raj to establish a political role for the jotedar to sustain political stability in the village unleashed a social dynamic that eventually threatened the stability of the town.

According to one set of estimates of the changing structure of India's national income over this period, in the three decades from 1900/09 to 1940/46, the real value of output at 1939 prices in the primary and secondary sectors increased by thirty four percent, but output in the tertiary sector increased by one hundred and forty three percent, the bulk of this accounted for by the growth of a "large and unwieldy government".32 Even allowing for statistical errors, the absolute and relative growth of the 'service' sector is remarkable.

In a sense, the continuing, and by now perhaps irrevocable responsiveness of the raj to the political demands of the 'countryside' represented a formal continuation of its commitment to the jotedar voice, but what does not emerge from Washbrook's analysis is that this relationship with the village elite had
by now created a large and growing urban constituency. The political culture and the history of its evolution impelled many within this group to continue a populist pressure in the name of the 'peasant', but the economic content of the demand had by now qualitatively changed. By the twenties and thirties, mass-movements emerged organized jointly by the urban middle classes and the rural jotedars. This was the key characteristic of political mobilizations which emerged in the 'Incipient Nation State', and was indeed to be the legacy it bequeathed to its successors.33

It is perhaps ironical that the Calcutta jute industry had contributed the most to the prosperity of the jotedar at the turn of the century. But it was a prosperity which was extremely vulnerable. First during the Great War, again during 1921-3 and throughout the thirties, the jute farmers were thrown into depression by the vagaries of the world market and the monopsonist powers of the Calcutta enclave economy. Jotedars did not on the whole do too badly, primarily because they were able to diversify into moneylending, but they provided an increasingly vociferous constituency for populist politics.34

If the Indian Councils Act of 1892 was a turning point for the Indian middle class, the 1937 elections to the provincial Legislative Councils marked yet another significant shift in the political balance of power. In Bengal, the decidedly jotedar Krishok-Proja Party of Fazlul Huq caught this tide of 'peasant' discontent at its flood. It was elected as the largest party and formed a coalition government with the Muslim League. The coalition notwithstanding, the relative electoral victory over the aristocratic Bengal Muslim League represented the coming of age of the Bengali muslim jotedar.

By now the aspirations of the upwardly mobile jotedar were explicit. While the demands of the movement were always couched in terms of justice for the peasant, neither the city-based leaders like Fazlul Huq, nor the rural
constituencies who acted as the mobilizers of the movement, revealed any great interest for the agrarian sector in their actions. In its first budget, the Fazlul Huq government allocated one percent of the budget to agriculture, half the allocation approved for 'stationery and printing'. On the other hand while both the urban and the rural jotedar were interested primarily in upward mobility, the prerequisite for this was a move to the town. The possibility had already begun to emerge, therefore, of conflicts of interest between the jotedar proper, a vast and nebulous class spread over hundreds of thousands of Indian villages, and their urban brethren who had graduated to the petty-bourgeois urban classes.

The ascendance of the jotedar in the politics of the countryside, and the symbiotic if tension-prone relationship with the political movements of the urban middle classes was one of the most significant of the political balances which were established as a result of the arrangements devised by the raj in its steadily more futile attempts to maintain a political balance of power. Whether in the village or in the town, the interests of this coalition would have to be henceforth taken into account. As Omkar Goswami shows, the 1938 Amendments to the Bengal Tenancy Act represented for the first time, a successful political mobilization of jotedars against the rights of the zamindar.

Soon afterwards, however, the creation of a separate muslim state became more of a possibility. With the much greater potential for upward mobility in an independent Pakistan, the muslim jotedar in Bengal had no hesitation in switching his support to the 'aristocratic' Muslim League in the elections of 1946, since that party promised a potentially much greater voice for the jotedar in a newly constituted state. The switch of allegiances from the Krishok Proja Party to the Muslim League has been colourfully demonstrated by Sugata Bose in series of case studies of grass roots activists.
By the time the British left India, the groups which had gained organizational rights during the raj, the urban middle class and the jotedar, clearly determined the course of decolonization and indeed the partitioning of India. While the rise of the jotedar - urban-middle-class nexus in British India can be strongly supported with the aid of contemporary historiography, the role of this fundamental political balance in conditioning the nature of the options available to the state in the process of industrialization has not been adequately examined.

The organizational rights the middle class had established as legitimate allowed it to bargain for resources and jobs in a way which we would describe as clientelist surplus appropriation. We will see in the next two chapters that the post-colonial state's attempts to attain economic viability has led it time and again to confront these rights. However, the traditions established by the raj encouraged the post-colonial state to seek solutions which gave temporary respite but were doomed to fail in the long run. As before, the state tried to balance an established power bloc by creating new ones. Once again, the state responded by appealing to the 'countryside', a strategy which sought to weaken existing clientelist organizations by giving organizational rights to a greater number of organizers. These strategies were to fail largely because even with the increased number of organizers, once new lobbies had been set up, the system was definitely not on the downward sloping section of the per capita payoff curve (see figure 6.3). The number of organizers was far smaller than the population, and these strategies were eventually destabilizing because they simply increased the size of the clientelist coalition and therefore the eventual payoff it could bargain for on the basis of its increased organizational power.
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2. A fascinating account of the conflicts between finance and trading capital on the one hand, and the interests of the declining nobility based on a complex structure of rights to the land tax is presented by Pavlov, who also looks at how this contributed to the defeat at Polachi. Pavlov (1979) pp. 83-107 and 215-56.

3. See Ahmad, Najaf (1968) pp. 98-104 for the growth and decline of the artisan sector. The new spelling 'Dhaka' will be used in preference to the older 'Dacca', except in titles and quotations.

4. The memoirs of a civil servant attests to the fact that the English were equally amazed at the role they had been catapulted into. Wooler (1962) p. 12.


11. See Kumar & Desai (1983) pp. 544-4 for Bengal. At an all-India level too, the late nineteenth century probably saw a net de-industrialization, ibid. p. 534 Table 6.1., but historians are divided as to whether this was caused by structural change, population growth or changes in enumeration techniques. See Thorner & Thorner (1962) and Krishnamurty (1975) for scepticism about de-industrialization at an all-India level. Bagchi's detailed study for Bihar, in Bagchi (1976) however, does support de-industrialization, and the evidence for neighbouring Bengal is also quite robust.


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15. See Mukherjee, Ramkrishna(1974) and Aliavi(1975) for the older view. The most persuasive exponents of the newer interpretation are Ray, Ratnalekha(1974) and (1979), and Ray, R. & R.(1973) and (1975).


17. Jotedars had different local names, for instance, Gantidar in Jessore, Haoladar in Bakargani, Mandal in Midnapur. Ray, Ratnalekha(1979) pp, 44-9. S, Bose gives a typology of three types of regional structure in Bengal, in Bose, S.(1983) Ch, 3. Broadly speaking, jotedars controlled larger tracts of land in North Bengal and smaller tracts in the East. See also Goswami(1982) who also uses the term jotedar in a general way, Goswami(1982) pp. 39-40. Sinha, N.K.(1962) dates the ascendance of this class from 1772 with the tax faring experiment of Mir Qasim, but Ray questions whether such a profound change could have come about without attracting the attention of contemporary observers. Buchanan in his 1808 survey of Dinajpur, in Buchanan(1833) found that 6 per cent of agricultural classes held 36.5 per cent of raiyati land, while 52 per cent were landless. Colebrooke noted sharecropping as early as in 1794 in Colebrooke(1804). See also Ray, Ratnalekha(1979) pp, 264-74.


22. The reasons behind the poor performance of agriculture is still a point of contention amongst economic historians of India. In any case, the work of Islam, M.M.(1978) shows a minimal growth of agricultural output in Bengal in the twenties and thirties. For a review of some of the major issues see Charlesworth(1982) pp, 17-31.

23. Chatterjee, Partha(1982) p.121. A fascinating first hand account of the transition of the Krishok-Proja Party from peasant politics to urban power is provided by one of the participants, Abul Mansur Ahmed, in Ahmed, Abul Mansur(1975). While there were important differences between the different sections of the new middle classes, they showed a common perception of themselves as representatives of the people : "Their rationale was that the illiterate masses could not speak for themselves, and the aristocracy spoke only for themselves. In their three-tiered view of society, only the middle classes, strategically placed could speak for all." Gordon, L.A.(1974) p. 28.


26. Ahmed, Abul Mansur[1975]. See also Chatterjee, Partha[1982]. In his study of the muslim middle classes of India and Pakistan, Nooruzzanan concludes that politics was the source of upward mobility especially for the muslim Bengali middle classes, Nooruzzanan[1965] p. 232.


29. Bagchi[1972] gives a vivid account of the effects of the conscious changes in state policy on the course of early industrial growth in India. It demonstrates not only the changes in the economic and political realities in the early part of this century, but also the importance of state intervention with 'large scale' technology. See Bagchi[1972] particularly pp. 420-43, See also Washbrook[1981] pp. 700-1.


32. Based on national income estimates of Sivasubramanian, in Sivasubramanian[1965], reproduced in Goswami[1982] Table 1.3.1.

33. Quite a lot of historical work is being done on the role of middle class leadership in popular movements in late colonial India, See for instance Sarkar[1983], particularly pp. 63-6.


East Pakistan was formed out of the eastern, rural hinterland of Bengal in 1947. Stephen Lewis has persuasively argued that the carved out state of Pakistan as a whole was constituted of areas which had previously supplied raw materials for industry situated elsewhere in British India. The first industrial initiatives in the new state were probably in response to the market signals created by disequilibrium when Pakistan refused to continue in its inherited exchange relationship with Indian industry, as expressed in the refusal to devalue in line with India in 1949.

There is a lot of evidence to support the conventional view that early growth was financed largely by the trading profits of the emigre Gujarati muslim merchants in West Pakistan. The Korean war boom had left large surpluses with these traders, and when a foreign exchange crisis hit Pakistan in the early fifties, the state imposed import controls which made domestic production extremely profitable. The early import substitution was primarily in textiles, generally of low capital intensity, and the evidence is that growth opportunities were soon exhausted.

Though the state did not yet have the resources to actively channel subsidies to industrialists, the imposition of controls did in fact amount to a hidden subsidy. Papanek reported that profits of fifty to a hundred percent a year were not uncommon in the early to mid-fifties. Apart from the perception of the importance of industrialization, personal contacts also existed between the Muslim League leadership and a small number of traders, dating back to the pre-partition days. 'Nation Building Companies' like the Mohammadi Steamship Company and Habib Bank Limited had been established by these traders in India in alliance with the Muslim League, and they provided obvious candidates, when individuals or companies had to be offered industrial projects.
Institutions were also established in the very early years which would become key elements in the state's later interventionist strategy. A month after independence, an industries conference was convened where various forms of assistance was offered to businessmen with an initially very poor response. Partly as a result of this disappointment, in 1952 the Pakistan Industrial Development Corporation was set up, with the objective of setting up and divesting to private owners new industrial units. Also established in the early years were the financial institutions: the Pakistan Industrial Credit and Investment Corporation and the Pakistan Industrial Finance Corporation (later Industrial Development Bank of Pakistan) which were to assume great importance in later years.

Industrial growth really took off, however, with the beginning of active state intervention in the economy, and the establishment of a working relationship between Karachi-based merchants in West Pakistan and a number of key state institutions. A pattern of proudly proclaimed discriminatory policies were established in favour of merchant capitalists aspiring to become industrialists. Growth in the late fifties and early sixties was further aided by buoyant world markets and a steady flow of aid. Even allowing for the statistical magnification caused by the initially tiny base, industrial growth centred in the west was indeed rapid from the mid-fifties to the mid-sixties, with substantial growth in the East as well, as can be seen from the relevant section of Table 12.1.

Underlying this industrial performance was the growth of a system of state subsidies and controls. While trading profits and retained profits had been the most important source of finance for industrial investments in the early fifties, from the mid-fifties onwards, and particularly in the sixties, the role of external financing, and particularly financing by the state owned institutions which could give foreign currency loans, increased significantly.
The system of exchange control ensured a multiple rate of exchange, so that importers of capital goods could import at an overvalued exchange rate. This ultimately represented a subsidy from agriculture to industry, since exports of agricultural raw materials were at a lower exchange rate. A differentiated structure of quantitative import restrictions and tariffs was also imposed.

<table>
<thead>
<tr>
<th>PERIOD</th>
<th>MANUFACTURING*</th>
<th>ALL-INDUSTRY*</th>
<th>AGRICULTURE*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(Large &amp; Small Scale)</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>1949/50 - 54/55</td>
<td>9.5</td>
<td>11.5</td>
<td>2.4</td>
</tr>
<tr>
<td>1954/55 - 59/60</td>
<td>8.5</td>
<td>8.6</td>
<td>0.3</td>
</tr>
<tr>
<td>1959/60 - 64/65</td>
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<td>17.4</td>
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<td>1964/65 - 69/70</td>
<td>5.3</td>
<td>7.7</td>
<td>2.8</td>
</tr>
<tr>
<td>1969/70 - 74/75</td>
<td>-9.8</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>1974/75 - 79/80</td>
<td>5.1</td>
<td>5.9</td>
<td>3.3</td>
</tr>
<tr>
<td>1979/80 - 84/85</td>
<td>2.6</td>
<td>5.0</td>
<td>2.3</td>
</tr>
</tbody>
</table>

Sources: a) 1949/50 - 69/70 annual growth rates calculated from annual figures for sectoral GDP at 1959/60 factor cost in Alamgir & Berlage[1974], Apdx C Tbl 4. Manufacturing includes large and small scale, All-Industry includes construction and utilities, 1969/70 - 74/75 annual growth rates for large-scale manufacturing alone were calculated from CMI figures, (See Appendix 14-A). No statistics on the small-scale sector was available over this period. 1974/75 - 1984/85 annual growth rates calculated from annual figures for sectoral GDP at constant 1972/3 market prices in IBRD[1984] and [1986], Manufacturing again adjusted to include an estimate of the small-scale sector.

b) Agricultural growth up to 1964/69 calculated from figures for agricultural GDP at constant 1959/60 factor cost in Khan & Berlage[1966], 1974/5 growth rates calculated from gross agricultural value added figures at 1972/3 market prices in IBRD[1984] and [1986].

Growth rates in each period is the parametric OLS rate of growth.

Reviewing the results of a large number of studies, many undertaken by the Pakistan Institute of Development Economics, Lewis concludes that the net effect on incentives of these policy instruments did not have a noticeable effect on the structure of the evolving industrial sector, but they undoubtedly had the effect of transferring large income flows to manufacturers raising the incentive to invest in manufacturing industries in general. The industrial structure which developed in the fifties seemed to be responding more to the structure of scarcity than the relative level of subsidy, since the former was certainly creating more powerful signals. In the sixties, however, Lewis argues
that the evidence suggests a growing inefficiency in sectoral choice and in the choice of techniques, in the sense that many of the projects chosen could never be competitive in international trade even if they achieved high levels of technical efficiency.

Nevertheless, based on a statistical evaluation of the rates of growth achieved, economists from the Harvard Advisory Group working on Pakistan, like Gustav Papanek, had begun to see Pakistan as the new model of growth:

Prophets of gloom and doom were disappointed by radical economic changes which began in the late 1950's. By the middle 1960's, the rate of economic growth was more than double the rate of population growth; investment was approaching a healthy 20 percent, and savings exceeded 10 percent of domestic resources. Prices were stable, foreign exchange earnings were increasing at 7.5 percent per year, and foreign resources were being used with increasing effectiveness. Pakistan was widely regarded as one of the half dozen countries in the world with the greatest promise of steady development.

With the benefit of hindsight, we can see that the weakness of Papanek's analysis was that although it examined the social composition of the classes involved in industry and the state apparatus in Pakistan, its primary aim was to show how appropriate market incentives could elicit socially useful responses from the most unlikely quarters. While it is true that market signals were instrumental in prompting a shift of trading fortunes into industry during the early fifties, the price structure itself was manipulated as an instrumental variable in the hands of state bureaucrats who had allied themselves with one section of the dominant classes at the expense of others. The acceleration of growth depended on the state's ability to direct vast quantities of resources into the hands of a tiny capitalist class during the late fifties and early sixties. Papanek's statistics do not show that the state's ability to create the conditions for capitalist growth during this period was based on a very precarious political settlement, a settlement imposed by the state which was eventually to be challenged and destroyed.
§ 12.1 The 1958 Coup and a New Political Settlement

The political problem facing the Pakistani state by the mid-fifties had two aspects which were relevant to the country's subsequent industrial prospects. The first was an imbalance in the institutional development of state structures in the two wings of Pakistan. In both wings, the senior personnel were Indian Civil Service officers who had opted for Pakistan, and in both wings, the state was in its initial years, undoubtedly very weak. How weak is perhaps best conveyed in a government document giving an evocative description of the arrival in East Pakistan of the senior personnel of the new state:

August 14 1947, A Sultry afternoon, 2 pm, A Dakota took off unobtrusively for Dacca from Dum Dum airport near Calcutta... That unobtrusive plane was at once a challenge and a symbol. As it landed about two dozen passengers stepped out. They were senior officers who had opted for Pakistan and had the experience required for manning some of the key posts in East Bengal. Strange though it may seem, only one Dakota flight to Dacca sufficed almost to exhaust the list of officials of that calibre.10

But while the lack of trained personnel was a problem shared by both East and West, at the time of its independence from the British Empire, the eastern wing of Pakistan was distinguished by being markedly free of an indigenous traditional elite of any size, deriving from either the colonial or pre-colonial past which had the legitimacy to naturally assume the responsibilities (and privileges) of administration. The zamindari elite, whether or not they would have been appropriate for this task, had disappeared in Bengal. In contrast, in north-western India, which was only annexed during the nineteenth century, the raj had been compelled to rule largely through the traditional structures of power. Carved out of this part of India, West Pakistan was notable for its landlord interests and the relative weakness of intermediate classes.11

The indigenous 'bureaucrats' in the north-west of British India, had enjoyed a relatively greater political autonomy which was legally expressed in the fact that most of north-west India belonged to the 'non-regulation' area.12 This
relative advantage perhaps partly explains how it was that bureaucratic structures in the west had the confidence to take over the administration of a country the majority of whose population was based in the east, and was socially and culturally, quite different from the new administrative class.

Even if Karachi had not subsequently attracted immigrant Gujarati Muslim merchants from western India, the social structure in the west was much better placed for the development of an industrial bourgeoisie. Of all the parts of British India, the north-west was probably the area where the writ of the raj carried the least weight. Traditional structures of authority and control were to a large extent untouched, and these structures could be and were successfully incorporated into the framework through which the post-colonial state functioned. Moreover, largely due to the same set of reasons, the north-west was also perhaps the least 'politically-developed' of all of the different areas of British India, in terms of the dynamic of upward mobility of the rural intermediate classes.

In the eastern wing, the weakness of legitimate traditional structures of authority which could act as a framework for the emerging post-colonial state placed a dual handicap on the development of a Bengali industrial class. Till 1971, the state apparatus remained firmly in the hands of the western military-bureaucratic alliance, despite frequent challenges from the relatively more active Bengali political process. Moreover, any state sponsored creation of a new industrial bourgeoisie here had to face the problem that candidates had to be selected not from a traditional dominant class who already enjoyed a 'legitimate' social advantage, but from within the ranks of the petty-bourgeoisie. This made the process much more transparent and consequently less acceptable to the wider society - and particularly to the members of the petty-bourgeoisie who failed to qualify.
The second aspect of the political problem confronting the Pakistani state was a more general one, but it would prove to be both initially and in the long run, the more serious constraint. While there was an imbalance in the institutional and political development of the two halves of the country, the Pakistani state faced on the whole a politically difficult task in convincing the legislatures of both wings, that the economic discrimination necessary for economic growth was in their own best interest. Economic historians who have examined the political impasse before the military coup of October 1958 have generally tended to see the problem in terms of a conflict between the West Pakistani 'feudal oligarchy', who dominated the Constituent Assembly, and the bureaucracy imported from British India who more clearly perceived the need to step up industrialization.  

This way of looking at the conflict perpetuates the mythology on which the raj based its social interventions. The large West Pakistani landlords were undoubtedly over-represented in the Constituent Assembly, just as the 'jotedar' dominated the Bengal Legislative Assembly. But like the 'jotedar' voice in East Pakistan, the 'landed interests' of the West were not primarily interested in rural issues. In East Pakistan, the Muslim League suffered a crushing defeat at the hands of the new United Front in the provincial elections of 1954, despite keeping its promise of land reform for the jotedar. The East Pakistani political elite had simply discovered that the Muslim League was not receptive to its demands for more autonomy for (and hence local access to state power in) East Pakistan. This political assertion by the class which had won East Bengal for Pakistan was however quickly suppressed by the central bureaucracy, which dismissed the legislative assembly and imposed Governor's Rule.

The divisions and conflicts in the central Constituent Assembly were quite similar in that here too the issue at stake was the sharing of the social surplus which the central state machinery had the power to allocate. The
debates which paralysed the constituent assembly were not about the price of
grain or the rights of tenants, but about the division of power between the
centre and the provincial assemblies and the division of power between East
and West Pakistan. The 'feudal oligarchy' was not so much interested in the
protection of feudal rights as in the negotiation of a constitutional
arrangement which would assure the West Pakistani political representatives a
secure control of the all-Pakistan political process, not only to control the
troublesome Bengalis in the east, but also to check the pretensions of other
groups who threatened their access to resources.

The state's resistance to political organizers who sought to ensure their
access to organizational rights and hence to resources ultimately reflected the
scarcity of resources in the new state. If there were enough resources at the
disposal of the state to satisfy all political demands the problem could
conceivably have been resolved, but in the minds of an influential section of
state decision-makers, this was not feasible.

Behind the bureaucratic and ultimately military suppression of the political
process in Pakistan from 1954 to 1958 were several powerful bureaucrats, men
like Ghulam Mohammad and Iskandar Mirza, in whose perception, the state faced
a stark choice. It could concede to the demands of the political
representatives. Conceivably, this could have resolved the constitutional
%8

Page 249
decisions of the military government which eventually took power in 1958 supports this interpretation of the motivations of state decision-makers.\(^7\)

**FIGURE 12.1: THE 1958 POLITICAL SETTLEMENT**

\(S_0\) and \(A_0\) refer to socially defined political and economic minimum viability limits. \(T_3\) and \(T_4\) refer to alternative tradeoffs based on specific resource endowments and political settlements.

The coup can be represented as an 'autonomous' intervention of the state which temporarily succeeded in creating a new political settlement. We would identify this as one of the factors which allowed the industrial growth of the late fifties and early sixties. In figure 12.1 this can be shown as a shift in the political frontier from \(T_3\) to \(T_4\). This allowed the state to assign rights in ways which favoured industrial growth without political viability falling below a sustainable limit. Nevertheless, the process through which this settlement was sustained ensured a growth in the political power of clientelist coalitions which eventually amounted to the state once again facing an extremely unfavourable tradeoff between economic and political viability, such as along \(T_3\). In terms of figure 12.1, the crisis of the late sixties was brought about by a gradual shift of the tradeoff curve back to the south-west.
From 1958 to 1962, the military government of Field Marshal Ayub Khan ruled entirely without the mediation of politicians, and even after the 1962 constitution, most of the important ministries, such as planning, finance, home affairs and defence were normally given to professional civil servants.\(^8\) While the army went back to the barracks shortly after the 1958 coup, it was clearly the political intervention of the army, and the ultimate sanction of the gun, which shifted the political balance of power, and allowed the state to change the organizational rights of clientelist coalitions along a much more favourable political frontier. The evidence suggests that the new political settlement allowed the state to direct side-payments to a narrowly defined capitalist class while restricting some organizational rights (an improvement in terms of conditions (c) and (f) of Table 7.1). On the other hand, the Ayub regime does not seem to have been too successful in breaking up sectional capitalist interests, (indicated for instance by Lewis's finding mentioned earlier, regarding the sectoral inefficiency of investments), or in attacking symbiotic clientelism which was to grow to unmanageable proportions, (conditions (e) and (g) of Table 7.1).

To accelerate industrial development given the technical and resource constraints, the state, now under the virtually exclusive direction of the bureaucracy quite consciously directed much of the resources it controlled towards a small number of monopoly houses. These were the institutional descendants of the traders who had initiated the process of industrialization. The monopoly houses became the backbone of the investment boom of the sixties in both East and West Pakistan. From 1958 to 1970, the Pakistan Industrial Credit and Investment Corporation allocated 44.7 per cent of loans disbursed to thirteen monopoly houses, while even the Industrial Development Bank of Pakistan, which concentrated on small loans (below 2.5 million rupees), allocated 31.9 per cent of loans disbursed to thirty monopoly houses between 1961 and 1970.\(^9\) Although these two institutions allocated only about a fifth
of total investible resources, Amjad has graphically described the interlocking system of control enjoyed by the monopoly houses, with the leading businessmen represented on the boards of all the state financial institutions and the Boards of Directors of other monopoly houses.20

The state's conception of the role of public enterprise was exemplified by the charter of the Pakistan Industrial Development Corporation, which was set up to initiate development in new sectors. The corporation was "expected" to transfer share capital in new enterprises to private capital "as and when practical". Four members on its board came from the leading monopoly houses, and the first head of the Corporation, Ghulam Faruq, was to become one of the leading industrialists of the country.

The industrial consequences of these arrangements, which would quite possibly not have developed to the same extent under the scrutiny of a clientelist political process, were initially dramatic. Pakistan diversified into the heavily capital-using new industries like chemicals, iron and steel, large scale textiles and cement, which became the growth sectors of the early sixties.21 In a study of the capital intensity of the Pakistan manufacturing sector for 1962/3, A.R. Khan discovered that capital intensities in most manufacturing sectors were higher in Pakistan than in Japan.22 The size of the discrepancy he reported makes it unlikely that the result was due to statistical errors, it was more probably a reflection of the absence in Pakistan of the dual structure of industry which characterized Japan, and the absorption by Pakistan of the most advanced technology available. A similar study by Rizwanul Islam for 1968/9 reached much the same conclusion.23 Whether or not this strategy was 'rational' given Pakistan's relative resource endowments and ruling international prices, the early sixties were certainly a boom period for manufacturing industry in both East and West Pakistan.
§ 12.2 The Collapse of the 1958 Settlement

The favourable political frontier was however to prove short-lived, and a number of factors pushed it back to the south-west to increasingly unmanageable positions. By failing to detach itself from sectional capitalist interests, and particularly by failing to attack symbiotic clientelism, the state failed to maximize the growth opportunities afforded by the new settlement. In terms of Figure 12.1, the state operated at a point such as A rather than G. This meant that growth and accumulation was lower than it could have been and this reduced the possibility that an improvement in the resource availability situation would be able to offset the growth in the political power of clientelist coalitions. The growth of clientelist political power combined with this failure of state policy ensured that from about the mid-sixties, the political frontier began to shift back towards $T_a$.

We would argue that the declining efficiency of the state, and consequently the factors behind the downward shift of the political frontier from the mid-sixties are at least as important in understanding the changing economic performance of the system as conventional factors like changes in resource availability and demand. The growth in the strength of clientelist coalitions occurred in two ways.

The first and possibly the most important was the search of the new regime for constituencies which could be mobilized to counter the urban middle classes. The traders and industrialists were numerically too small, and in a political framework whose culture and institutions were responsive to the argument of numerical majorities, they provided insignificant political support for the military government. Ayub Khan's Basic Democracies Order of 1959 was one of the first acts of the martial law authorities, and was intended to redress this imbalance. It attempted to create a countervailing constituency in the 'countryside' by creating a structure of local ('union') councils, for units
of ten to twelve thousand people, which were grouped into larger units, 'thana' councils (in East Pakistan) and 'tehsil' councils (in West Pakistan).

The Basic Democracy programme was, very simply, a return to the politics of the 'High Colonial State'. It attempted to create a countervailing political voice for a new constituency to balance the political pressures which the state found most disruptive at a particular conjuncture. Once again, the ubiquitous jotedar, this time together with the West Pakistani village elites, were a natural choice for the state, for a number of reasons. They were sufficiently numerous and could mobilize more people than could any urban coalition, their demands were small and could at least initially be easily met, their dissatisfaction was in any case worrying for the state, and as an added bonus, the Basic Democracy system could be used as a structure for rural development. As before the strategy worked, but at a cost.

The Basic Democracy system for a time deprived urban coalitions of their access to rural constituencies since the latter were given a direct voice in resource allocation. The new and more numerous set of organizers initially set fewer political constraints on the state. Over time however, the costs increased as more and more resources were pumped through the Basic Democracy structure, through programmes such as the Food for Work programme. The growing strength of the new constituency led to its eventual realization that an alliance with the urban petty bourgeoisie against the restrictions imposed by the state would be a faster way of getting access to more resources.

From the mid-sixties onwards, the state was faced with a growing identity of interests between the clientelist coalition it had created and the one which it had tried to suppress. By then the regional inequality of East and West Pakistan had also been substantially exacerbated and Bengali nationalism became the rallying ideology of the Bengali middle classes who had been left
out of the economic boom. The landslide victory of the Awami League in the 1970 elections in East Pakistan, both in town and country, was the culmination of this process. But even in the West, although the victory was not as marked, populism had arrived on the scene with Bhutto's Pakistan People's Party.

An indication of the growth in the political strength of the clientelist coalition is the growth in the numbers of potential clientelist organizers. Throughout the sixties, there was a rapid growth in the educated urban population, a group we loosely referred to as the petty bourgeoisie, at a rate much faster than that of the overall population. This was a reflection of the growth in state expenditures in urban areas and the expansion of secondary and university education, a concomitant of the growing prosperity of the jotedars and the migration of their sons and daughters to the towns for a university education and the claim to a job. Once begun the process had a dynamic of its own despite the growth in unemployment even within the urban elite. Some figures for the growth of the numbers actually employed will serve to demonstrate the trend.

In the nine years from 1962 to 1971, civil service employees of the East Pakistan provincial administration alone grew, according to one set of figures, by more than 100,000, from less than 400,000 to more than 500,000. In the six years between 1964 and 1969/70, the number of lawyers in all Pakistan increased from 18,000 to 27,000, of which more than half were in East Pakistan. Similar figures may be shown for doctors, teachers and other professional groups. It should be remembered that these figures were in the context of a much larger growth of the total urban educated population, many of whom acquired generalist educations, dropped out, or were otherwise unemployed, and fed the ranks of the powerful political movements that were beginning to envelop the country.
The second process which eroded the political balance of 1958 was the state's failure to create an industrial capitalist class in East Pakistan. The social and institutional evolution in the East was, as we have argued, less favourable for the development of indigenous industrialists in this province. Nevertheless, the growing political strength of the urban middle classes in the sixties led the state to try and create a Bengali capitalist class.

As table 12.2 shows, from the mid-sixties, the state directed a growing share of investible resources to East Pakistan in what proved to be a desperate attempt to stem the disaffection in that province. Much of this growth in East Pakistani industrial investments was at the expense of West Pakistan, where total investments had to be cut back in real terms. Of course, allocations to West Pakistan had been much larger to start with despite its smaller population, which was one of the principal arguments of the eastern middle classes. However, the state's response to the political pressures emanating from East Pakistan, dramatic as it was, was too little and too late.

**TABLE 12.2 TOTAL INDUSTRIAL INVESTMENTS IN PAKISTAN 1961-70**

( Million Rupees in Constant 1960 Prices )

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<thead>
<tr>
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</thead>
<tbody>
<tr>
<td><strong>West Pakistan</strong></td>
<td>852.94</td>
<td>846.15</td>
<td>757.05</td>
<td>1062.50</td>
<td>1221.43</td>
<td>1087.96</td>
<td>987.16</td>
<td>1013.79</td>
<td>916.87</td>
<td>1061.36</td>
</tr>
<tr>
<td>Public Sec %</td>
<td>5.1</td>
<td>3.9</td>
<td>15.6</td>
<td>3.2</td>
<td>9.8</td>
<td>10.8</td>
<td>10.9</td>
<td>11.6</td>
<td>8.3</td>
<td>3.2</td>
</tr>
<tr>
<td><strong>East Pakistan</strong></td>
<td>205.99</td>
<td>459.42</td>
<td>332.21</td>
<td>382.30</td>
<td>450.21</td>
<td>390.00</td>
<td>477.02</td>
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</tr>
<tr>
<td>Public Sec %</td>
<td>21.7</td>
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<td>29.8</td>
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<td>24.8</td>
<td>53.0</td>
<td>50.7</td>
<td>45.7</td>
</tr>
</tbody>
</table>


The weakness of the Bengali bourgeoisie is also shown in the table since much of the growth in industrial investments in East Pakistan initially took place
through a dramatic growth in the public sector, public sector investments as a share of total investments peaking at 53 percent in 1968. Nevertheless, the growth of the Bengali industrial bourgeoisie took off during this period. At the time of liberation in 1971, one study found sixteen major Bengali business houses, each with assets of more than Rs. 25 million, and with combined assets of nearly Rs. 700 million. The bulk of the nascent industrial bourgeoisie was, however, small to medium entrepreneurs. Excluding the large jute and textile industries, state financial institutions funding the establishment of enterprises had, by 1971 given over 3000 loans to Bengalis, most below Rs. 400,000, helping to set up around 1300 units.

As we shall see in Part IV, the sudden pouring of resources into East Pakistan from the mid-sixties onwards did not have a corresponding effect on manufacturing productivity. Investments do of course have gestation periods but at least a partial explanation of poor productivity performance could be sought in the evidence of a substantial loss of resources through 'symbiotic' clientelism. Alavi makes a distinction between the Bengali 'contractors' and the 'contactors' of this period. Both used the general susceptibility of the state to the growing political pressures in the east to get allocations of resources. The first group did invest, although some of the allocation may have been absorbed into foreign accounts through overinvoicing capital imports. But the second group represented a total loss because they were only interested in the margins they could earn by trading their ability to get allocations from the state with monopoly houses who were now forced to pay premiums to the 'contactors'. Alavi's schematic representation brings out the growth of what we termed the symbiosis of clientelist with capitalist surplus appropriation systems during the late sixties.

The sharing of benefits between enterprises and the state undoubtedly already existed. Much of the interlocking institutional framework through which the
merchant monopoly houses had sustained their access to investible resources entailed rent-seeking losses. The premiums which could be earned on the basis of access even to growth-augmenting side-payments encouraged and allowed a part of these resources to be diverted to rent-seeking networks. Even as early as the fifties, a well developed system had emerged whereby each monopoly house would pay monthly retainers to their 'coalitions' within the state bureaucracy involved in sanctioning investments and loans.30

These rent-seeking arrangements undoubtedly led to a loss of resources from potentially productive uses, but as we have seen, the state intervention which 'caused' the rent-seeking had dynamic implications for industrial growth. On the other hand, the efficiency of the Pakistan state should not be exaggerated. The obstacles particularly from the point of view of the new investor have been graphically recorded by Pears. Writing in the mid-sixties, he says from the point of view of the investor that

in no country, with the possible exception of India, will he find quite so much of what is commonly called 'red tape'. This is characterized by the fact that everybody wants to have a finger in the pie, but no one wants to be accused of wanting to eat it. In other words, everyone wants to be associated in decision taking but no one wants to be identified with the actual decision taken. A standard example of this is manifest at the beginning of the wearisome procedure to be followed for (the) establishment of an industry. The investor has to fill in thirty copies of a questionnaire form supplied to him by the IP&S (Industrial Promotion and Supplies Department - MK). These are then sent round to about sixteen different ministries and departments from the central and the two provincial governments for their scrutiny and comments. Any of them can hold matters up by requiring additional data or simply placing an objection to the scheme. If there is an objection, the investor will have all the difficulty in the world in locating the source of the objection.31

Bureaucrats did not like to be accused of "wanting to eat the pie" but the labyrinthine system of controls which achieved the direction of resources to emerging capitalists did allow a mutually satisfactory sharing of the benefits.
Whether the loss of these resources would significantly slow down industrial growth depends on how successful the industrial policy of the state was in achieving rapid growth. At the very end of its life, in 1969, the Ayub government identified and sacked three hundred and three top bureaucrats for corruption (the 'three nought three' case), but by then the political frontier in terms of figure 12.1 had already deteriorated probably to a position like T3, and positions like G were no longer feasible.

The emergence of what Alavi calls the contactors needs to be distinguished from the persistence of corruption in the Pakistani state. The allocation of resources to contactors was the outcome of a process of growing political pressure where some actual or potential organizers were able to bargain for payoffs which were allocations of side-payments earmarked for industry. The growth in the number of contactors was thus an indication of the growth in clientelist pressure and this determined the character of the emergent Bengali capitalism. Thus began the symbiosis of capitalism and clientelist pressure which persists in Bangladesh to this day.

The settlement created in 1958 was thus coming to an end. It had come about as a result of the response of a section within the bureaucracy and the army to the political constraints facing the economic viability of the new nation. Temporarily, it had solved both the problem of the social and institutional imbalance between East and West Pakistan, and the more enduring problem of the politically supported demands of large and conflicting non-productive coalitions for 'political' side-payments. In the end, the methods the state adopted for sustaining the settlement resulted in the growth of new clientelist coalitions which threatened to unite in an assault against the dictatorship. And quite apart from the gradual change in the political balance, the evidence also suggests that the state was not very successful in maximizing growth opportunities within the feasible set of options available to it.
Notes to Chapter Twelve


6. Our periodization and the qualitative changes in trends for the Pakistan period using updated data are broadly consistent with those reported earlier by Papanek (1967), Lewis (1969) and (1970), Lewis & Soligo (1965a) and Aniad (1982). While there is agreement in ranking the various Pakistan periods in terms of growth, there are disagreements on quantitative conclusions. See for instance the exchange between Lewis and Papanek in Lewis & Soligo (1965b) and Papanek (1965).

7. See Aniad (1983).


14. See for instance Aniad (1983), Alavi (1983) criticizes the feudal conceptualization, but his argument is in terms of the 'structural imperative of peripheral capitalism', see Chapter Nine.

15. In 1950 the Muslim League satisfied the long unfulfilled populist demand of the Jotedar, and abolished the legal fiction of zamindari.
16. There are many accounts of the constitutional crisis of the fifties, such as Sayeed, K (1960) and (1967).

17. Alavi (1983) points out that the new regime gave substantial economic concessions to the large landlords of West Pakistan in terms of subsidies for mechanization and supported prices for grains. This supports the argument that there was no conflict of the military with the landlords qua landlords.


20. Amjad (1982) pp. 30-60. In East Pakistan in 1970, the four largest monopoly houses controlled 57.1 percent of jute production, 20 percent of cotton textiles, 44 percent of paper and board, and the single private sector fuel and power project ( 100 percent ). Amjad (1983) Table 9.7. In April 1968, Mahbub ul Haq, the Chief Economist of the Planning Commission revealed that twenty-two families controlled 87 percent of banking and insurance and 60 percent of industrial assets in the country, 'Dawn' daily 25th April 1968.


22. Khan, A.R. (1970) in particular Table VIII.


24. Sobhan (1968) traces the growth of rural surplus appropriation through the Basic Democracy structure in East Pakistan over the sixties.

25. Emajuddin Ahmad (1980) p. 98. The figures assume an approximately equal distribution of provincial employees between East and West Pakistan, which seems reasonable.


30. Hanza Alavi who was at one time one of the most senior bureaucrats of the State Bank of Pakistan informed me of the existence of this system.

The new Bangladeshi state made no immediate effort to attack clientelism. In fact, the clientelist coalition was one of the bases of the political power of the regime. Economic performance was poor throughout the life of the short-lived democratic experiment, due to a combination of factors, of which clientelism was only one. These reasons collectively ensured that the stability-efficiency tradeoff was particularly poor. In figure 13.1, our hypothesis is that no part of the tradeoff curve was initially located in the north-east quadrant. This hypothesis is corroborated by the frequent changes in policy in the new state and its ultimate failure in achieving politically viable growth. These policy changes which alternated between attempts to improve political and economic viability can be interpreted as moves along an unfavourable frontier such as $T_3$, between points such as $X$ and $Y$.

**FIGURE 13.1: POLITICAL FRONTIERS IN BANGLADESH**

$S_0$ and $A_0$ refer to socially defined political and economic minimum viability limits. $T_3$ and $T_4$ refer to alternative tradeoffs based on specific resource endowments and political settlements.

In 1975 sections of the state apparatus once again struck down on organizational rights and initiated a new period of dictatorship. The size of
the clientelist coalition and the institutionalization of clientelism meant, however, that the attempts to impose growth-oriented political settlements were now much more short-lived than before. Essentially the same processes were operating, but the forces which reversed attempts to attack clientelism had now become more pervasive and were able to organize much faster.

§ 13.1 The Awami League Period

The ascendance of a new alliance through the nationalist movement, primarily of the urban petty-bourgeoisie and professionals, was reflected as we have seen, in the victory of the Awami League in the general elections of 1970. Out of 162 seats in the National Assembly allocated to East Pakistan, the Awami League won 160, thus gaining an absolute majority in the all-Pakistan assembly, and precipitating the constitutional crisis that led to the creation of Bangladesh. A breakdown of the 162 Awami League nominees in that election showed that only nineteen percent described themselves as businessmen. All the rest were urban professionals, mostly lawyers, who alone constituted forty seven percent of the total.

The departure of the Pakistani capitalists together with the pressures of the new constituency resulted in a reconstituted set of political pressures affecting the state. The takeover of the assets of the West Pakistani capitalists by the state resulted in the growth of the state's share in modern industry from 34 per cent to 81 per cent. The Presidential Order of March 1972 brought in addition, the Bengali-owned factories in the jute, cotton and sugar sectors into public ownership, raising the public sector's share to 92 per cent of the assets of modern industry, with a corresponding increase in the economic involvement of the state and in jobs for the new constituency.

Employment in the public services also witnessed a dramatic expansion. At the time of liberation in 1971, the World Bank estimates that there were 450,000
employees of all grades in the public services, of which only 320 were officers at the level of Joint Secretary or above. By 1973 total employment in the public services had increased to over 650,000, with officers in the higher grades increasing to 660. Some of this growth was due to the change in coverage from the inclusion of new industrial units within the public sector which brought their administrative staff within the ambit of the public services. But the number of white collar staff in Bangladesh’s small industrial sector would only account for a fraction of the increase.

The performance of the economy was dismal. An assessment of 1970-1975 is difficult because of the very real disruptions caused by the war, and the short life of the regime. Productivity in manufacturing was on average less than 50% of the level reached in 1970, and real wages in manufacturing, around 60% of their 1969/70 level. The state could not of course remain insulated from the economic consequences of these developments. Periodic attempts were made to check the depredation which was contributing to the unsustainable performance of the economy, but evidence suggests that the political party in power was too dependant on clientelist coalitions for any of these attempts to succeed.

Many of these attempts to improve economic viability (a move along the tradeoff curve) had to be rapidly abandoned because of political pressure, which supports the existence of a very unfavourable viability tradeoff, with the state alternating between positions such as X and Y along T in figure 13.1. The implementation of attempts to assert discipline were themselves distorted by being used as instruments of conflict between competing clientelist coalitions. Nurul Islam describes the conflict between the Ministry of Industry and eventually the Cabinet on the one hand and the public sector corporations on the other, over the procedures of hiring and firing of personnel and the appropriate level at which such decisions should be taken. Islam quite rightly points out that part of the reason why the central
authorities felt it necessary to actively intervene lay in the prevalence of politically motivated appointments, but equally, their intervention often led to further politically motivated appointments. The rate of turnover itself had economic costs. Of seventy-six chief executives appointed in 1972, not one was in place three years later. Quite a few professional managers emigrated.

Another example was the political mobilization which was organized to oppose the implementation of the recommendations of the 1972 Administrative and Service Reorganization Committee. The recommendations of this committee, as of the 1973 National Pay Commission sought to rationalize the pay structure of the existing 2,208 pay scales in the public administration system into ten grades. Its effects would have been to reduce the pay differential between top and bottom, but also, and more significantly, reveal the level of overstaffing, by allowing the assessment of aggregate levels of employment and the costs. The government failed to implement any of the recommendations of these bodies.

The failure, or perhaps the futility, of the attempts to create a state apparatus appropriate to the needs of the 'intermediate regime' ensured that the experiments of 1971-5 were only to be a short-lived though turbulent historical interlude. The material basis for the enormous growth in clientelism was partly created by the much greater inflows of external resources since the late sixties, but this alone does not explain the phenomenon. The ability of the clientelist coalition to siphon off a large part of the resources over which the state was assigning rights, has to be explained in terms of the political dominance of a new class.

Ironically, the rapidity of the processes of differentiation within the ruling alliance as a result of the much greater possibilities for clientelist surplus appropriation in the early seventies, created a constituency which would eventually support the military in its attempts to create an environment more
appropriate for industrial investment. Nurul Islam describes some of the processes which lay behind this change:

By 1974 there were a number of factors which had contributed to an accumulation of surplus funds in private hands. For one thing, high profits were earned in domestic and import trading activities, including illegal trade such as trade in contraband goods and in smuggling jute and other exportables across the border. Since these transactions were illegal, the risk premium was high and hence profits, once realised, were high. In addition, many residential buildings and trading or commercial enterprises, abandoned by Pakistanis, were illegally occupied by private persons. The 'caretakers' of such commercial enterprises, hastily appointed by the government in 1972 immediately after independence, made large fortunes through the undeclared sale of assets. Moreover, there were gains to be obtained from rental or sales proceeds of the abandoned houses which were illegally occupied by private persons. Those who had accumulated financial resources were pressing the government to commit itself to a more substantial and permanent role for private enterprise in the economy of Bangladesh.11

By 1974, pressure from the new 'capitalist' class resulted in a revision of the government's 'socialist' industrial policy. The ceiling on private investment was increased from two and a half million to thirty million takas. Partnerships with foreign private investors were allowed, and the moratorium on nationalization was increased from ten to fifteen years.

The growth of these demands, and the creation of a constituency which could be the basis of a new balance of power allowing a more favourable renegotiation of rights for industrial investment led to growing tensions within the Awami League. Mujib's response was the 'Second Revolution' of 1975. In January 1975 the constitution was amended, replacing the parliamentary system with a presidential one. The concentration of power was intended to restrict the organizational rights of the urban petty bourgeois groups. As Mujib put it, 'free style democracy' had failed.12 In June 1975 the Bangladesh Peasant Worker Awami League (BAKSAL) was formed and all other political parties banned. Mujib rapidly lost support within the very petty-bourgeois coalitions which were the
mainstay of his power. The attempt to restrict petty-bourgeois organizational rights using a petty-bourgeois dominated political machine could not be tested in practice. In August 1975 the army struck. Mujib was assassinated and organizational rights effectively curtailed. However, as table 12.1 shows, post-1975 industrial growth has been better but by no means dramatic.

§ 13.2 The Return to Dictatorship

President Zia and his eventual successor President Ershad both represented new interventions of the armed forces in 'creating' political settlements. Both seized power with the declared objective of improving the economic conditions in the country, particularly for the industrial sector. In terms of our stylized analytical framework, the political evidence for this period suggests that the changes in the balance of forces brought about during the Awami League period gave the state the opportunity to intervene in politics to impose a settlement which allowed it to operate along a more feasible tradeoff in the subsequent period. On the other hand, the new political settlements were not very stable.

Once more, the state was forced to resort to attempts to balance the un-productive urban coalitions by encouraging the formation of clientelist rural coalitions. Now, however, these attempts had become more transparent to the urban middle classes and were resisted with much greater determination. The costs of creating rural clientele had also increased as decades of involvement in urban politics had created an intelligent jotedar, who was quite adept at using the tensions in the towns to increase his bargaining power. Finally, the institutions of the state including the armed forces had been exposed to clientelism for so long that every attempt to attack clientelism was now increasingly likely to be appropriated in one or other clientelist arrangement.

In terms of figure 13.1, while the shifting mobilizations during this period did move the tradeoff curve up and down, the state was increasingly reduced to attempts to move along a tradeoff curve which had very few feasible points in
the north-east quadrant, while attempts to preserve even this political balance required an almost permanent state of political strife in the country.

President Zia was undoubtedly the more popular president, partly because of his involvement in the liberation struggle and partly because of his ability of being able to judge how far his constituency would be prepared to let him go. Most importantly, perhaps, he died before having to tackle many important issues affecting capitalist viability in Bangladesh. His regime started the policy of denationalization of public sector enterprises, but most of the units put up for divestment were smaller units in the food, chemical and engineering sectors which were not very attractive to clientelist coalitions within the state, and which were only attractive to private sector investors because they were offered on the basis of auctions, with a reserve price set so low that it implicitly gave large hidden subsidies to investors. These moves to improve capitalist efficiency conditions were quite consistent with the changes in the political balance and generated comparatively little political opposition.

Between 1976 and 1983, in the denationalization initiated by President Zia's government, a total of 217 public sector enterprises were wholly or partially sold to the private sector or returned to their former Bengali owners from whom they had been nationalized in the aftermath of liberation. The total sale value of the 111 units for which figures were available, amounted to Tk. 1,158,248,000. It should however be pointed out that the sale values have been criticized for having a significant downward bias.

One difficulty facing any evaluation is the inbuilt tendency for large-scale enterprises in developing economies like Bangladesh, which have received substantial side-payments from the state, to evolve accounting methods which disguise enterprise surplus appropriation and use. This would be true whether or not capitalists had control over the surplus appropriation process, though
the implications for the consumption and use of the undeclared surplus could be different between the two cases. What we can investigate is whether policies which supported the rights of private capital were associated with a possible increase in the investible surplus. Table 13.1 presents some evidence which suggests that this may indeed have been the case.

**TABLE 13.1: ZIA’S DENATIONALIZATIONS: DISINVESTED ENTERPRISE PERFORMANCE 1976-83**

<table>
<thead>
<tr>
<th>INDICATOR</th>
<th>Number of Units in Sample</th>
<th>Improved in: Declined in: Unchanged</th>
<th>Units Laid Off</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Annual Production</td>
<td>35</td>
<td>19</td>
<td>11</td>
</tr>
<tr>
<td>2 Annual Sales</td>
<td>43</td>
<td>29</td>
<td>9</td>
</tr>
<tr>
<td>3 Annual Sales at 1972/3 Prices</td>
<td>43</td>
<td>23</td>
<td>15</td>
</tr>
<tr>
<td>4 Profitability</td>
<td>24</td>
<td>8</td>
<td>11</td>
</tr>
<tr>
<td>5 Labour Employment</td>
<td>31</td>
<td>13</td>
<td>17</td>
</tr>
<tr>
<td>6 Employment of Officers &amp; Staff</td>
<td>5</td>
<td>0</td>
<td>5</td>
</tr>
</tbody>
</table>

Note: The 5 Units in Row 6 refer to 5 Industry Groups composed of 31 Enterprises.

Source: Sobhan & Ahsan (1983); From Tables 3A, 3B, 3C, 3D, 4A, & 4B.

The sample size is very small and no adjustment is made for any underlying cyclical or trend movements in the economy over the period. Sobhan & Ahsan emphasize that profitability declined in more enterprises after denationalization. However, their figures are for reported profitability, and with large repayments due to the state, given standard tax avoidance practices, it is quite likely that under-reporting of profitability figures increased after denationalization. It is standard practice for the controllers of large state-subsidised enterprises to appropriate a large part of the surplus through transactions which are not shown on the books.

The indications provided by the other rows of table 13.1 gives some support to this possibility. Rows 1, 2 and 3 show that production and sales, both in nominal and real terms increased in quite a few units. Unfortunately, figures for the aggregate amounts are not provided. On the other hand, there was, as
Row 5 suggests, a tendency for the labour force to be cut back. Here dis-aggregated figures are available showing a drop in aggregate labour employment, of about 7.5% across the 31 sample units. Moreover, behind the aggregate figures, there was a marked growth in the use of so-called casual labour. If this category is excluded, the fall in employment jumps to 25%.

Even if all casual labour is counted as fully employed, the change implies an improvement in the enterprise's cost profile and surplus generating capacity.

But it is Row 6 which is the most important from our point of view: a decline in the employment of Officers and Staff in each of the five industry groups without exception. What is more, the extent of the decline, reported by Sobhan & Ahsan without comment, was a steep 27% on average. A retrenchment programme on this scale must have implied a significant shift in the bargaining power of white collar workers, and in their power to mobilise at the enterprise level. The changes in the national balance of power are thus directly related to a micro level shift in bargaining strength in this case. Since there is no evidence that the effect on output or sales was crippling, a rationalization on this scale, given the higher salary structures of office staff and their participation in clientelist surplus appropriation, must have resulted in noticeable (if unreported) increases in the investible surplus.

On the other hand, the Zia regime faced much more opposition to its attempts to rationalize the public services, a process which the successor regime would be compelled to continue. The 1976 Pay and Service Commission once again recommended rationalizations of the pay structure and the criteria for promotion within the public services. This time the government did push through their implementation, but in the face of considerable opposition in the form of strikes and demonstrations by public sector employees. The pay structure was transformed into twenty one grades and scales, but the regime also discovered the negative tradeoff it was operating along.
The relative growth in prosperity during the Zia period also contributed to the long established processes which were essentially unchanged since the days of the raj, and which worked to create a permanent growth of the urban middle classes through rural migration, education and the demand for jobs. Table 13.2 shows the sustained growth in the share of employment of urban professions in total employment over the period of Zia's regime, at a time when total employment was also growing. This implies much higher comparative rates of growth of employment in white collar jobs. The rapidity of the growth in urban service sector employment suggests again that while the growth could partly be the result of an endogenous demand, it was quite likely that to a large extent economic growth in general increased both the exogenous pressure for jobs by members of clientelist coalitions, and the costs of trying to resist it. Thus while economic growth created the conditions for a strengthening of the support capitalists could demand from the state and their own ability to defend their rights, it simultaneously created the political conditions which would lead to a significant weakening of the settlement achieved in 1975.

**TABLE 13.2: OCCUPATIONAL STRUCTURE OF URBAN EMPLOYMENT 1974-1980 (Percent)**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Professional Admin &amp; Clerical</td>
<td>11.4</td>
<td>20.2</td>
<td>13.7</td>
<td>12.2</td>
</tr>
<tr>
<td>Sales</td>
<td>20.9</td>
<td>21.2</td>
<td>3.0</td>
<td>5.8</td>
</tr>
<tr>
<td>Service</td>
<td>7.5</td>
<td>15.2</td>
<td>58.3</td>
<td>74.4</td>
</tr>
<tr>
<td>Agriculture</td>
<td>14.7</td>
<td>10.8</td>
<td>7.7</td>
<td>4.5</td>
</tr>
<tr>
<td>Production &amp; Transport</td>
<td>45.4</td>
<td>32.6</td>
<td>17.3</td>
<td>3.2</td>
</tr>
</tbody>
</table>


In 1978 Zia, facing increasing clientelist pressure for political resource allocation, formed the Bangladesh Nationalist Party from a motley collection of smaller oppositional parties. This institutionalized the political process through which political pressure translated into surplus appropriation. In terms of our argument, we would expect the political frontier to start moving towards the south-west, constraining the ways in which the state could
intervene efficiently in the economy. Zia's belief that problems could be
solved by distributing resources was quite possibly a confidence which
political realities compelled him to display. In effect the distribution of
resources not only to the clientelist coalition, but through the involvement of
capitalists in clientelism, the distribution of resources to the capitalists
too, increasingly reflected the growth in clientelist pressure.17

Like his predecessors, Zia too tried to avoid dependence on this growing
political constituency by evolving new strategies of involving the
'countryside' in the political process. Much of his institutional ideas however,
like the Gram Sarkar or village government, remained largely unimplemented at
the time of his assassination in 1981.

The popular base of the Ershad regime has been much narrower, and state
decision-makers have been resigned to move down an unfavourable tradeoff,
trying to improve economic viability even at the expense of steep declines in
the political viability of the regime. The post-1982 period has been marked by
a series of increasingly violent political confrontations between the state
apparatus and large mobilizations of the urban middle-classes.

Analytically, there are two quite separate aspects to this confrontation. On
the one hand, while the political conditions for efficient state intervention
were still better than in the Mujib era, they were certainly not as favourable
as in the early sixties. In terms of the frontier \( T_A \) in figure 13.1, this meant
that the feasible space \( FS \) was by 1982 much smaller, and the point \( G \) would be
reached at a much slower rate of growth over time. State decision-makers seem
to have realized that to stem the increasing pressures on resources, and
perhaps partly as a response to pressures from external lenders and donors,
the conditions for faster growth would have to be created. The state seems to
have taken the decision to improve capitalist efficiency conditions by moving
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beyond the maximum politically tolerable point $G$, which now provided a much lower growth possibility than in the sixties. $T_\alpha$ was much lower in the new circumstances, and even more so since the late seventies.

On the other hand, the growth of the 'democratic movement' particularly after 1984, and the increasing resort to clientelist politics by the regime meant that the political settlement was threatened by a much more fundamental movement downward, and the frontier itself was being pushed back to a position like $T_\alpha$, a process which has led to increasingly violent mobilizations.

The perception within the new regime regarding the tasks facing it and the potential costs, was quite remarkable. A series of committees were set up to make recommendations about the economic re-structuring felt to be necessary. The main results of the findings led the regime to embark on a process of denationalization, liberalization and administrative decentralization. The analysis of the critically important jute industry given in the confidential report of Committee for Re-Organization of the Public Statutory Corporations deserves to quoted at length. We also reproduce the table provided by the committee alongside the text.

Although the total production of the nationalised jute sector increased only marginally, i.e., from about 56,000 tons in 1969-70 to about 58,000 tons in 1980-81, there was very substantial increase in the number of officers, employees and workers as the following figures will show. Thus productivity per employee deteriorated sharply after nationalization of the industry.

### TABLE 7

<table>
<thead>
<tr>
<th>Category</th>
<th>As on 30.6.1970</th>
<th>As on 30.6.1981</th>
</tr>
</thead>
<tbody>
<tr>
<td>Officers</td>
<td>2,310</td>
<td>6,589</td>
</tr>
<tr>
<td>Employees</td>
<td>16,077</td>
<td>22,744</td>
</tr>
<tr>
<td>Workers</td>
<td>129,048</td>
<td>175,685</td>
</tr>
<tr>
<td>Total</td>
<td>147,435</td>
<td>205,018</td>
</tr>
</tbody>
</table>

(Source: BJMC)
It is the considered view of the Committee that even with the establishment of the zonal offices, the present set-up in BJMC has remained highly centralized which is not conducive to achieving the desired improvement in management performance at the enterprise level. The Committee believes that the organisational re-structuring being proposed here will drastically cut down the span of control in the nationalized jute industries, which is at present over extended and that this will have a salutary impact upon the quality of management and productivity.

There is no doubt whatsoever that unless the corrupt practices specially at the mill level are effectively checked and the inefficient and corrupt elements weeded out, the tremendous waste of resources cannot be stopped and the cost of production significantly reduced. The *sine qua non* of efficient management is the ability to employ and terminate services of personnel in the best interest of the organisation. What is being sought to be preserved so assiduously by the Jute Division is an organisational structure which has all the demerits of a departmental undertaking without its advantages. The Committee cannot persuade itself to agree with the contention that any structural change, albeit for the better, is fraught with danger and will invite the wrath of the World Bank and other financing institutions. The committee is aware that in any area where strong vested interest has grown over the years there is a built in resistance to change.

Under the New Industrial Policy adopted by the regime in 1982, denationalization of large-scale public enterprises was given priority. In the face of substantial and growing political opposition, the government divested 110 units in little more than a year, after which the programme continued at a slower pace. In terms of the government's (unpublicized) goal of rationalizing the structure of employment in the large-scale industrial sector, the denationalization strategy did produce some results.

Table 13.3 presents information on the changes in employment structure in the jute mills denationalized since 1982/3. The mills were not all denationalized together. By the end of 1982/3, 29 mills were denationalized, a further 4 were denationalized over 1983/4, and one was denationalized in 1984/5. Moreover, no retrenchment was legally allowed in the first year of denationalization according to an agreement between the government, the mill-owners and the
employees. Nevertheless, the pattern of retrenchment carried out by 1988 conforms with our expectation of substantial overstaffing at the intermediary levels. In relative terms, 13.6 percent of staff, 8.3% of officers and only 5.6% of production workers were laid off over the period 1983-88.

<table>
<thead>
<tr>
<th>MILL</th>
<th>1983 Looms</th>
<th>1983 Officers</th>
<th>1983 Staff</th>
<th>1983 Workers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alijan</td>
<td>256</td>
<td>-0.4</td>
<td>66</td>
<td>-18.2</td>
</tr>
<tr>
<td>Ajax</td>
<td>250</td>
<td>0.0</td>
<td>58</td>
<td>3.4</td>
</tr>
<tr>
<td>Amtiara</td>
<td>389</td>
<td>0.0</td>
<td>97</td>
<td>-22.7</td>
</tr>
<tr>
<td>Alhaj</td>
<td>250</td>
<td>0.0</td>
<td>52</td>
<td>-13.5</td>
</tr>
<tr>
<td>Airil</td>
<td>250</td>
<td>0.0</td>
<td>62</td>
<td>-4.8</td>
</tr>
<tr>
<td>BBI</td>
<td>68</td>
<td>0.0</td>
<td>39</td>
<td>-10.3</td>
</tr>
<tr>
<td>CJMCL</td>
<td>1177</td>
<td>1.1</td>
<td>216</td>
<td>-23.1</td>
</tr>
<tr>
<td>Cooperative</td>
<td>263</td>
<td>5.3</td>
<td>54</td>
<td>27.8</td>
</tr>
<tr>
<td>Delta</td>
<td>541</td>
<td>0.0</td>
<td>85</td>
<td>-9.4</td>
</tr>
<tr>
<td>Dhaka</td>
<td>416</td>
<td>0.0</td>
<td>119</td>
<td>-23.5</td>
</tr>
<tr>
<td>Fauji</td>
<td>260</td>
<td>0.0</td>
<td>62</td>
<td>-11.3</td>
</tr>
<tr>
<td>Gawsia</td>
<td>250</td>
<td>0.0</td>
<td>71</td>
<td>-12.7</td>
</tr>
<tr>
<td>Howlader</td>
<td>250</td>
<td>0.0</td>
<td>55</td>
<td>-1.8</td>
</tr>
<tr>
<td>Jabbar</td>
<td>250</td>
<td>1.2</td>
<td>68</td>
<td>-17.6</td>
</tr>
<tr>
<td>Janata</td>
<td>256</td>
<td>1.6</td>
<td>57</td>
<td>59.6</td>
</tr>
<tr>
<td>Kohinoor</td>
<td>250</td>
<td>0.0</td>
<td>61</td>
<td>-26.2</td>
</tr>
<tr>
<td>Mah Esran</td>
<td>250</td>
<td>4.0</td>
<td>68</td>
<td>13.2</td>
</tr>
<tr>
<td>Mashriqui</td>
<td>56</td>
<td>17.9</td>
<td>38</td>
<td>28.9</td>
</tr>
<tr>
<td>Mhsin</td>
<td>68</td>
<td>0.0</td>
<td>40</td>
<td>22.5</td>
</tr>
<tr>
<td>Noapara</td>
<td>210</td>
<td>1.0</td>
<td>68</td>
<td>-27.9</td>
</tr>
<tr>
<td>National</td>
<td>318</td>
<td>0.0</td>
<td>91</td>
<td>-22.0</td>
</tr>
<tr>
<td>N Askari</td>
<td>500</td>
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<td>103</td>
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<tr>
<td>Pubali</td>
<td>250</td>
<td>0.0</td>
<td>57</td>
<td>0.0</td>
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<tr>
<td>Saltar</td>
<td>278</td>
<td>0.0</td>
<td>53</td>
<td>-22.2</td>
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<td>SHK</td>
<td>68</td>
<td>0.0</td>
<td>48</td>
<td>8.3</td>
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<tr>
<td>Sonali</td>
<td>500</td>
<td>0.0</td>
<td>82</td>
<td>6.1</td>
</tr>
<tr>
<td>Star Alkaid</td>
<td>304</td>
<td>0.0</td>
<td>72</td>
<td>5.6</td>
</tr>
<tr>
<td>Taj</td>
<td>55</td>
<td>0.0</td>
<td>47</td>
<td>-56.3</td>
</tr>
<tr>
<td>Victory</td>
<td>496</td>
<td>-19.8</td>
<td>81</td>
<td>-16.0</td>
</tr>
<tr>
<td>W Rahane</td>
<td>500</td>
<td>0.0</td>
<td>90</td>
<td>-16.7</td>
</tr>
<tr>
<td>ALL MILLS</td>
<td>9229</td>
<td>-0.5</td>
<td>2170</td>
<td>-8.3</td>
</tr>
</tbody>
</table>

Source: Mill level data from Bangladesh Jute Mills Association. Full information was not available for five other denationalized mills, and they are not reported. 'Looms' refers to all types including Hessian, Sacking, and Carpet Backing, and give a rough measure of capacity, but not output. Workers refer only to permanent registered workers.

The denationalized mills were a relatively small part of the jute industry, consisting of the mills owned by Bangladeshis prior to 1971, which amounted to only 38 percent of total installed capacity. Nevertheless, given the scale of
the problem identified by a section of the state apparatus, the restructuring achieved in the private sector must have been disappointing. Even without the figures suggested in the government report, we would have suspected substantially higher clientelist over-employment in the large-scale sector, but the restructuring achieved here seems to have been less than in the smaller industries denationalized by Zia.

This could be an indication of the greater strength of clientelist coalitions in larger organizations. It is certainly true that an alliance of worker and employee trade unions emerged as a political actor in 1984 as a direct response to the denationalizations, the Worker Employee United Front (SKOP from its Bengali acronym), which successfully put pressure on the government to slow down the denationalization strategy. As we would expect, 'petty-bourgeois office workers' have been the most influential component of SKOP. Finally, inter-enterprise differences have also been substantial, with some enterprises dismally failing in the task of restructuring and eventually ending up in serious financial trouble.

The restructuring in the privatized mills may be compared with the employment trends in the mills which remained under public ownership, which is shown in table 13.4. In these mills there was an overall growth in employment for each category of employee, but with officer and staff employment growing much faster than that of production workers. The employment of officers grew by 22.5%, staff 11.2% and production workers 2.0%. Once again, these trends are quite systematic within the public enterprise set at the mill level. Since output between the two sets of mills did not diverge in this dramatic way, (we shall see in the next chapter that there was stagnant or declining output trend over this period for jute manufacturing), the differences in employment growth between the two sets of mills have to be explained.
### TABLE 13.4 EMPLOYMENT CHANGES IN PUBLIC SECTOR JUTE MILLS 1983-88

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Adabjee</td>
<td>874</td>
<td>20.9</td>
<td>2496</td>
<td>-3.6</td>
<td>23828</td>
<td>6.6</td>
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<tr>
<td>Alleem</td>
<td>46</td>
<td>58.7</td>
<td>172</td>
<td>52.3</td>
<td>1220</td>
<td>7.1</td>
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<tr>
<td>Amin</td>
<td>208</td>
<td>28.8</td>
<td>672</td>
<td>33.3</td>
<td>6391</td>
<td>-3.8</td>
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<tr>
<td>Bangladesh</td>
<td>121</td>
<td>-0.8</td>
<td>367</td>
<td>27.5</td>
<td>3271</td>
<td>-0.5</td>
</tr>
<tr>
<td>Bawa</td>
<td>82</td>
<td>32.9</td>
<td>266</td>
<td>41.7</td>
<td>2050</td>
<td>5.4</td>
</tr>
<tr>
<td>BDGF</td>
<td>44</td>
<td>27.3</td>
<td>112</td>
<td>52.7</td>
<td>482</td>
<td>-34.2</td>
</tr>
<tr>
<td>Carpeting</td>
<td>48</td>
<td>22.9</td>
<td>194</td>
<td>7.7</td>
<td>877</td>
<td>8.9</td>
</tr>
<tr>
<td>Crescent</td>
<td>205</td>
<td>28.8</td>
<td>753</td>
<td>0.1</td>
<td>7022</td>
<td>-8.0</td>
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<tr>
<td>Daulatpur</td>
<td>51</td>
<td>41.2</td>
<td>243</td>
<td>11.1</td>
<td>1585</td>
<td>-4.7</td>
</tr>
<tr>
<td>Eastern</td>
<td>59</td>
<td>5.1</td>
<td>293</td>
<td>18.1</td>
<td>1281</td>
<td>6.1</td>
</tr>
<tr>
<td>FKC</td>
<td>39</td>
<td>43.6</td>
<td>114</td>
<td>43.9</td>
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</tr>
<tr>
<td>Gul Ahmed</td>
<td>88</td>
<td>19.3</td>
<td>266</td>
<td>29.3</td>
<td>1929</td>
<td>9.1</td>
</tr>
<tr>
<td>Hafiz Jute</td>
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<td>328</td>
<td>14.3</td>
<td>2951</td>
<td>10.7</td>
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<tr>
<td>Hafiz Textile</td>
<td>38</td>
<td>52.6</td>
<td>133</td>
<td>44.4</td>
<td>549</td>
<td>9.5</td>
</tr>
<tr>
<td>Jessore</td>
<td>123</td>
<td>22.8</td>
<td>463</td>
<td>-0.4</td>
<td>2686</td>
<td>-7.1</td>
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<tr>
<td>Karim</td>
<td>125</td>
<td>34.4</td>
<td>320</td>
<td>45.6</td>
<td>3598</td>
<td>-2.1</td>
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<tr>
<td>Karnafuli</td>
<td>79</td>
<td>43.0</td>
<td>200</td>
<td>47.5</td>
<td>1331</td>
<td>-8.6</td>
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<tr>
<td>L.Bawany</td>
<td>218</td>
<td>-8.7</td>
<td>606</td>
<td>3.0</td>
<td>5263</td>
<td>3.7</td>
</tr>
<tr>
<td>MM</td>
<td>48</td>
<td>20.8</td>
<td>177</td>
<td>7.3</td>
<td>672</td>
<td>3.6</td>
</tr>
<tr>
<td>Munawar</td>
<td>52</td>
<td>7.7</td>
<td>161</td>
<td>9.3</td>
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<td>22.4</td>
</tr>
<tr>
<td>Mynessingh</td>
<td>95</td>
<td>24.2</td>
<td>242</td>
<td>38.0</td>
<td>2307</td>
<td>7.6</td>
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<tr>
<td>Nabarun</td>
<td>66</td>
<td>12.1</td>
<td>229</td>
<td>16.6</td>
<td>1459</td>
<td>-3.4</td>
</tr>
<tr>
<td>Nishat</td>
<td>106</td>
<td>-3.8</td>
<td>349</td>
<td>0.3</td>
<td>2270</td>
<td>3.7</td>
</tr>
<tr>
<td>People's</td>
<td>147</td>
<td>36.7</td>
<td>594</td>
<td>16.7</td>
<td>5330</td>
<td>9.9</td>
</tr>
<tr>
<td>Platinum</td>
<td>171</td>
<td>13.5</td>
<td>659</td>
<td>1.1</td>
<td>5368</td>
<td>1.6</td>
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<tr>
<td>Purbachal</td>
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<td>31.1</td>
<td>165</td>
<td>23.6</td>
<td>660</td>
<td>3.6</td>
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<tr>
<td>Quamri</td>
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<td>17.5</td>
<td>423</td>
<td>3.5</td>
<td>3237</td>
<td>8.4</td>
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<tr>
<td>Rajshahi</td>
<td>56</td>
<td>53.6</td>
<td>284</td>
<td>4.6</td>
<td>1453</td>
<td>7.1</td>
</tr>
<tr>
<td>RR</td>
<td>38</td>
<td>52.6</td>
<td>144</td>
<td>35.4</td>
<td>647</td>
<td>5.1</td>
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<tr>
<td>Star</td>
<td>101</td>
<td>75.2</td>
<td>611</td>
<td>-14.1</td>
<td>4343</td>
<td>-9.2</td>
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<tr>
<td>UMC</td>
<td>146</td>
<td>17.1</td>
<td>557</td>
<td>4.7</td>
<td>5478</td>
<td>-0.9</td>
</tr>
<tr>
<td>TOTAL</td>
<td>3780</td>
<td>22.5</td>
<td>12593</td>
<td>11.2</td>
<td>101031</td>
<td>2.0</td>
</tr>
</tbody>
</table>

**Source:** Bangladesh Jute Mills Corporation, Workers are permanent registered workers only.

Clientelism seems to be the most likely explanation for this divergence. The public enterprises were not only much larger organizations (the average size in terms of production worker employment was about double that of the average privatized firm), but we would also expect clientelism to be much more entrenched in the public sector in an economy such as that of Bangladesh. A further explanation suggested by some private sector managers is that the state transferred large numbers of staff and officers to the private sector just before denationalization to let the private sector do the 'dirty work'. If this is true, this is also quite damaging for the public sector, because it shows an inability to operate without responding to clientelist pressures.
The New Industrial Policy also extended the liberalization process begun in 1980. The investment sanctioning procedure was further decentralized and the number of 'Free Sectors' increased to about fifty. Investors in free sectors theoretically needed no sanctioning at all, and could purchase the necessary foreign exchange for capital goods imports from the open market (known as the Wage Earner Scheme or WES market since the foreign currencies sold are mostly the remittances of overseas Bangladeshi workers). Fiscal incentives such as tax holidays and interest rate subsidies were extended. Personal and company taxation rates were reduced, estate and stamp duties removed. The system of preferential exchange rates for exporters was extended and rationalized with the introduction of the Export Performance Benefit (XPB) Scheme.

Initially, the response to these policies was encouraging. According to one set of estimates, between 1981 and 1984, private sector imports of capital goods doubled from 44 to 85 million US dollars, entirely due to a steep increase in capital imports through the WES market, from less than 5 to 54 million US dollars. Nevertheless, private capital imports through the official market declined, and as a newspaper editorial pointed out in 1985, despite the privileges enjoyed by the private sector, investment by this sector in the second five year plan period 1980-5, amounted to eight billion takas, less than one-third of the government's target. From 1984 the democratic movement against the military regime began a fairly sustained campaign, and private industrial investment in the subsequent period performed even less well. The Third Five Year Plan envisaged private sector industrial investment of Taka 32 billion at constant 1984/5 prices over the plan period 1985-90, but after the first two years of the period, total private sector industrial investment stood at a mere Taka 6.8 billion.

Another indication that an overall change in the investment climate has not come about is provided by the almost total lack of response over the past
several years to the incentives given to domestic and foreign investment in the duty and tax-free Export Processing Zone which the government has been trying to establish at Chittagong. Though this drive began during the 1975-81 administration of President Zia, in late 1985 there were a mere seven firms operating in the Zone. Compared to South Korea, Bangladesh's export drive is clearly at the other end of the spectrum in terms of performance in the setting and fulfilling of export targets.

To deal with the question of public employment generally, the Committee on Organizational Set-up was commissioned shortly after the regime took power and reported a substantial overstaffing in the public services. It recommended a reduction in the number of ministries from 44 to 19 and the number of Divisions from 60 to 42. The 'surplus' employment reported at the highest levels of the state apparatus and the extent of the retrenchment recommended in the Committee's report, from which Table 13.5 has been constructed, shows the depth of the conflict at the apex of political power.

<table>
<thead>
<tr>
<th>Category of Officers and Staff</th>
<th>Actual</th>
<th>Revised</th>
<th>Surplus</th>
<th>Percentage Surplus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Class I Officers</td>
<td>1,524</td>
<td>1,349</td>
<td>175</td>
<td>11.5</td>
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<tr>
<td>Class II Officers</td>
<td>93</td>
<td>54</td>
<td>29</td>
<td>34.9</td>
</tr>
<tr>
<td>Class III Employees</td>
<td>5,225</td>
<td>3,161</td>
<td>2,064</td>
<td>39.5</td>
</tr>
<tr>
<td>Class IV Employees</td>
<td>2,608</td>
<td>1,554</td>
<td>1,054</td>
<td>40.4</td>
</tr>
<tr>
<td>Total Officers and Employees</td>
<td>9,440</td>
<td>6,118</td>
<td>3,322</td>
<td>35.2</td>
</tr>
</tbody>
</table>

Source: Committee on Organizational Set-up reported in IBRO(1984) p. 117.

The committee, which came to be known as the Enam Committee, after its chairman, Brigadier Enamul Huq Khan, also estimated surplus employment at lower levels of government, in Sector Corporations, Departments, Directorates and Subordinate Offices, and these lower level findings are publicly available. Perhaps taking into account political considerations, the aggregate recommendations of the committee were not very radical. At these lower levels,
the net effect of the recommendations was a small (less than one per cent) reduction in the number of vacancies in the public services. On the other hand, substantial structural change was recommended, with large reductions in Classes III and IV, and increases in Classes I and II. These changes did require the retrenchment of large numbers of employees in particular categories. In a report written in 1987, Murshid and Sobhan write:

The notion that a long tradition of welfare based employment policies (sic) can be eradicated through discharge of surplus employees is a fantasy. For all its declaration of 'surplus' employees the Enam Committee did not succeed in reducing the public work force by a single person. All so-called 'surplus' employees were either relocated in other agencies of government or were retained on the salary roster of their original employer until the impact of the original order was eroded by a process of attrition.28

Faced with the impossibility of structural change, the Ershad regime simply resorted to a blanket ban on further public sector employment, but political pressures have made this an increasingly less feasible policy and the ban is beginning to be relaxed. Table 13.6 shows that the post-1975 regimes have experienced a slowing-down in the growth of public sector employment, but, as we have seen, even this small change has had a heavy political price.

<table>
<thead>
<tr>
<th>TABLE 13.6: PUBLIC SECTOR EMPLOYMENT 1973-1984</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>Central Government</td>
</tr>
<tr>
<td>Autonomous Bodies</td>
</tr>
<tr>
<td>Financial Institutions</td>
</tr>
<tr>
<td>Railways</td>
</tr>
<tr>
<td>Public Corporations (ex. Manufacturing)</td>
</tr>
<tr>
<td>Manufacturing</td>
</tr>
<tr>
<td>TOTAL</td>
</tr>
</tbody>
</table>

Source: Based on Murshid & Sobhan[1987] Table 1.

Finally the Ershad regime, like many before it, turned to agrarian constituencies in an effort to balance urban opposition. This time however, a
much more radical process of administrative decentralization was attempted. Following the Report of the Committee on Administrative Reorganization/Reform, another committee set up by the regime almost immediately following its accession to power, the government adopted a programme which was intended to give a qualitatively greater political voice to new aspirants to power in the villages. The old 'thana' was to be upgraded to an 'upazilla', a new administrative unit. Its chairman was to be directly elected, it would for the first time have the power to raise some revenues, it would be the administrative centre through which rural development would be organized and funded, and its jurisdiction would extend over district towns which happened to fall in its domain.29

From 1984 onwards the urban middle classes have engaged in an unremitting struggle against this latest attempt to undercut their access to state power. On the other hand a politically mature village elite has increased the costs of the traditional strategy of attacking urban clientelism by encouraging rural clientelism. A contemporary newspaper article examining the effects of local government elections in 1984, contrasts the patently wasteful political processes which were eventually being adopted with the greater priority the regime was giving to attracting available surplus to industry.

While the real extent of the dominance of black money within the economy can be nothing more than a guess estimate, knowledgeable circles feel that its continuing dominance is still an inflationary threat. The countrywide Union Parishad (UP) elections, (the administrative level below the Upazilla - MK) which concluded on January 10 last, were amply reflective of a massive display of money and finance by the election contestants in 4,400 unions in the rural areas. With a record number of candidates contesting the last UP polls this year, a very conservative estimate suggests that not less than Tk, 4.4 billion were spent on electioneering by all candidates, the electoral expense as such for each Union being taken at the level of one million takas...

The available indications point out that the declarants of black money under MLR-V (Martial Law Regulation which enabled black or undeclared money to be legalized by
investments in specified sectors - MK, have not gone in a big way for investments in disinvested industries, notwithstanding the government's original intention of routing such untaxed income for investment purposes connected with (the) disinvestment programme. This is evident from the fact that only 38 per cent of total sale proceeds under different disinvestment packages had so far been deposited with the government. 30

The experience of the present government has demonstrated that even a well-conceived plan of devolving political power to the 'countryside' is now unlikely to gain the state even a temporary respite by changing the political balance in a way which allows it to operate along a more favourable tradeoff curve. Clientelism has also pervaded some of the institutions where it was not as rife before. The army in particular is widely known to be involved in the distribution of contracts, and President Ershad himself has been publicly implicated in the international media. 31

§ 13.3 The Experience of Other Developing Countries

The nature of the political constraints on efficient state intervention in the economy are not unique to Bangladesh. What is perhaps special about Bangladesh is the particularly unattractive set of options facing the state. This has demanded a high degree of institutional sophistication and political leadership to manage the economy, to an extent which has often not been forthcoming. But there is evidence which suggests that the general features of the problem plague a large number of developing countries. It would therefore seem that the extent of the problem across different countries, and the quality of the state's institutional response could be quite important in explaining differences in performance across countries.

The collective experience of developing countries suggests that there have been important structural changes in some critical features of capitalist growth, from the time of the early capitalist developers, who started industrializing during the late nineteenth century. The first is in the nature of technology,
investments in specified sectors - MK,) have not gone in a big way for investments in disinvested industries, notwithstanding the government's original intention of routing such untaxed income for investment purposes connected with (the) disinvestment programme. This is evident from the fact that only 38 per cent of total sale proceeds under different disinvestment packages had so far been deposited with the government.\textsuperscript{30}

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The collective experience of developing countries suggests that there have been important structural changes in some critical features of capitalist growth, from the time of the early capitalist developers, who started industrializing during the late nineteenth century. The first is in the nature of technology,
which now allows late-developers to enjoy relatively high rates of growth. The second change, which is less often noticed, is in the 'labour market', and has to do with the supply and demand of different categories of labour. Table 13.7 presents World Bank figures for developed and developing countries at comparable periods of development showing the sectoral distribution of the labour force and the rate of growth of labour force in each sector.

**TABLE 13.7: LABOUR FORCE STRUCTURE AND GROWTH IN DEVELOPED AND DEVELOPING COUNTRIES**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Developed Countries 1880 Share %</th>
<th>Rate of Growth 1880-1900</th>
<th>As Ratio of Total</th>
<th>Developing Countries 1960 Share %</th>
<th>Rate of Growth 1960-70</th>
<th>As Ratio of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>56.2</td>
<td>0.4</td>
<td>0.33</td>
<td>70.7</td>
<td>1.1</td>
<td>0.55</td>
</tr>
<tr>
<td>Industry</td>
<td>24.1</td>
<td>2.1</td>
<td>1.75</td>
<td>11.5</td>
<td>3.8</td>
<td>1.90</td>
</tr>
<tr>
<td>Services</td>
<td>19.5</td>
<td>2.1</td>
<td>1.75</td>
<td>17.8</td>
<td>3.9</td>
<td>1.95</td>
</tr>
<tr>
<td>TOTAL</td>
<td>100.0</td>
<td>1.2</td>
<td>1.00</td>
<td>100.0</td>
<td>2.0</td>
<td>1.00</td>
</tr>
</tbody>
</table>

Source: Squire (1981) Tables 2 and 8. Developing Countries include Africa except South Africa, Latin America, Asia except China, Japan, North Korea, Mongolia and North Vietnam, and Oceania except Australia and New Zealand. Developed countries include Japan, Australia, New Zealand, South Africa, Canada, the U.S. and Western Europe.

Despite the capital intensity of modern technology, the rate of growth of the industrial labour force in modern developing countries has been almost eighty per cent higher over the periods compared. However, the higher rate of growth of the industrial labour force notwithstanding, because of the much smaller initial share of industry, its share overall remains low. What is interesting, however, is the comparable size of the service sector in modern developing countries, and the even faster rate of growth of employment there. Despite this, as Squire points out, it is within the educated middle-classes, the potential aspirants for service sector jobs, that the highest measured incidence of 'unemployment' is observed, as they are the only major section of the population who can 'afford' to be unemployed, the others being forced to seek at least some form of partial employment.32

Part of the explanation of the much higher growth in service sector employment could be on the demand side, brought about by changes in the nature of
technology and in tastes, but table 13.8 shows that there have also been independent changes on the supply side, which have affected the relative supply of educated applicants in the job-market. We see that primary education has been growing faster in developing countries, but from a lower base, while secondary education is growing at about the same rate, but the base is four times larger with respect to the total population, and consequently much larger with respect to the relatively smaller industrial sector. While the absolute size of these figures may appear to be small, the example of Bangladesh serves to show that the social processes underlying these figures may be very significant.

**TABLE 13.8: PARTICIPATION AND RATE OF GROWTH IN EDUCATION**

<table>
<thead>
<tr>
<th></th>
<th>Primary School</th>
<th>Secondary School</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Percentage of Population Attending</td>
<td></td>
</tr>
<tr>
<td>Developed Countries 1900</td>
<td>15.0</td>
<td>0.4</td>
</tr>
<tr>
<td>Developing Countries 1960</td>
<td>8.1</td>
<td>1.6</td>
</tr>
<tr>
<td><strong>Average Annual Rate of Expansion in Attendance</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Developed Countries 1890-1900</td>
<td>1.6</td>
<td>8.3</td>
</tr>
<tr>
<td>Developing Countries 1960-70</td>
<td>5.4</td>
<td>8.4</td>
</tr>
</tbody>
</table>

Source: Squire[1981] Table 5. Developed Countries are Japan, Sweden, Italy, France, Norway, UK, US, Netherlands and Belgium. Developing Countries are all countries with per capita GDP less than $2000 in 1975 and populations more than 1 million, except centrally planned economies.

**Conclusion**

The argument in Part III has tried to provide a re-reading of the contemporary political and economic history of Bangladesh. Our objective has been to interpret the historical material using the analytical indicators which were developed in previous chapters, where a model of efficient state intervention was developed. The method employed was to select from secondary and some primary sources, information which on the basis of our model, allowed us to hypothesize about the kinds of constraints the state was operating under in different periods. In Part IV we will see that the historical information on which our hypotheses of phase changes were based may be quite relevant in
aiding our understanding of the performance constraints in the industrial sector in Bangladesh. We distinguished three phases in the recent history of state-society relationships from 1958 onwards.

The stylized political history of the first phase, which lasted from 1958 to 1971 supports the hypothesis that the 1958 coup represented a successful shift in the political settlement. In analytical terms, we argued that this could be represented by a shift of the tradeoff curve to the north-east. This represented favourable possibilities for re-assignments of rights by the state which could improve the dynamic efficiency of capitalist industrial investment. Our hypothesis for this phase goes on to say that the process through which the state attempted to sustain the political settlement eventually led to its collapse and the tradeoff curve starts to shift back to a less favourable position from the mid-sixties.

The second phase corresponds to the democratic period of Bangladesh from 1971 to 1975. From the evidence of the political balance which characterized this era and the policy responses of the Awami League government, we hypothesized that the political frontier for this period was entirely in the south-west quadrant, with the state making successively less sustainable moves along the curve in a search for political and economic viability.

The third phase begins in 1975 and is still with us today. It has been characterized by the rule of civilianized military regimes, and a successively greater priority being given to the private sector. The evidence for this period is more complex, as we would expect given our lack of historical distance, but we made the following tentative hypothesis. It seems that a growth in the political dominance of the capitalist class towards the end of the Awami League period allowed the new regime of President Zia to establish a more favourable settlement and operate along a somewhat more favourable
Part III

Chapter Thirteen

tradeoff. The tradeoff curve thus moves to the northeast but the evidence also suggests that it does not improve very much. Comparatively minor improvements in 'efficiency conditions' result in a decline in stability, suggesting that for some kinds of reform, the state had to opt to move down the tradeoff curve, probably into politically non-viable regions.

The political changes which began in the latter part of Zia's tenure, from 1978 in particular, would also have shifted the frontier to somewhat less favourable positions, but perhaps not back to the pre-1975 situation. President Ershad's regime is included in this phase because there is no evidence that a new political settlement has been reached. In fact the evidence suggests that the new decision-makers in charge of the state apparatus explicitly recognized that dramatic improvements in the political balance were unlikely, but decided to press on with attempts to improve 'efficiency conditions' nonetheless. The hypothesis for the post-1982 Ershad period is therefore that the state consciously chose to move down a largely stationary tradeoff curve, sacrificing political stability, but hoping economic conditions would improve sufficiently to allow a compromise in the future. At the same time it attempted a radical decentralization to improve the political balance, but there is no evidence that the tradeoff curve has moved up. On the contrary, political movements have strengthened and are increasingly challenging the settlement of 1975, threatening a new political settlement which may well shift the political frontier further to the south-west.

The task of subsequent chapters will be to test if other evidence validate these hypotheses, and examine whether they improve our understanding of the constraints on the improvement of industrial performance in Bangladesh.
Notes to Chapter Thirteen


2. Sobhan & Ahmad(1980) Table 10, p. 192. In an earlier work, Sobhan(1974), the fall in the share of the private sector was estimated to be from 64% to 14% as a result of the 1972 nationalizations. Nusrat & Sobhan(1983) pp. 3-4.


6. Varah(1980) is the best source for descriptions of how Awami League corruption affected the economy. See also Ahmad, Fazluddin(1986) p. 27.


10. In Sobhan’s account of aid-induced differentiation within the bourgeoisie in Sobhan(1982) pp. 48-52, he concentrates on the post-1975 period and the transformation of traders into industrial capitalists. He does not deal with the prior accumulation by members of the strategically placed state and political structures during the Mujib years, or the role of this differentiation on the viability of the political alliance on which the regime was based. In his view accumulation even in the earlier period, was primarily the achievement of the trading bourgeoisie who were able to develop and exploit their role as intermediaries between donors and projects. Ibid p. 45.


Part III Notes to Chapter Thirteen


17. Zia's growing willingness to buy off the 'opposition' with promises of resources to those making claims was epitomized in his well-known phrase 'Money is No Problem'. Hossain, Mosharraf[1988] pp. 60-1.


22. Shongbad 15 June 1988, article by Tanveer Mukanai: 'The Ongoing Democratic Struggle: A Point of View'.


31. See Leslie Ploomer's front page article in the Sunday Observer, London, 31 August 1986, entitled 'Love and Graft in the World's Poorest Nation'. Ershad's overseas assets are 'conservatively' alleged to be £ 100 m.

PART FOUR, CLIENTELISM, EFFICIENCY AND INDUSTRIAL GROWTH IN BANGLADESH

Summary

For reasons of length Part IV (Chapters Fourteen and Fifteen) is presented as an appendix. The following is a summary after which the reader may proceed to the conclusion. In Chapter Fourteen we find that in Bangladesh there have been systematic cyclical trends in the indices which measure efficiency and these cycles coincide with the political phases identified in Part III. In contrast, the trends in efficiency indicators in more successful economies show no such cyclical patterns. Moreover, in Bangladesh performance in manufacturing sub-sectors tend to change simultaneously, again in contrast with more successful countries, where different sectors lead and lag in different periods. The nature of the cycles in efficiency indicators in Bangladesh tell us something about the 'limits to growth' over a longer time-frame since the cycles may be a reflection of a recurring political problem faced by states like Bangladesh.

Chapter Fifteen looks at alternative explanations of industrial investment and productivity performance in Bangladesh. Conventional demand and supply side explanations are examined and found to be deficient on their own. Investments are not closely related to the availability of resources but are strongly related to the disbursement performance of state financial institutions. The widespread notion that the domestic market constrains industrialization is also critically examined and rejected as a sufficient explanation. Import substitution is found to have taken place during periods of low productivity growth when the state was compelled to impose import controls. On the other hand during periods of better productivity performance the state attempted or was encouraged to try liberalization which resulted in negative import substitution as imports were sucked in. Looking at the evidence for upswings and downswings together suggests in fact that the primary constraint has been the lack of competitiveness in Bangladesh's manufacturing sector.
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Finally in Chapter Fifteen we discuss some evidence which supports the hypothesis that clientelist payoffs are negotiated in Bangladesh's manufacturing sector but not in South Korea. Since we only have access to secondary data to make a comparative analysis, we look at the relationship between the share of white collar workers in total employment and the productivity index. These two variables could be related for at least three different reasons. First there could be a technological relationship between the structure of employment and productivity, secondly there may be a cyclical relationship between the two. A third possibility is that there is clientelist bargaining and productivity gains result in an increase in the maximum potential payoff. To the extent that a consequent increase in the payoff results in an increased share of white collar employment, we have another possible relationship between the two variables.

The relationship between the variables in manufacturing sub-sectors in Bangladesh and South Korea are empirically tested to see which hypothesis is best validated in each of the two countries. We find the technological relationship is strongest in South Korea with a strong time trend for the productivity index while in Bangladesh the clientelist hypothesis is strongly supported. While these crude tests do not allow us to quantify the extent to which clientelism constrains manufacturing performance, the analysis of Part II suggests that where clientelist payoffs are negotiated, we should expect efficiency to be lower.

While the empirical evidence is at best indicative, it points out the importance of further work on the rights underlying clientelist bargaining. We would argue that if industrial performance in countries like Bangladesh is to be improved, political, institutional and contractual responses have to be devised to curtail these processes. The text of Chapters Fourteen and Fifteen follows as an appendix but the reader may proceed to page 380.
Chapter Fourteen Productivity Performance 1960-80.

Introduction

We would expect the political frontier to be different not only across countries but to vary in the same country over time. In Part III we suggested a number of hypotheses regarding changes in the political settlement in Bangladesh which in turn have implications for the political frontier and therefore the efficiency of rights supported by the state.

An analysis of the industrial sector in Bangladesh is constrained by the quality of the statistics available. However, by looking at trends within a consistent data set, we can examine qualitative changes in the trend and so minimize the effects of measurement errors. We have so far looked at the manufacturing sector as a whole, which includes the small-scale manufacturing sector. The statistics for the small-scale manufacturing sector are tentative at best. Moreover, this sector is not as closely linked with the state as the large-scale manufacturing sector. In this chapter we will concentrate on the latter.

The large-scale manufacturing sector is officially defined to include units employing more than ten workers, and the statistics for this sector are collected annually in the Census of Manufacturing Industries (CMI). The Bangladesh Bureau of Statistics also publishes a Quarterly Production Index based on a rather smaller sample of enterprises. Rates of growth based on different sources are presented in Table 14.1.

Comparing the CMI growth figures with those based on the Quarterly Production Index, we see that the annual growth figures based on the CMI are in general much larger in absolute terms. However, trend movements in the rate of growth, (increasing, decreasing or staying unchanged), are generally reflected in all
the series whenever they overlap. The differences between the series can be traced to the range of coverage of the different indices, the CMI figures generally being based on a larger sample. The figures for gross value of annual production based on the Census were judged to be the best basis for analysis given the existing state of data.¹

<table>
<thead>
<tr>
<th>PERIOD</th>
<th>Real Value Added (Corrected CMI)</th>
<th>Real Output (Corrected CMI)</th>
<th>Quantum Production Index (QPI)</th>
<th>Revised QPI (BBS/1980)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1949/50-54/55</td>
<td>21.4 %</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1954/55-59/60</td>
<td>13.4 %</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1959/60-64/65</td>
<td>12.5 %</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1964/65-69/70</td>
<td>9.1 %</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1969/70-74/75</td>
<td>-9.8 %</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1974/75-79/80</td>
<td>15.8 %</td>
<td>6.5 %</td>
<td>6.9 %</td>
<td></td>
</tr>
<tr>
<td>79/80-81/82</td>
<td>7.9 %</td>
<td>3.9 %</td>
<td>3.9 %</td>
<td></td>
</tr>
<tr>
<td>1979/80-84/85</td>
<td>1.1 %</td>
<td>4.5 %</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Sources: Real value added growth for 1949/50 to 1964/65 have been calculated from annual figures for large scale manufacturing value-added at 1959/60 factor cost in Alamgir & Berlage(1974), Table C-4. They deduct indirect taxes from the value-added figures provided by the CMI and markup CMI figures by 10% to correct for undercoverage. Real Output figures in Column 2 have been calculated from CMI statistics. See Appendix 14-A for details. Figures based on the QPI and revised QPI have been calculated from BBS[1986] Annex I Table I, p,138, r is calculated from \( \log Y_t = \log Y_0 + rt \), using Ordinary Least Squares.

We will use the information available from the CMI in our subsequent analysis, corrected for undercoverage, as information on the number of registered and reporting firms is available annually. The data and correction procedure are discussed in Appendix 14-A. To corroborate our trends, we also use physical output and employment data for sectors where they were available.

Section 14.1 looks at our choice of performance indicator. We argue that in the context of countries like Bangladesh, productivity rather than profitability is the more relevant indicator for our purposes. Section 14.2 looks at the recent structure of sectoral labour productivity in Bangladesh and in other countries. Section 14.3 looks at trends in total factor productivity, and this is extended
in Section 14.4 to a sub-sectoral examination of labour productivity trends. Finally in Section 14.5 we discuss the relationships of the productivity trends with the political cycles identified in Part III. While output and productivity performance have many interrelated determinants, it is argued that the notion of the political frontier and changes in the nature of state intervention are consistent with the evidence, and do indeed help us to make more sense of inter-temporal and inter-country evidence.

\[ 14.1 \text{ Performance Indicators} \]

Clearly, in a market economy, a firm or sector's prospects for survival and growth will depend on both internal and external factors. While overall success is a resultant of endogenous and exogenous conditions, two conditions are arguably necessary: a) the ability to use resources as well as or better than one's competitors, and b) the availability of investible resources to ensure that a) is maintained over time. Our indicator should therefore measure performance in both these respects. However, while a) and b) may both be important in the short run, and indeed b) may be critical in establishing an initial advantage, in the long-run, efficiency is likely to be the critical variable, and indeed success in a) would ensure success in b).

Profitability has conventionally been an acceptable composite indicator of performance at the firm and industry level, because it indicates both the efficiency with which resources have been utilized, as well as the surplus potentially available for investment and future growth. If accounting prices do not approximate to opportunity costs, however defined, profitability will no longer indicate efficiency of resource use, although it may still show the potential claims over surplus resources held by the unit of accounting. In an economy such as Bangladesh, we can expect prices to diverge substantially and to varying degrees from their 'equilibrium' levels. A large number of markets have fixed or managed prices and are cleared through alternative rationing
mechanisms, such as queues and political patronage. 'Disequilibrium' in such a context may be a stable state of the economy.2

The usual answer is to resort to world market prices for 'tradeables',3 but in a poor economy, 'non-tradeables', and particularly the utilization of different categories of labour-power constitutes an important element in total cost. Shadow-pricing these quantities introduces a degree of subjectivity into the analysis which deprives the profitability criteria of its attractiveness as an index of efficiency. Pre-tax profitability has been suggested as a performance criterion on the grounds that taxation deprives public sector enterprises of resources they have generated.4 This too ignores the importance of price distortions and hidden subsidies, which together account for significant explicit and implicit transfer payments to firms. Pre-tax profitability may not reveal the level of such cross-subsidization, and changes in pre-tax profitability may be unrelated to productive changes in the enterprise.

Even as an indicator of the availability of investible resources, profitability becomes less important if we recognize the significance of the state in directing investment resources to firms. In Bangladesh's public sector, virtually all investment is routed through the government's development budget though part of these resources may initially have been produced within the public enterprise sector in the first place. In the private sector, long term finance is provided primarily by two state-owned industrial investment banks.5 We will see in Chapter Fifteen that changes in the level of aggregate investments in the industrial sector are quite significantly related to changes in the annual level of investment resources allocated by the state.

Finally, at the level of measurement, there is a lot of informal evidence that the underreporting of profitability is a serious problem. The incentive is not only to avoid company taxation, but also to limit to a minimum the repayment
of the usually large loans received from the development finance institutions. Thus a permanent loss situation often appears on company balance-sheets, while casual observation confirms that the enterprise is providing a reasonable return to owners. Such a tendency to underreport profits does not appear to be random, but we do not know whether the margin changes from good to bad years.

The complexity of these distortions makes the more 'basic' productivity criterion more appropriate if we want to assess changes in the efficiency of resource use over time, or compare resource use across industries. The question of surplus availability for investment is not directly answered by any productivity measure, but in a dynamic context, firms or sectors with higher productivity growth would be able to capture a higher share of total demand and thus generate a larger absolute claim on the surplus. This argument obviously requires accommodating changes in the sectoral structure of demand, and even at the level of the firm, we require sectoral demand to be maintained, but the argument is *ceteris paribus* true.

§ 14.2 *Comparative Sectoral Labour Productivities*

The relative productivity in manufacturing sub-sectors across a number of countries in 1981/82 quantifies why abysmally low wages do not necessarily help countries like Bangladesh to industrialize. Poor countries not only have low levels of nominal wages, they also have much lower levels of value added per employee. In fact there is no systematic tendency for the wage share to be lower in low-wage countries, as can be seen from the figures in Table 14.2. The figures for wage share indicate that what Marx called 'the rate of exploitation', the share of value added appropriated by capital, is in fact higher in high-wage countries due to the much higher absolute levels of productivity. Brazil however, exemplifies the possibility of combining high productivity with relatively low wages to give even lower wage shares.
<table>
<thead>
<tr>
<th>TABLE 14.2: COMPARATIVE SECTORAL VALUE ADDED AND NOMINAL WAGES : 1981/2</th>
</tr>
</thead>
<tbody>
<tr>
<td>TVA=Total Value Added in Million US$  VA/L=Value Added/Employee and W/L= Wages/Employee in Thousand US$  Vage Share = W / VA</td>
</tr>
<tr>
<td><strong>BANGLADESH</strong></td>
</tr>
<tr>
<td>-----------------</td>
</tr>
<tr>
<td><strong>FOOD PRODUCTS</strong></td>
</tr>
<tr>
<td>TVA</td>
</tr>
<tr>
<td>VA/L</td>
</tr>
<tr>
<td>W/L</td>
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<tr>
<td>Vage Share %</td>
</tr>
<tr>
<td><strong>TEXTILES</strong></td>
</tr>
<tr>
<td>TVA</td>
</tr>
<tr>
<td>VA/L</td>
</tr>
<tr>
<td>W/L</td>
</tr>
<tr>
<td>Vage Share %</td>
</tr>
<tr>
<td><strong>WEARING APPAREL</strong></td>
</tr>
<tr>
<td>TVA</td>
</tr>
<tr>
<td>VA/L</td>
</tr>
<tr>
<td>W/L</td>
</tr>
<tr>
<td>Vage Share %</td>
</tr>
<tr>
<td><strong>LEATHER</strong></td>
</tr>
<tr>
<td>TVA</td>
</tr>
<tr>
<td>VA/L</td>
</tr>
<tr>
<td>W/L</td>
</tr>
<tr>
<td>Vage Share %</td>
</tr>
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<td><strong>PAPER</strong></td>
</tr>
<tr>
<td>TVA</td>
</tr>
<tr>
<td>VA/L</td>
</tr>
<tr>
<td>W/L</td>
</tr>
<tr>
<td>Vage Share %</td>
</tr>
<tr>
<td><strong>PRINTING</strong></td>
</tr>
<tr>
<td>TVA</td>
</tr>
<tr>
<td>VA/L</td>
</tr>
<tr>
<td>W/L</td>
</tr>
<tr>
<td>Vage Share %</td>
</tr>
<tr>
<td><strong>GLASS</strong></td>
</tr>
<tr>
<td>TVA</td>
</tr>
<tr>
<td>VA/L</td>
</tr>
<tr>
<td>W/L</td>
</tr>
<tr>
<td>Vage Share %</td>
</tr>
<tr>
<td><strong>OTHER MINERALS</strong></td>
</tr>
<tr>
<td>TVA</td>
</tr>
<tr>
<td>VA/L</td>
</tr>
<tr>
<td>W/L</td>
</tr>
<tr>
<td>Vage Share %</td>
</tr>
<tr>
<td><strong>INDUSTRIAL CHEMICALS</strong></td>
</tr>
<tr>
<td>TVA</td>
</tr>
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<td>VA/L</td>
</tr>
<tr>
<td>W/L</td>
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<tr>
<td>Vage Share %</td>
</tr>
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<td><strong>OTHER CHEMICALS</strong></td>
</tr>
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</tr>
<tr>
<td>VA/L</td>
</tr>
<tr>
<td>W/L</td>
</tr>
<tr>
<td>Vage Share %</td>
</tr>
<tr>
<td><strong>IRON &amp; STEEL</strong></td>
</tr>
<tr>
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<tr>
<td>VA/L</td>
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<tr>
<td>W/L</td>
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<td>Vage Share %</td>
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<tr>
<td><strong>METAL PRODUCTS</strong></td>
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</tr>
<tr>
<td>VA/L</td>
</tr>
<tr>
<td>W/L</td>
</tr>
<tr>
<td>Vage Share %</td>
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### TABLE 14.2 CONTINUED

<table>
<thead>
<tr>
<th></th>
<th>BANGLADESH</th>
<th>INDIA</th>
<th>PAKISTAN</th>
<th>S. KOREA</th>
<th>BRAZIL</th>
<th>UNITED STATES</th>
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<tbody>
<tr>
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<td></td>
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</tr>
<tr>
<td>VA/L</td>
<td>1.2</td>
<td>2.9</td>
<td>3.6</td>
<td>9.6</td>
<td>13.8</td>
<td>46.2</td>
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<tr>
<td>W/L</td>
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<td>1.5</td>
<td>3.6</td>
<td>4.8</td>
<td>20.3</td>
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<tr>
<td>Wage Share %</td>
<td>34.3 %</td>
<td>45.7 %</td>
<td>41.0 %</td>
<td>37.3 %</td>
<td>34.7 %</td>
<td>43.9 %</td>
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</tr>
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<td>VA/L</td>
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<td>3.3</td>
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<td>41.1</td>
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<td>1.5</td>
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<td>3.8</td>
<td>18.5</td>
</tr>
<tr>
<td>Wage Share %</td>
<td>24.3 %</td>
<td>43.1 %</td>
<td>25.6 %</td>
<td>30.6 %</td>
<td>20.7 %</td>
<td>45.0 %</td>
</tr>
<tr>
<td><strong>TRANSPORT EQUIPMENT</strong></td>
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<td>2.9</td>
<td>2.5</td>
<td>3.1</td>
<td>14.5</td>
<td>18.5</td>
<td>46.8</td>
</tr>
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<td>1.8</td>
<td>4.7</td>
<td>4.1</td>
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<td>58.3 %</td>
<td>32.6 %</td>
<td>22.3 %</td>
<td>51.3 %</td>
</tr>
</tbody>
</table>


Even in such a traditionally labour-intensive industry as textile manufacturing, South Korea and even the United States with much higher levels of dollar wages have a lower wage share than both India and Bangladesh. In another labour-intensive sub-sector, iron and steel, South Korea manages to have a wage share lower than that in Bangladesh where dollar wages are almost a fifth of the South Korean level. We have looked at a snapshot picture of a number of economies but since countries have different endowments and are clearly at different levels of development, we really need to look at trends in sectoral productivity indicators. We do this in the next two sections.

### 14.3 Total Factor Productivity Growth

A substantial amount of effort has been directed in recent years to the measurement of total factor productivity growth, defined as the residual in the rate of growth after the 'contribution' of labour and capital had been allowed for. The practical advantage which has been perceived in this measure, despite its theoretical shortcomings lies in the fact that it combines the growth of labour and capital productivity in a weighted measure, where the weights used are at least consistent across countries. Before presenting any results, we should remind the reader of exactly what is measured and its limitations.
The usual weighting convention for capital and labour is to use the respective shares in output in the base period. The residual may then be measured as:

\[
\frac{1}{P} \frac{dP}{dt} = \frac{1}{Q} \frac{dQ}{dt} - \left( \alpha \frac{1}{L} \frac{dL}{dt} + \beta \frac{1}{K} \frac{dK}{dt} \right), \quad (\beta = 1 - \alpha)
\]

where \( P \) is the total factor productivity index, \( Q \) the index of output growth, \( L \) the index of labour supply, \( K \) the index of capital stock, and \( \alpha \) and \( \beta \) are the respective elasticities of output with respect to each of the inputs. This equation may obviously be derived from the constant returns to scale Cobb-Douglas production function, with its (rather unrealistic) assumptions of disembodied technical progress, unit elasticity of factor substitution, homotheticity and perfect competition. With these assumptions, \( \alpha \) and \( \beta \) may be estimated from base year factor shares. On the other hand, and with some justification, such an equation together with the weighting of factor contribution to output according to factor shares may be used as an accounting device to estimate how much faster outputs have grown compared to inputs.

The most serious criticism which may be made of this approach concerns the implicit assumption that productivity growth is disembodied, in the sense that it appears distinct from the physical process of installing new machines. In principle the criticism, presented by the 'vintage approach' to accumulation is perfectly correct, but in practice, neither the value nor any of the conventional measures of the 'quantity' of capital has a one-to-one correspondence with the productivity of the investment in any year. In other words, investments of the same vintage and 'size' in different contexts are known to yield different results, and it is this difference which needs to be somehow measured. Since the total productivity measure is widely used, it may at least be justified as a consistent index of the efficiency of investment till a theoretically more satisfactory index gains wide acceptance.

Using an industrial investment series and an estimate for base year capital stock for Bangladesh, the rate of growth of capital stock may be estimated
under various assumptions. The methods are discussed in Appendix 14-B. The trends in output and employment shown in figures 14.1 and 14.2 are derived from the Census of Manufacturing Industries, with our corrections for undercoverage. Both the output and employment series show a dip from 1970, together with fairly large fluctuations till 1975 when both indices begin to improve, although they do not return to their pre-war levels till around 1977, when a growth trend again emerges. Rates of growth of the output, employment and capital stock are shown in table 14.3. The rate of growth of output could not be calculated for the entire period 1960-65, because consistent data was only available from 1964. From the evidence of other series, we would expect the growth rate of manufacturing output for 1960-65 to be rather higher than in 1964-66 which serves as a proxy for the early sixties in table 14.3.

### Table 14.3: Output and Factor Growth Rates in Bangladesh Manufacturing (Percentages per annum)

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Output (Y)</td>
<td>8.5</td>
<td>9.1</td>
<td>-9.8</td>
<td>15.8</td>
<td>7.9</td>
</tr>
<tr>
<td>Labour (L)</td>
<td>-4.2</td>
<td>6.6</td>
<td>5.0</td>
<td>2.5</td>
<td>4.2</td>
</tr>
<tr>
<td>Capital (K)</td>
<td>7.3</td>
<td>8.9</td>
<td>-2.4</td>
<td>1.3</td>
<td>7.3*</td>
</tr>
<tr>
<td>K/L</td>
<td>11.5</td>
<td>2.3</td>
<td>-7.4</td>
<td>-1.2</td>
<td>3.1</td>
</tr>
<tr>
<td>K/Y</td>
<td>-1.2</td>
<td>-0.2</td>
<td>7.4</td>
<td>-14.5</td>
<td>-0.6</td>
</tr>
<tr>
<td>Y/L</td>
<td>12.7</td>
<td>2.5</td>
<td>-14.8</td>
<td>13.3</td>
<td>3.7</td>
</tr>
</tbody>
</table>

**Sources:** For Output and Labour data sources see Appendix 14-A. Capital stock growth figures are based on a 5% scrapping rate, see Table 3 Appendix 14-B. * Capital growth figures are for 1980-81.

Table 14.4 shows comparative total factor productivity performance for a number of Asian countries. Keeping in mind the margins of error possible with the quality of statistics and estimation techniques, some broad observations may be made. First, unlike the advanced capitalist countries, productivity growth is not always a substantial part of an explanation of total growth in these countries, since growth can occur largely as a result of capital widening. But secondly, as in the advanced countries, there is here too, a correlation between sustained sectoral growth and the growth of total factor productivity in the sector.
FIG. 14.1 MANUFACTURING OUTPUT LOG INDICES

FIG. 14.2 MANUFACTURING EMPLOYMENT LOG INDICES
The Bangladesh manufacturing figures have been divided into five sub-periods. Total factor productivity growth shows a positive but decelerating trend in the sixties. Productivity growth was particularly high in the early sixties but declines during the late sixties. The rapid growth of labour productivity in the early sixties seems to have been accompanied by a costly growth in capital stock relative to more successful countries corroborating arguments that the structure of the emerging industrial base in Pakistan was inefficient.  

The post-1965 decline in productivity performance may have been exacerbated by the effects first of the brief war with India in 1965 and the subsequent reduction in American aid, and then by the onset of political unrest from 1969.
culminating in the nine months of civil war and the secession of Bangladesh in 1971. However, if these disruptions are to be the explanation, the effect on productivity should be through lower output growth. But as we have seen in table 12.2, as far as the eastern wing of Pakistan was concerned, investment was booming in the late sixties, and table 14.3 confirms that output growth accelerated over the period.

The seventies constitute an exceptional period. As we would expect from Chapter Thirteen, the decline in performance continues in the early seventies, and indeed the fall in total factor productivity is quite precipitate. Despite the sharp fall in output, which was inevitably associated with the closure of many enterprises, total employment was actually growing. The decline in capital stock was due to an almost total disruption of investment during 1971 and 1972 following the uncertainties created in the aftermath of the liberation war. Output fell much faster than capital stock and employment grew, accounting for the steep decline in total factor productivity.

The conventional explanation of the poor productivity performance of this period has been in terms of the disruption caused by the nine-month civil war which led to shortages of foreign exchange, raw materials and spare parts, and ultimately to low capacity utilization. There is undoubtedly an element of truth in this. However, productivity performance can in principle improve while output falls. The evidence of other wartime and postwar economies suggests that where the state succeeds in enforcing production oriented rights, productivity if not production has often been much higher than in peacetime.

When investments are cut back and capacity utilization falls, we may expect conflicting effects on labour and capital productivity. To the extent that this leads to the closure of plant or parts of plants of less than average productivity, both capital and labour productivity may be expected to improve.
On the other hand, to the extent that production falls in existing plant without a corresponding retrenchment of labour, or plant of above average labour productivity is closed down, labour productivity declines, and in the same way, if unused capital is of above average productivity, capital productivity would also decline. What happens to total factor productivity thus depends on the resource allocating rationality of the economic system. The political movement which brought the Awami League to power clearly did not allow a production oriented ('capitalist' or 'socialist') structure of rights to develop. The political economy of the system which emerged from the war must thus be considered in an explanation of the poor post-war performance.

The decline in capital use measured in table 14.4 is not adjusted for capacity utilization, and it could be argued that this underestimates the decline in capital use, and therefore overestimates the fall in total factor productivity. We do not have full information about capacity utilization and therefore the correction of capital stock figures would be somewhat arbitrary, but on the basis of available information, it seems that the capacity utilization argument does not explain the precipitous decline in output over the first half of the seventies.

### Table 14.5 Capacity Utilization in Selected Manufacturing Sectors

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Sugar</td>
<td>55</td>
<td>11</td>
<td>52</td>
<td>58</td>
<td>51</td>
<td>82</td>
<td>93</td>
</tr>
<tr>
<td>Oil Products</td>
<td>31</td>
<td>27</td>
<td>26</td>
<td>39</td>
<td>46</td>
<td>61</td>
<td>64</td>
</tr>
<tr>
<td>Jute Manufacturing</td>
<td>74</td>
<td>56</td>
<td>69</td>
<td>61</td>
<td>66</td>
<td>68</td>
<td>72</td>
</tr>
<tr>
<td>Cotton Yarn</td>
<td>79</td>
<td>60</td>
<td>59</td>
<td>59</td>
<td>57</td>
<td>67</td>
<td>65</td>
</tr>
<tr>
<td>Cotton Cloth</td>
<td>49</td>
<td>49</td>
<td>77</td>
<td>84</td>
<td>66</td>
<td>55</td>
<td>80</td>
</tr>
<tr>
<td>Paper</td>
<td>100</td>
<td>61</td>
<td>66</td>
<td>69</td>
<td>50</td>
<td>66</td>
<td>83</td>
</tr>
<tr>
<td>Newsprint</td>
<td>69</td>
<td>78</td>
<td>75</td>
<td>82</td>
<td>59</td>
<td>48</td>
<td>50</td>
</tr>
<tr>
<td>Urea</td>
<td>91</td>
<td>47</td>
<td>62</td>
<td>16</td>
<td>63</td>
<td>46</td>
<td>34</td>
</tr>
<tr>
<td>Cement</td>
<td>27</td>
<td>32</td>
<td>55</td>
<td>42</td>
<td>47</td>
<td>89</td>
<td>86</td>
</tr>
<tr>
<td>Diesel Engines</td>
<td>43</td>
<td>45</td>
<td>na</td>
<td>65</td>
<td>11</td>
<td>14</td>
<td>na</td>
</tr>
</tbody>
</table>

Table 14.5 shows that while there were indeed falls in capital use across sectors, by 1973/4 capacity utilization had almost recovered to the 1969/70 level. Behind this lay the improvements in resource availability from 1973 onwards, particularly as a result of foreign inflows (see table 15.1). Moreover, while in some sectors capacity utilization improved after 1973/4, in others it declined, so that capacity utilization alone cannot really be used to explain the sharp improvements in total factor productivity after 1975.

Part of the recovery was undoubtedly associated with an improvement in capacity utilization, but the growth in output was far greater than the growth in factor supply even if we make allowances for the improvement in capacity utilization, suggesting that resources were being directed to end-uses with greater efficacy. The figures do not show to what extent the new political balance after 1975 was responsible for the simultaneous improvement in efficient resource use, but the two did coincide.

By the eighties, these possibilities seem to have been exhausted, and there is a steep decline in productivity growth. Both labour and capital productivity register small improvements, and as a consequence the total factor productivity index also improves, but total factor productivity performance is now much less impressive compared to either the previous period or the early sixties. Explanations which stress the greater availability of resources, and particularly foreign resources in the post-1975 period would have to explain why there was such a dramatic decline in productivity growth at a time when resource availability was actually accelerating. The decline in performance is however consistent with an increasingly inefficient state intervention from the late seventies onwards.

While we do not have consistent data for subsequent periods to see if this performance has at all improved, all the indications are that it has not, and
in fact given the slowing down of output growth since 1981, together with the increasingly more successful mobilizations of clientelist coalitions since 1984, we could expect to find a further decline in productivity performance in the subsequent period.

While total factor productivity trends are consistent with the phase changes identified in Part III, capital productivity growth in Bangladesh is poor throughout and also less responsive to changes in the political frontier. Given the importance of the state in allocating new investments, one reason behind the poor performance in capital use could be the inability of the state to attack clientelism on the part of capitalists. Efficiency in dynamic growth would have required the state to have the ability to change allocations to capitalists in line with perceptions of growth possibilities, and also to curtail what we have called symbiotic clientelism. It seems that political changes have had a less dramatic effect on the state's performance vis-a-vis its ability to take on clientelism within capitalist coalitions.

The state could have faced political constraints in establishing the appropriate rights (the improvements in the political frontier were not great enough to enable the state to attack the capitalist constituency as well) or it could simply have been a failure of perception on the part of leading decision-makers (which prevented the state moving down a tradeoff curve even when it was possible, so that growth could be maximized at a point such as G in figure 13.1). From Part III, we would expect the latter to be the explanation of inefficient allocation of capital in the sixties while political constraints would be the more likely explanation for the seventies.

Looking at the figures for (West) Pakistan, we see that although the growth in manufacturing output in the sixties in what was then the western wing was significantly higher compared to the eastern wing, total factor productivity
growth in the western wing was not significantly different in the study cited in Table 14.4. After 1965, total factor productivity growth declines in East Pakistan/Bangladesh, because of a steep decline in labour productivity, but we do not know if the rate of growth of total factor productivity declined in the western wing as well.

The results across countries also suggests that there is a tendency for a larger proportion of total growth to be attributable to the residual when the growth rate is larger. Thus quite apart from differences in resource availability, disparities in the efficiency of factor use have been important in explaining the disparities in growth performance even across developing countries. This is an area in which the gradual refinement of statistics and techniques of estimating productivity growth would improve our understanding. In particular, we need to distinguish between the growth brought about by the injection of capital goods in the typical disequilibrium developing economy where even the most 'inefficient' use of capital may bring about some growth, and genuine increases in productivity, which may or may not be embodied in new investments.

The weighting method used by us and the other studies cited, ensures that the productivity growth measured includes both technical progress and that part of growth which is the result of improvements in factor proportions given input prices.\textsuperscript{10} Furthermore, in a disequilibrium situation where marginal factor productivities are not equalized across sectors, an improvement in the allocation of resources would also show up as part of total factor productivity growth.\textsuperscript{11} In other words, total factor productivity growth is also a measure of improvements in the efficiency of resource allocation, in the first case given inefficient factor proportions at current prices, and in the second given disequilibrium sectoral allocation of factors. Although these are explicitly static neoclassical concepts of allocational efficiency, the higher
total factor productivity growth rates observed in the faster growth countries are consistent with the other evidence presented in Part I which showed that rapid growth is a function of rapid and efficient changes in the sectoral allocation of resources.

§ 14.4 Labour Productivity in Manufacturing

In this section we look at labour productivity trends from 1955 in aggregate, and also by manufacturing subsectors. For the decade from 1955 to 1965, labour productivity showed a moderate rate of growth. We know from the work of Stephen Lewis for united Pakistan that the improvement and acceleration in productivity performance after 1960 was quite important in ensuring that the manufacturing productivity performance for the period as a whole was positive. This can be seen in Table 14.6 which indicates that the moderate rates of productivity growth in the decade from the mid-fifties to the mid-sixties were largely due to a fairly rapid growth in output per worker from around 1959/60, a trend which we shall see came to an end in the mid-sixties.

<table>
<thead>
<tr>
<th>Year</th>
<th>Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>1954/55</td>
<td>100.0</td>
</tr>
<tr>
<td>1957/58</td>
<td>96.1</td>
</tr>
<tr>
<td>1959/60</td>
<td>90.9</td>
</tr>
<tr>
<td>1962/63</td>
<td>115.8</td>
</tr>
</tbody>
</table>

Source: From Lewis[1970] Table 3.6, p.43.

The labour productivity figures in table 14.7 conform with the total factor productivity trends in terms of their cyclical trends. The rate of growth is higher in the early sixties, declines over the late sixties, becomes steeply negative in the early seventies, recovers sharply over the late seventies and then declines again. Plotting the indices for the manufacturing sector and for some important sub-sectors in figures 14.3 and 14.4 shows that the decline began around 1977/8, coincident with the civilianization process of the military regime of President Zia ur Rahman.
### TABLE 14.7: OUTPUT EMPLOYMENT & PRODUCTIVITY GROWTH IN BANGLADESH MANUFACTURING.

#### I. AVERAGE ANNUAL RATE OF GROWTH OF LABOUR PRODUCTIVITY

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Food Manufacturing</td>
<td>16.1 (-19.3)</td>
<td>-5.1</td>
<td>-22.9</td>
<td>14.0</td>
<td>13.2</td>
</tr>
<tr>
<td>Tobacco</td>
<td>2.0 (-1.1)</td>
<td>6.2</td>
<td>-5.5</td>
<td>9.8</td>
<td>2.1</td>
</tr>
<tr>
<td>Textiles</td>
<td>3.7 (12.1)</td>
<td>6.1</td>
<td>-15.9</td>
<td>3.7</td>
<td>-7.1</td>
</tr>
<tr>
<td>Paper</td>
<td>16.2 (2.5)</td>
<td>5.6</td>
<td>-23.4</td>
<td>13.1</td>
<td>-2.8</td>
</tr>
<tr>
<td>Printing and Publishing</td>
<td>5.4 (-6.2)</td>
<td>7.3</td>
<td>-5.3</td>
<td>3.3</td>
<td>-3.3</td>
</tr>
<tr>
<td>Leather</td>
<td>3.2 (15.2)</td>
<td>29.0</td>
<td>-14.1</td>
<td>25.1</td>
<td>-7.7</td>
</tr>
<tr>
<td>Chemicals</td>
<td>8.9 (5.2)</td>
<td>3.2</td>
<td>-13.2</td>
<td>14.9</td>
<td>10.7</td>
</tr>
<tr>
<td>Mineral Products</td>
<td>3.6 (12.4)</td>
<td>12.6</td>
<td>-10.2</td>
<td>20.9</td>
<td>-3.2</td>
</tr>
<tr>
<td>Basic Metals</td>
<td>13.8 (9.5)</td>
<td>1.5</td>
<td>-20.2</td>
<td>17.6</td>
<td>8.5</td>
</tr>
<tr>
<td>Metal Products</td>
<td>6.0 (20.8)</td>
<td>4.1</td>
<td>-11.5</td>
<td>-1.8</td>
<td>22.2</td>
</tr>
<tr>
<td>Machinery (non-electr)</td>
<td>2.9 (8.5)</td>
<td>9.2</td>
<td>-22.4</td>
<td>26.3</td>
<td>-30.5</td>
</tr>
<tr>
<td>Electrical Machinery</td>
<td>16.5 (14.2)</td>
<td>-1.6</td>
<td>-13.2</td>
<td>16.2</td>
<td></td>
</tr>
<tr>
<td>Transport Equipment</td>
<td>11.3 (32.1)</td>
<td>-6.2</td>
<td>5.9</td>
<td>25.9</td>
<td>12.8</td>
</tr>
<tr>
<td>ALL MANUFACTURING</td>
<td>n.a. (12.6)</td>
<td>2.5</td>
<td>-14.8</td>
<td>13.3</td>
<td>3.7</td>
</tr>
</tbody>
</table>

#### II. AVERAGE ANNUAL RATE OF GROWTH OF REAL OUTPUT (at base year prices)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Food Manufacturing</td>
<td>26.0 (10.9)</td>
<td>1.1</td>
<td>-16.1</td>
<td>14.2</td>
<td>16.8</td>
</tr>
<tr>
<td>Tobacco</td>
<td>35.9* (34.9)</td>
<td>24.1</td>
<td>-5.8</td>
<td>9.5</td>
<td>5.0</td>
</tr>
<tr>
<td>Textiles</td>
<td>12.8 (9.7)</td>
<td>11.8</td>
<td>-11.1</td>
<td>7.6</td>
<td>-4.0</td>
</tr>
<tr>
<td>Paper</td>
<td>21.0 (13.6)</td>
<td>5.2</td>
<td>-4.2</td>
<td>14.5</td>
<td>6.2</td>
</tr>
<tr>
<td>Printing and Publishing</td>
<td>6.1 (0.4)</td>
<td>6.3</td>
<td>-2.4</td>
<td>11.7</td>
<td>3.6</td>
</tr>
<tr>
<td>Leather</td>
<td>11.7 (19.4)</td>
<td>27.5</td>
<td>-14.2</td>
<td>17.6</td>
<td>1.2</td>
</tr>
<tr>
<td>Chemicals</td>
<td>19.4 (9.3)</td>
<td>6.1</td>
<td>-7.3</td>
<td>17.9</td>
<td>16.4</td>
</tr>
<tr>
<td>Mineral Products</td>
<td>9.7 (10.7)</td>
<td>7.2</td>
<td>2.1</td>
<td>25.9</td>
<td>-0.7</td>
</tr>
<tr>
<td>Basic Metals</td>
<td>43.6 (-2.8)</td>
<td>-0.7</td>
<td>6.6</td>
<td>16.5</td>
<td>12.2</td>
</tr>
<tr>
<td>Metal Products</td>
<td>13.7 (16.4)</td>
<td>-6.7</td>
<td>-5.9</td>
<td>3.0</td>
<td>31.0</td>
</tr>
<tr>
<td>Machinery (non-electr)</td>
<td>13.2 (-2.7)</td>
<td>18.0</td>
<td>-20.4</td>
<td>33.5</td>
<td>-7.8</td>
</tr>
<tr>
<td>Electrical Machinery</td>
<td>29.4 (32.4)</td>
<td>10.8</td>
<td>-18.8</td>
<td>39.5</td>
<td>-</td>
</tr>
<tr>
<td>Transport Equipment</td>
<td>10.5 (13.1)</td>
<td>7.8</td>
<td>17.2</td>
<td>10.3</td>
<td>22.0</td>
</tr>
<tr>
<td>ALL MANUFACTURING</td>
<td>n.a. (8.5)</td>
<td>9.1</td>
<td>-9.8</td>
<td>15.8</td>
<td>7.9</td>
</tr>
</tbody>
</table>

#### III. AVERAGE ANNUAL RATE OF GROWTH OF EMPLOYMENT (Production Workers plus Employees)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Food Manufacturing</td>
<td>9.9 (-8.4)</td>
<td>6.2</td>
<td>6.8</td>
<td>0.2</td>
<td>3.6</td>
</tr>
<tr>
<td>Tobacco</td>
<td>33.9* (36.0)</td>
<td>17.9</td>
<td>-0.3</td>
<td>-0.5</td>
<td>2.9</td>
</tr>
<tr>
<td>Textiles</td>
<td>9.1 (-1.5)</td>
<td>5.8</td>
<td>4.8</td>
<td>4.0</td>
<td>3.2</td>
</tr>
<tr>
<td>Paper</td>
<td>4.8 (11.0)</td>
<td>-0.4</td>
<td>19.3</td>
<td>1.4</td>
<td>9.0</td>
</tr>
<tr>
<td>Printing and Publishing</td>
<td>0.7 (6.6)</td>
<td>-1.1</td>
<td>3.0</td>
<td>8.4</td>
<td>6.8</td>
</tr>
<tr>
<td>Leather</td>
<td>8.5 (4.2)</td>
<td>-1.6</td>
<td>-0.1</td>
<td>-7.6</td>
<td>8.8</td>
</tr>
<tr>
<td>Chemicals</td>
<td>10.5 (4.1)</td>
<td>3.0</td>
<td>5.9</td>
<td>3.0</td>
<td>5.7</td>
</tr>
<tr>
<td>Mineral Products</td>
<td>6.1 (-1.7)</td>
<td>-5.4</td>
<td>12.3</td>
<td>5.0</td>
<td>2.6</td>
</tr>
<tr>
<td>Basic Metals</td>
<td>29.8 (-12.3)</td>
<td>-2.1</td>
<td>26.8</td>
<td>-1.2</td>
<td>3.6</td>
</tr>
<tr>
<td>Metal Products</td>
<td>7.7 (-4.5)</td>
<td>-10.8</td>
<td>5.7</td>
<td>4.8</td>
<td>8.8</td>
</tr>
<tr>
<td>Machinery (non-electr)</td>
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<td>8.8</td>
<td>2.1</td>
<td>7.2</td>
<td>22.7</td>
</tr>
<tr>
<td>Electrical Machinery</td>
<td>12.9 (18.2)</td>
<td>12.4</td>
<td>-5.6</td>
<td>23.4</td>
<td>11.9</td>
</tr>
<tr>
<td>Transport Equipment</td>
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<td>11.3</td>
<td>-15.6</td>
<td>9.2</td>
</tr>
<tr>
<td>ALL MANUFACTURING</td>
<td>n.a. (-4.2)</td>
<td>6.6</td>
<td>5.0</td>
<td>2.5</td>
<td>4.2</td>
</tr>
</tbody>
</table>

**Sources:** Figures for 1955 - 1965/6 (Col. One above) are from *Rizwanul Islam* (1976), Table 2.4(A).

* Tobacco figures from Islam are for 1959/60-1965/66. Since further information was unavailable, productivity growth for 1955 -65/6 was estimated using the approximation

\[
\frac{L_{AP}}{L_{AY}} = \frac{L_{AY}}{L_{AT}}
\]

All subsequent periods have been calculated from corrected CMI figures, using the method described in Appendix 14-A. The growth rates for productivity are independent of the correction method, and Appendix 14-C presents results for output and employment growth under alternative assumptions about the correction procedure.
What is interesting is that these patterns are reproduced at the sub-sectoral level, with the important manufacturing sub-sectors moving together in terms of their period-wise performance. Labour productivity performance throughout was particularly poor in food manufacturing, textiles, and chemicals, which respectively accounted for 11.3, 33.9 and 16.2 per cent of manufacturing value added in 1981, or together for almost two-thirds of manufacturing value added.

### TABLE 14.8: PRODUCTIVITY IN JUTE COTTON AND SUGAR MANUFACTURING

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<th>JUTE</th>
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<tr>
<td>Productivity</td>
<td>2.5</td>
<td>2.1</td>
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<td>-3.5</td>
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<tr>
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<td>-0.2</td>
<td>6.5</td>
<td>2.6</td>
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<tr>
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<td>7.7</td>
<td>29.5</td>
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<td>4.7</td>
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<td>-35.1</td>
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<tr>
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<td>8.0</td>
<td>3.5</td>
<td>2.7</td>
<td>1.1</td>
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</table>

Sources: Jute industry figures are for total output in tons and all employees, for 1960 to 1982 covering both nationalized and denationalized mills, but 1983-85 figures are for nationalized mills alone. Bangladesh Jute Mills Corporation figures were listed in BBDI(1983) Table 8.3 and BBS Monthly Statistical Bulletin April 1986. Cotton textile figures are from the Bangladesh Textile Mills Corporation for the set of textile mills retained in the public sector after the denationalizations of the post-1982 period. Output figures are for yarn and cloth in tons which have been added using base year prices. Figures for output in tons and total employment in the public sector sugar mills are from the Bangladesh Sugar and Food Industries Corporation. Periods chosen to coincide with peaks and troughs of the respective productivity indices. All growth rates semilogarithmic OLS.

While the CMI figures have had to be corrected and deflated, the cyclical trends in productivity performance are corroborated by figures from three sub-sectors for which physical output and employment data were available, the jute...
and cotton textile sectors and sugar production. The trends are reported in Table 14.8. Productivity growth in jute manufacturing is positive but declining in the sixties. In the early seventies all three sectors register negative productivity growth followed by a recovery after 1975/6. After 1978 performance deteriorates, the rate of growth becoming negative for sugar and jute. Productivity performance worsens in the eighties, except in sugar, which experiences a brief spurt before it too becomes strongly negative. Sugar is of course a somewhat special sector as performance depends quite critically on output, which in turn is related to the cane crop and the success of purchasing policy since the sugar mills compete with traditional sugar (gur) manufacturing.

Different phases of the long-term cyclical trend which we have pointed out in the manufacturing productivity index in Bangladesh are consistent with the findings of other observers who have looked at particular sectors for particular periods. Ahmad and Chowdhury looked at total factor productivity growth in Bangladesh's manufacturing sub-sectors and reported very poor performance figures. Their work, however, covered only four industries, jute and cotton textiles, cigarettes and match production, over the period 1962-69. They found annual rates of total factor productivity growth in jute manufacturing of -1.3 per cent, in cotton textiles of 0.7 per cent, in cigarette manufacture 5.3 per cent, and in matches, -4.4 per cent. Our results are also consistent with Atiq Rahman's work on productivity, but previous work has not in general looked at time series.

When compared to other countries, Bangladesh's experience appears as an extreme case of cyclical fluctuations around a stagnant trend. A number of studies have looked at productivity performance in West Pakistan from the mid-sixties onwards, when the two units constituted a single political entity. West Pakistani productivity performance appears as an intermediate case, since here
too, there is evidence of a slowing down and even decline after about 1962/3. But unlike Bangladesh, performance recovered in most sectors in the late sixties and productivity growth was again positive. In the West, for the period as a whole, the textile manufacturing sector showed an annual productivity growth rate of between three and six percent (there is some variation between indices and studies), with a similar performance in the machinery sectors.

Table 14.9 presents the average annual rates of change in the labour productivity index in South Korea and Taiwan. Two things appear to be fairly uncontroversial from this comparison. The successful industrializers not only had much higher rates of aggregate growth in manufacturing (Table 1.1), we can now see that they achieved significantly higher rates of productivity growth across sectors, at least over the years reported in the table.

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<th></th>
<th></th>
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<td>Textiles</td>
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<td>9.3</td>
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<tr>
<td>Paper and Publishing</td>
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<td>11.1</td>
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<td>10.9</td>
<td>3.7</td>
</tr>
<tr>
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<td>14.0</td>
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<td>na</td>
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<td>Chemicals</td>
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<td>10.6</td>
<td>9.4</td>
<td>1.2</td>
<td>9.0</td>
</tr>
<tr>
<td>Mineral Products</td>
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<td>6.8</td>
<td>8.7</td>
<td>7.3</td>
<td>15.8</td>
</tr>
<tr>
<td>Metal Products</td>
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<td>11.4</td>
<td>14.2</td>
<td>14.4</td>
<td>13.2</td>
</tr>
<tr>
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<td>7.1</td>
<td>15.0</td>
<td>14.4</td>
<td>-7.7</td>
</tr>
<tr>
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<td>14.8</td>
<td>18.0</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Transport Equipment</td>
<td>25.4</td>
<td>1.2</td>
<td>9.6</td>
<td>1.5*</td>
<td>7.8</td>
</tr>
<tr>
<td>ALL MANUFACTURING</td>
<td>9.5</td>
<td>11.0</td>
<td>10.6</td>
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<td></td>
</tr>
</tbody>
</table>

Sources: Figures for South Korea based on annual indices of labour productivity published in the Monthly Statistics of Korea, National Bureau of Statistics, various years, Sub-sectoral rates for Taiwan constructed from figures for average annual sectoral productivity at 1964 prices provided in Hsing [1971] Table A,32. The all-manufacturing figures for Taiwan calculated from figures for Value Added at 1964 prices and total employment provided in Chen [1979] Table A,13. * 1952-7 all-manufacturing figure for Taiwan had to be based on productivity indices for 1955-7 as earlier years were unavailable, Sub-sectoral figures suggest that this is an underestimate.

Growth rates for each period calculated from the indices by estimating the time coefficient in the standard semi-log Ordinary Least Squares equation.

In the case of Bangladesh, we have seen that while productivity growth across sectors often did not coincide with aggregate trends in output growth, sub-sectoral productivity trends broadly tended to move together, tracing out an
identifiable cyclical pattern. In contrast, in both South Korea and Taiwan, productivity performance in sub-sectors seems to have varied not only quite independently of the cycles in aggregate manufacturing output, as in Bangladesh, but were in general, also independent of productivity performance in other sub-sectors.

In South Korea, for instance, there was a slowing down of aggregate manufacturing output growth in the late seventies, with a trough in 1979/80, while in Taiwan, manufacturing output grew fairly steadily over the period reported. In both cases, productivity growth does not seem to have been related to the aggregate cycle in any simple way. In addition, productivity performance across sub-sectors is significantly different in the faster growing economies. Downturns in productivity performance in some sectors have coincided with upturns in others. Clearly economy-wide pressures which could affect the movement in sub-sectoral output and employment across all sub-sectors simultaneously played a more dominant role in Bangladesh.

§ 14.5 Political Cycles and Productivity Growth

While productivity is the outcome of a number of determinants, the phases of the productivity cycle observed in Bangladesh coincide with the phases proposed by our examination of social and political developments in Part III. Figure 14.5 puts together our results for labour productivity performance to show the historical trends in the movement of the labour productivity index in Bangladesh in a schematic way.

The upturn in labour productivity in the early sixties coincides with the notional improvement in the political frontier following the first military coup in 1958. The pattern of resource allocation it allowed made possible a high rate of growth of productivity, although in Chapter Twelve we suggested that this growth was not maximized. Productivity growth begins to slow down
in the latter half of the sixties despite the growth in investments, and again, this is consistent with an increasingly unfavourable tradeoff in the latter half of the sixties which had implications for the allocation of investible resources.

FIGURE 14.5: SCHEMATIC OUTLINE OF MANUFACTURING LABOUR PRODUCTIVITY CYCLE

The creation of Bangladesh in 1971 temporarily legitimized the non-viable political frontier which had eventually been arrived at, and this is reflected in the industrial performance of the period, which was much worse than can be attributed to the very real disruptions caused by the war. The next upturn again coincides with a political change. A series of military interventions in 1975 established a new settlement and productivity seems once again to have responded to the allocations which could be made under the new tradeoff.

The precariousness of the 1975 settlement and the contradictory ways in which it was maintained were discussed in Chapter Thirteen, but the economic indicators do support the hypothesis that the pressures for clientelist civilianization through the Bangladesh Nationalist Party in 1978 did have
resource allocational and consequently efficiency implications. The measures adopted by the post-1982 regime to break out of the much more unfavourable tradeoff facing state decision makers have also been discussed, but the indicators available suggest that these measures have not on the whole succeeded in achieving efficient allocations. The problems of the regime have been compounded by a tightening of world market conditions particularly for the older established sectors like jute. On the other hand, the World Bank has been arguing that while output performance was poor in the older manufacturing sectors, there was substantial growth in newer sectors (Table 14.1). Nevertheless, the available evidence suggests that the conditions for efficient capitalist accumulation remained unfavourable.

It would be an error to simply take productivity growth as the dependent variable, movements in which could be unequivocally attributed to the relative level of success of independent supply-side changes in the productive structure. Productivity growth should rather be seen as the interactive result of, on the one hand, 'supply-side' allocative decisions regarding investment and employment policy, and on the other hand changes in the structure of demand, which may or may not allow the supply-side changes to be realized.17

'Supply-side' failures may be traced to investment policy or employment trends. Poor investment performance may be due to an inefficient state, scarcity of resources or other factors or a combination of factors. Employment performance from the point of view of productivity depends on the adoption of efficient technology, or it may have a political basis in the rights defended by groups of employees. Our next task will be to examine some of the alternative explanations. The possibility of 'demand-side' constraints preventing the economy from locking into virtuous cycles also needs to be considered, and the importance of this kind of problem evaluated.
Appendix A Chapter Fourteen

Output Employment and Price Data Used in Chapter Fourteen

The statistical results presented in this chapter have been based on published series for gross value of output, employment and capital assets in aggregate, and disaggregated for sub-sectors. The source is the Census of Manufacturing Industry (CMI) of the Bangladesh Bureau of Statistics which collects statistics for the large-scale manufacturing sector disaggregated into twenty sub-sectors. These are published in the Statistical Yearbook of Bangladesh, BBS, Dhaka, various years. Although these series are based on the replies of (approximately three thousand) institutions who respond to the BBS questionnaire, they have the desirable attribute of consistency, that is, they all relate to the same group of units at any one time.

There are two relatively minor changes in coverage. First, coverage was marginally widened from 1967/8 onwards, to include factories registered under section 2(f) (10 or more workers, with or without power, any part of the process being manufacturing), along with those under 2(j) (20 or more workers with power) and 5(1) (10 or more workers, with or without power) as before. Secondly, 1974/5 - 1976/7 data, unlike the other years, include non-response results. However, no systematic break in the data can be observed for either year. We have also used an investment series for investments in the large scale manufacturing sector, whose construction and sources are detailed below and various price series for wholesale prices for the products in each of the sectors studied, as well as a price series for the price of capital goods.

One problem with the CMI data is that the number of firms responding every year does not remain the same. For the West Pakistan data, which has similar problems, Kemal1976a has pointed out that these year-to-year variations are quite significant. Kemal's method of correction of CMI data was to construct an independent capital stock series and then to estimate annual output, employment and other indicators by using the implicit capital-output, capital-labour and other ratios available from the uncorrected data. We did not use this approach because it makes the output and employment figures overly dependent on the rate of growth of capital stock. Moreover, investment statistics are very poor at the sub-sectoral level. Kemal rather arbitrarily assumes that 70% of the investment sanctioned by the government in each sector each year actually takes place.

The main criticism of this correction procedure is that the rates of growth of productivity or capital intensity available from this method are exactly the same as from the uncorrected data.

See the debate over Kemal's procedure in Korve1978a, 1978b and Kemal1978. Instead, to smooth out any jumps in the series which may be attributed to random changes in the number of firms responding to the questionnaire every year, we adjusted the annual figures in the following way: the Bureau of Statistics publishes for each year, the number of enterprises responding to the questionnaire both in aggregate and in each of the twenty sub-sectors. It also publishes annual statistics for the number of firms known to be registered, again both in aggregate and for each sub-sector. We therefore calculate a ratio αi,t where

\[
\alpha_{i,t} = \frac{\text{Number of firms responding in sub-sector } i \text{ in year } t}{\text{Number of firms known to be registered in sub-sector } i \text{ in year } t}
\]
Part IV

Variations in the ratio $a_{xx}$, the ratio of registered firms responding, can analytically be due to two sorts of reasons. First, the proportion of respondents can vary due to variations in the number of firms responding, output and employment remaining constant. If this was the only factor accounting for the variation, we should simply divide the output and employment figures by the appropriate $a_{xx}$ to get the actual output and employment, assuming that non-responding firms were similar to the responding firms. On the other hand, if variations in $a_{xx}$ were largely due to a few enterprises closing down or re-opening while remaining registered, output and employment would change because of a change in the number of firms actually in production. In this case, the CMI figures would be correct and would not require correction.

The CMI figures and CMI/$a_{xx}$ therefore constitute two limits on the actual output and employment figures. If the large variations in $a_{xx}$ observed within sub-sectors is due entirely to large changes in the number of registered firms actually producing in any year, output in each surviving firm being fairly stable, we should use the uncorrected CMI figures. If the changes in output and employment are more evenly spread across firms, the variations in $a_{xx}$ being more a result of year-to-year changes in the number of firms reporting, we should use CMI/$a_{xx}$. Since we do not know which assumption would be better, we use the geometric mean of the two.

Corrected Output, Employment Figures = (CMI × CMI/$a_{xx}$)$^{1/2}$

Note: A few observations were greater than one. This was clearly the result of errors or leads and lags in enumeration of collected statistics, as the number of reporting firms is found to be greater than the number of registered firms, usually by a very small margin. In these cases, as well as those where the number of reporting firms was equal to the registered firms, an observation of 1.0 was returned.

Note:

The rates of growth calculated using the corrected figures would be the arithmetic average of the rates of growth calculated using raw CMI figures and those calculated using CMI/$a_{xx}$. In Appendix C these rates of growth are also presented as they show the range within which output and employment growth lay on the basis of the information available in the Census of Manufacturing Industries.

---

TABLE 14-A 1: CORRECTION FACTORS $a_{xx}$ FOR CMI OUTPUT AND EMPLOYMENT

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<th>PRAG</th>
<th>LEAT</th>
<th>CHEM</th>
<th>MINI</th>
<th>BAR</th>
<th>MET</th>
<th>METL</th>
<th>MACH</th>
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Note: A few observations were greater than one. This was clearly the result of errors or leads and lags in enumeration of collected statistics, as the number of reporting firms is found to be greater than the number of registered firms, usually by a very small margin. In these cases, as well as those where the number of reporting firms was equal to the registered firms, an observation of 1.0 was returned.
Part IV APPENDIX (Appendix Fourteen - A)

should only be regarded as a first approximation towards correction for undercoverage since on the one hand the CMI's list of registered firms does not cover all firms actually in production in that sector, and on the other there is some evidence that some of the firms registered with the CMI in some years were not actually in production. See Kemal (1976a). However, we only require the changes in the number of registered firms to be a reasonably acceptable index of actual changes in the number of productive units. The Bureau also states that the results for 1974/5-1976/7 have been corrected for 'non-response', but gives no detail as to the correction procedure. We first tried to exclude these years from our correction procedure, but this did not produce any significant change in the trends. Thus the correction factor was applied to all years subsequently. It should be noted that these correction factors would affect our results for output and employment but not for productivity or productivity growth, since output and employment in each year and each sector is divided by the same factor.

It is arguable that real value added would be a better basis for an output measure which could be used to calculate productivity performance. However, we rejected the value-added figures in favour of the figures for the gross value of production because price indices of the inputs used in each sector was not available separately. The gross value of production series for the manufacturing sector as a whole was deflated by a manufacturing wholesale price index for Bangladesh constructed by the Bangladesh Bureau of Statistics and presented in a number of sources, including the Statistical Yearbook of Asia and the Pacific, ESCAP, Bangkok, various years. When sectoral gross value of production figures had to be deflated, price indices for wholesale manufacturing prices in that sector had to be constructed. Since no consistent series for the subsectors was available over the entire period, a chain index was constructed for each sector. Three sources were used:

For 1963-70, the sectoral price indices were constructed from sub-sectoral wholesale price indices published in Pakistan; Monthly Statistical Bulletin, Central Statistical Office, various years. The index for some sectors were constructed as a weighted average of indices using the implicit sectoral weights used later by the BBS in constructing the price index for domestically produced industrial products. The following weights were used:

Food Manufacturing: Weighted average of ghee (butter oil) 0.06343, mustard oil 0.06343, coconut oil 0.06343, vegetable ghee 0.10788, tea 0.17939, and refined sugar 0.5224.

Tobacco: Tobacco manufactures price index.

Textiles: Weighted average of cotton manufactures 0.44372, and jute manufactures 0.55628.

Paper: Paper and Newsprint price index.

Printing and Publishing: Paper and Newsprint price index.

Leather: Leather manufactures price index.
**Part IV**

**APPENDIX**

(Appendix Fourteen - A)

**Chemicals:** Weighted average of general chemicals 0.03678, dyeing materials 0.03103, soaps 0.25402, fertilizers 0.26457, and drugs and medicines 0.30575.

**Mineral Products:** Weighted average of cement 0.72727 and glass products 0.27273.

**Basic Metals:** The metal product price index was used as a proxy for this sector.

**Metal Products:** The price index for this sub-sector caused problems. The listed WPI for metals includes the iron and steel sector where inflation was much faster. Using this index was rejected in this period and instead we used the utensils price index as the metal products output deflator for this period.

**Machinery:** Machinery WPI.

**Electrical Equipment:** Electrical goods WPI.

**Transport Equipment:** Weighted average of machinery 0.95088 and cycles 0.04912.

**TABLE 14-A 2 : WHOLESALE PRICE INDICES IN THE MANUFACTURING SECTOR AND A PRICE INDEX FOR CAPITAL GOODS.**

(Base years chosen to convenience calculations, when necessary indices have been reworked with required base.)

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Page 319
For 1970-75 disaggregated price indices were not available for the sub-sectors. We therefore chained on to each sub-sectoral price index the aggregate wholesale price index for manufactured products for this period, assuming that there were no relative price changes of substantial magnitude to alter the qualitative results. It should be said that all statistical information for this period should be treated only as broad indicators of trends.

For 1975-80, we used the price index of Domestically Produced Industrial Products. This is published in Statistical Yearbook of Bangladesh, Bangladesh Bureau of Statistics, various years. Since the sectoral classification of the price indices corresponds to the CMI data, we could chain on these indices directly.

With the exception of the metal products sector, the results presented at the sub-sectoral level are not qualitatively sensitive to the price index. All the results were also computed using the aggregate manufacturing wholesale price index as the common deflator for all the sectors and no qualitative change in the results was observed. See Appendix 14-C.

The price index for capital goods has to be appropriate for use with our series on investment in fixed assets and the base year measure of capital stock, both of which include expenditures on land and construction. Our index is based on three sources where such a price index of capital goods is presented for different periods. From 1959/60 to 1969/70 we used the price index for capital goods in East Pakistan constructed by Anjad in Anjad(1982) Table A.5. No official figures are available for the period 1969/70 to 1973/74, but a capital goods price index for Bangladesh constructed by the World Bank in IBRD(1978) Annex 1.14 gives us estimated index figures for these two terminal years. We were therefore also able to calculate indices for the three intermediary years to our base, by assuming a constant compound rate of inflation in the capital goods prices (the two terminal indices implied an exponential rate of inflation of 24.6 %) over this period. For the subsequent period, 1973/74 to 1983/84, we have chained on the deflator for gross capital formation available from the Bangladesh Bureau of Statistics, in Statistical Yearbook, 1983/84.
Appendix 8 Chapter Fourteen

INVESTMENT AND CAPITAL STOCK DATA

To use the perpetual inventory method, we need a series for investments at current prices, a price index of capital goods (which we have as part of Table 14-A.2), an estimate of the base year capital stock, and some information on the rate and pattern of scrapping of old stock. The main problem was that a series for Gross Fixed Capital Formation in the large-scale manufacturing sector in Bangladesh could not be found. However, estimated series for investments in the industrial sector as a whole in Bangladesh do exist and we have updated the existing series using the best data available to us. A series for industrial investment from 1959/60 to 1975/76 is available from the World Bank in [1978]. Amjad's figures in [1982] covers the period 1960/1 to 1969/70. Ahmad in [1984] gives figures for investment from 1972/3 to 1978/9. Finally, the World Bank in [1982b] gives figures for 1975/6 to 1980/81. All these sources are based on Planning Commission and World Bank estimates, but as these are continuously updated, there are small discrepancies between the earlier and later estimates. Whenever possible we have used the more recent set of estimates.

For 1959/60, we used the World Bank estimate for aggregate industrial investment in Bangladesh. From 1960/61 to 1969/70 Amjad's figures for public and private industrial investment was available. Amjad's estimates for public and private industrial investment in East Pakistan, in [1982] Tables A.6 and A.9 covers the period 1960/61 to 1969/70. This series is based on much more robust data, provided by the Planning Commission and the Central Statistical Office of Pakistan, and we have used this series in its entirety for the relevant years in our series. In 1970/71 and 1971/72, the two years directly affected by the 1971 civil war, official figures are not available, and all the evidence suggests serious disruption in this period. The World Bank series estimates zero investment in these two years, and in the absence of other information, we have used these figures. From 1972/3 to 1974/5, we have used Ahmad's estimates provided by Ahmad [1984] in his Table 3.12. To be consistent with our figures for previous years, we used his figures for fixed capital formation rather than total investment, but the difference between the two sets of figures is in any case quite small. Ahmad's figures are based on Planning Commission and World Bank reports. Finally, for 1976 to 1980, we used World Bank's estimates provided in [1982b] Table V.1. In the case of Amjad and Ahmad, investment in 'electricity and gas' in the first case, and 'power and natural resources' in the second case are reported separately, so the figures for industrial investment cover only large and small-scale manufacturing. World Bank figures are for manufacturing alone, so the figures are reasonably consistent and cover investment in large and small-scale manufacturing.

The next step is to use the investment figures to estimate a rate of growth of capital stock. Given that the investment refers to the entire manufacturing sector, whereas we are primarily interested in the large-scale manufacturing sector covered by the CMI, there are two ways in which we can tackle the problem. The first is used by the World Bank in its estimate of the rate of growth of capital stock in Bangladesh. This is based on the CMI's figures for 'value of fixed assets', which is the book value of assets of census respondents. As the Bank points out, see [1978] and in particular the methodological explanations in Annex I.14, Vol.II pp. 181-2, these census returns for the value of fixed assets are unusable because they make no adjustment for
price changes. The Bank method then attempts to correct for this by estimating annual correction factors which can be used to mark up the CMI estimates of fixed assets.

### Table 14-B: Industrial Investment in Bangladesh at Current Prices (Million Takas)

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This method is weak because of two reasons. First the Bank method ignores the divergence between depreciation conventions, which are generally high for taxation purposes, and the actual withdrawal and scrapping of capital. This can be seen as follows. Book values of assets are $B_T$, where

$$B_T = \sum_{t=1}^{T} (1 - d)^{T-t} I_t$$

and where $d$ is the depreciation allowance, assumed to be on average 10%, and $I_t$ the investment series. We require, however, $K_T$, where

$$K_T = \sum_{t=1}^{T} \frac{(1 - s)^{T-t} P_t I_t}{P_t}$$

where $s$ is the rate of scrapping, and $P$ the price index of capital goods.

The Bank method assumes that the relative investment in the large-scale CMI firms in any year is the same as for the industrial sector as a whole. So even if $I_t$ for the large-scale sector is not known, $I_t / I_{11}$ can be deduced from the figures for the industrial sector. Using this the Bank estimates a ratio $K_t / B_t$ for each year and uses this to mark up the CMI figures for fixed assets. The problem is clearly that by ignoring the fact that $s < d$, this method seriously underestimates the actual size of the capital stock.
The second and more serious problem with the Bank method is that year-to-year variations in the CMI reported 'fixed assets' are extremely suspect, and the trend shows fluctuations which can only be explained by unsystematic book-keeping and depreciation practices on the part of reporting firms, as well as changes in the proportion of operating firms which actually report in any year. For these reasons we chose not to use or attempt an improvement in the Bank's method.

The second approach, which we felt was analytically and statistically more defensible, starts with a base year figure for capital stock, and then uses the investment series, price indices for industrial investment, and reasonable assumptions about scrapping to directly estimate $K_t$. Since our investment figures are for the entire manufacturing sector, we need a capital stock estimate which is for the entire sector. However, the large-scale sector dominates the manufacturing sector in terms of output and even more in terms of capital stock, although the small-scale sector employs by far the more people. The figures for the rate of growth of capital stock estimated in this way will, of course, reflect the rate of growth in the manufacturing sector as a whole, but given the dominance of the large-scale manufacturing sector in terms of capital stock (see below Table 14-8.2), and given the fairly constant shares of the large and small-scale sectors in total output (see Table 2.1), this figure may be reasonably used as a proxy for the rate of growth of capital stock in the large-scale manufacturing sector. Actually Table 2.1 shows a small decline in the relative share of the small-scale sector's output, which could be due to capital stock growing faster in the large-scale sector. Hence our estimates of the rate of growth of capital stock in large-scale manufacturing using this method could be slight underestimates, but at least the assumptions used here are quite explicit.

Our base year estimate of capital stock is based on the estimation of capital stock at replacement cost for the Bangladesh manufacturing sector by Khan & MacEwan (1967), based on the 1962-3 CMI. Based on their method, Rizwani Islam (1976) estimates the value of capital stock for 1968-9, by adjusting similar BBS/CMI figures for that year. The latter figures are for book values, and following Khan & MacEwan, Islam devised a procedure to adjust the figures to take account of the discrepancy between depreciation conventions and physical withdrawal patterns. Once again, the basic objective is to get a ratio $K_t / B_t$, which can be used to mark-up the CMI figures for fixed assets. Unlike the World Bank, Khan and MacEwan make a clear distinction between depreciation conventions and actual retirement rates, as well as making the price correction, in their estimation, Khan & MacEwan (1967) pp. 447-52. Moreover, their exercise is only for a single year, which corrects the reported asset figure by an order of magnitude, and is not dependant on year to year variations in the reported asset magnitude. We have used the capital-value added ratios reported by them for 1962/3 together with the CMI figures for value added in 1962/3 to estimate the capital stock in large-scale manufacturing in 1962/3. When necessary, Khan & MacEwan's capital-value added ratios were aggregated to sub-sectoral ratios which were consistent with the classification currently used by the CMI. The weights used were the sectoral value-added weights used by the BBS in computing price indices. The results are presented in Table 14-8.2.

Khan & MacEwan also present capital-value added ratios for the small scale sector based on an extensive study carried out in East Pakistan in 1964 by the East Pakistan Small Industries Corporation. This study in fact looked at different small-scale sectors separately, on the basis of which Khan & MacEwan present sector-wise
capital-value added figures. Since the variation within the range of figures was small, we used the simple average of the capital-value added figures. The average value was 0.522. The value-added in the small scale sector in 1962/3 was available in the National Income Estimates in Alamgir & Beriag (1974) Table C.3. In 1962/3, this was Tk. 581,000,000. This gave a total value of capital stock in the small-scale manufacturing sector of Tk. 303,282,000 in 1962/3.

TABLE 14-2: ESTIMATE OF CAPITAL STOCK IN LARGE-SCALE MANUFACTURING 1962/3

<table>
<thead>
<tr>
<th>SECTOR</th>
<th>KHAN AND MACEWAH'S CAPITAL-VALUE ADDED RATIO</th>
<th>VALUE OF CAPITAL STOCK '000 TK</th>
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<tr>
<td>Food Manufacturing</td>
<td>2,869</td>
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<td>Beverages</td>
<td>1,613</td>
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<td>Textiles</td>
<td>2,782</td>
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<td>Wood, Cork and Furniture</td>
<td>2,437</td>
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<td>Paper and Printing</td>
<td>13,798</td>
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<tr>
<td>Leather</td>
<td>1,269</td>
<td>7,075</td>
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<tr>
<td>Rubber</td>
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<tr>
<td>Chemicals</td>
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<td>Minerals</td>
<td>2,642</td>
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<tr>
<td>TOTAL</td>
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<td>3009,723</td>
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</table>

Source: See Text.

The base year capital stock for the industrial sector may now be estimated. To the nearest 10 million takas, the capital stock in the small-scale sector is 300 million takas, and in the large-scale sector, 3010 million takas, giving a total of 3310 million takas. In the estimations below, we assume a base year capital stock of 3500 million takas.

The value of the measures of capital growth estimated under assumptions of varying reliability have been severely questioned, for instance by Kravis in Kravis (1976) pp. 12-13, who suggests instead a reliance on labour productivity to assess performance. While the questions are real enough and should be kept in mind, studies such as the one commissioned in Panis (1976) demonstrate that there is no reason why this procedure should not aid our understanding of variations in the overall growth experience.

To estimate the rate of growth of capital stock requires, finally, information regarding the vintages of the capital stock and scrapping patterns, information which is not available for Bangladesh. Nevertheless, we can
get some indicative results by assuming an average annual 'scraping factor' $\lambda$, where $\lambda$ is the constant factor by which the gross capital stock is assumed to be scrapped every year. The stream of capital values at base year prices can then be generated using the equation:

$$K_{t+1} = (1 - \lambda) K_t + \frac{I_t}{P_t}$$

The $K$s represent values of capital stock at base year prices, the $I$s investment at current prices and $P$ is the price index of capital goods. If five per cent of capital is scrapped annually, $\lambda$ would be 0.05. In Table 14-B.3, we see some alternative estimates of the trend rate of growth of capital stock in various periods, under alternative assumptions about the scraping factor. We also see what happens to the estimates if we increase or decrease our base year capital stock estimate, to check for error from this source. The capital growth rates are found to be fairly sensitive to the choice of scraping factor but much less so to the choice of base year capital stock size. These results are clearly specific to the characteristics of the data set.

The World Bank assumes ten per cent scrapping to be reasonable for Bangladesh, but casual observation of industrial convention suggests that this is probably seriously overestimated. If a rule of thumb is to be adopted, a figure of five per cent would be more realistic, but it would not be surprising if detailed studies in the future found the actual rate of scrapping to be even lower. The choice of periods in Table 14-B.3 has been made with a view to making the capital stock figures comparable with the trends in output and employment.

<table>
<thead>
<tr>
<th>TABLE 14-B.3: ESTIMATES OF RATE OF GROWTH OF CAPITAL STOCK IN BANGLADESH LARGE SCALE MANUFACTURING</th>
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<td>Million Takas,</td>
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<td>(3000)</td>
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<td>(4000)</td>
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</table>

Sources: For the Price Index of Capital Goods see Appendix A, Investment series from Table 14-B.1. Using this information and the appropriate Scapping Factor, $\lambda$, a series of capital stock at base year prices was derived in the way described in the text.
Appendix C Chapter Fourteen

ALTERNATIVE ESTIMATES OF MANUFACTURING RATES OF GROWTH

Our analysis of productivity trends has been based on the Census of Manufacturing Industries (CMI) data available to us. To correct for undercoverage we used the correction procedure described in Appendix 14-A. Here we present rates of growth estimated using the output and employment values which define the range of variation as discussed in Appendix A, Table 14-C.1 presents rates of growth using raw CMI data, while Table 14-C.2 presents rates of growth using CMI/a, values for output and employment. The rates of growth used in the text are the arithmetic average of these, since we have used the geometric mean of the two sets of values. Since the rate of growth of productivity is identical in all three cases, Table 14-C.1 does not present productivity growth rates which are the same as in Table 14-C.2 and Table 14.7. The results show that even with substantial changes in the assumptions, the underlying data is sufficiently robust for the qualitative results of Chapter Fourteen to be unaffected.

| TABLE 14-C: UNADJUSTED CMI OUTPUT & EMPLOYMENT GROWTH IN BANGLADESH MANUFACTURING. |
|-----------------------------------------|---------|---------|---------|---------|---------|
| I. AVERAGE ANNUAL RATE OF GROWTH OF REAL OUTPUT |
| Food Manufacturing                      | 26.0    | -1.3    | -15.3   | 12.6    | 16.7    |
| Tobacco                                 | 35.9    | 20.7    | -1.3    | 9.8     | 6.0     |
| Textiles                                | 12.8    | 12.6    | -5.2    | 7.6     | -4.0    |
| Paper                                   | 21.0    | -0.6    | -0.9    | 10.8    | 0.7     |
| Printing and Publishing                 | 6.1     | 3.4     | -1.1    | 10.3    | 7.7     |
| Leather                                 | 11.7    | 24.3    | -10.6   | 15.9    | -0.6    |
| Chemicals                               | 19.4    | 0.6     | -2.4    | 16.6    | 15.2    |
| Mineral Products                        | 9.7     | 5.7     | 3.4     | 23.8    | -1.9    |
| Basic Metals                            | 43.6    | 1.4     | 9.4     | 15.6    | 10.8    |
| Metal Products                          | 13.7    | -11.4   | -0.8    | 2.6     | 30.0    |
| Machinery (non-electr)                  | 13.2    | 15.3    | -17.2   | 32.4    | -6.0    |
| Electrical Machinery                    | 29.4    | 6.5     | -13.7   | 40.5    | -      |
| Transport Equipment                     | 10.5    | 2.6     | 21.9    | 11.7    | 15.7    |
| ALL MANUFACTURING                       | n a     | 5.1     | -4.3    | 15.9    | 7.9     |

II. AVERAGE ANNUAL RATE OF GROWTH OF EMPLOYMENT

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<td>7.6</td>
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### Table 14-C.2: CMI/a. Output & Employment Growth in Bangladesh Manufacturing

#### I. Average Annual Rate of Growth of Labour Productivity

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#### II. Average Annual Rate of Growth of Real Output

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#### III. Average Annual Rate of Growth of Employment

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<td>Leather</td>
<td>8.5</td>
<td>1.6</td>
<td>-3.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chemicals</td>
<td>10.5</td>
<td>8.5</td>
<td>1.0</td>
<td>4.3</td>
<td></td>
</tr>
<tr>
<td>Mineral Products</td>
<td>6.1</td>
<td>-3.9</td>
<td>10.9</td>
<td>7.1</td>
<td></td>
</tr>
<tr>
<td>Basic Metals</td>
<td>29.8</td>
<td>-4.2</td>
<td>24.0</td>
<td>-0.3</td>
<td></td>
</tr>
<tr>
<td>Metal Products</td>
<td>7.7</td>
<td>-6.0</td>
<td>0.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Machinery (non-electr)</td>
<td>10.3</td>
<td>11.5</td>
<td>-1.2</td>
<td>8.3</td>
<td></td>
</tr>
<tr>
<td>Electrical Machinery</td>
<td>12.9</td>
<td>17.2</td>
<td>-10.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transport Equipment</td>
<td>-0.8</td>
<td>19.3</td>
<td>6.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ALL MANUFACTURING</td>
<td>-4.0</td>
<td>9.6</td>
<td>-0.5</td>
<td>2.4</td>
<td></td>
</tr>
</tbody>
</table>

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Notes to Chapter Fourteen

1. The World Bank, in its recent evaluations of industrial performance in Bangladesh, has preferred not to use the CHI figures, particularly for value added, and opted instead for the Quantum Production Index (QPI), also provided by the Bangladesh Bureau of Statistics, but using re-estimated weights for aggregating sectors rather than the ones used by the Bureau of Statistics. The World Bank's explicit objective in reworking the Quantum Index was to assess if the decline in growth after 1979/80 was really as disappointing as appeared at first sight, despite the liberalization attempts of the government and its pushing through of 'one of the most extensive denationalization programmes of public sector enterprises in the world'. By re-estimating weights in favour of sectors which had grown faster since 1973/4 when the weights were first calculated, the Bank was able to show that the slowdown in growth in the early eighties was less disappointing than it appeared.

Of the different sets of figures, the use of even the revised Quantum Index is not satisfactory for several reasons. First, it is based on a much smaller sample, around five hundred enterprises, compared to the three thousand or so covered in the Census. Secondly details of the statistical methods used by the Bureau of Statistics in calculating the quantum index are not available in published form so that the implications of the rules of thumb which are necessarily employed cannot be assessed. Since wholesale price indices for the manufacturing sector and its sub-sectors can be constructed with reasonable accuracy, it was felt preferable to use the Census figures for the gross value of annual production and use the price indices as deflators to get estimates of real output.

The stated reasons for the World Bank's choice were first that the last CHI was in 1981/2, so anyone interested in subsequent years has to turn to other series which consistently cover later years, and secondly, the two price indices which could be used to deflate value added figures from the CHI, the manufacturing Wholesale Price Index (WPI), and the Price index for Domestically Produced Manufactured Goods (OPPI), do not move together, and it is not clear which should be used. ILO[1986] pp. 101-42, particularly pp. 134-42. We have used the WPI for manufacturing, primarily because a consistent series could be found going back to the sixties, this is described in Appendix A.

2. See Kornai[1971] and Kornai[1980].

3. This is an essentially static approach adopted within the neoclassically inspired methodology of cost-benefit analysis. The World Bank for instance performs this exercise for a number of countries including Bangladesh, calculating what it calls Domestic Resource Costs, defined as the ratio between the domestic resources used in each unit of production and the foreign exchange saved by producing rather than importing it. The higher the ratio, the greater the taka cost of saving one dollar by domestic production, and if the ratio is above the current exchange rate, trade would be preferable to production if foreign exchange were available. A further variation is to calculate 'economic' domestic resource costs, which uses shadow prices instead of market prices for the factors. See ILO[1978] pp. 35-39 and ILO[1979] pp. 46-49. The problem with this type of approach, apart from its being a snapshot, is that it would show inefficient production in all countries with
substantial levels of protection, not only because of real inefficiencies, but also because the local currency in 'import-substituting' countries tends to be overvalued to a large but indeterminate extent, in other words the method is too sensitive to the shadow price parameters chosen. As we have argued in the text, when there is a large gap in absolute levels of productivity, some protection may be unavoidable, whether directly or through exchange rate adjustments, the real question then becomes a dynamic one.


6. Pioneering work on total productivity growth was done by Abramowitz(1956), Solow(1957), Reddaway & Smith(1960) and Denison(1967). Elliott(1976), Elliott & Hughes(1976), and other pieces in Panitz(1976), provide useful examples of applied work. Some applied work has been done on the NIC's as in Kim & Roemer(1979) on South Korea, but work on the developing countries have been less common partly because of data problems. Reviews of the various studies which have been done and of the limitations may be found in Nadiri(1972), Kennedy & Thrivall(1972), Kravis(1976), and Devine et al.(1979) amongst others.

7. Growth accounting as distinct from the estimation of production functions became popular following the work of Denison. Purely arithmetic estimates of productivity using weights based on capital and labour's initial shares in output have become known as National Bureau of Economic Research (NBER) method; Kenai(1983). The distinction between the two approaches is discussed in Nadiri(1970). The latter clearly requires less severe assumptions about the weights used for capital and labour.

As for the Cobb-Douglas form itself, the additional improvement in measurement offered by alternative forms, in particular the CES function, which is not restricted to unit elasticity of factor substitution, has been questioned; see for example Kennedy & Thrivall(1972) pp. 23-6. The identification problem created by elasticities of substitution significantly different from one is also limited in our case, as we shall see that the two factors have grown at very similar rates over time.


9. The slowing down of the Bangladesh economy after 1981 is looked at by the World Bank in IRAD(1986). In Table 14.1 the rate of growth in the quantum production index for the manufacturing sector tapers off after 1980/81. The Bank argues that by reweighting faster growing sectors, a better performance is obtained, but even their revised index shows a slowing down in the rate of growth over the period 1981-85 compared to the previous five year period.

10. This happens through a bias in the measure of factor contributions. For instance if capital is being underused in the economy, (that is the relative return to capital is below its relative marginal productivity), β estimated from factor shares will be less than the actual output elasticity of capital. The contribution of a
faster growth of capital will therefore be underestimated, and the resulting growth will instead be captured as productivity growth. This built-in bias ensures that growth in this scenario is 'accounted for' as an increase in (price) efficiency, and incorporated in the residual, as factor proportions are brought more into line with relative factor costs. Consequently Millward et al. (1983) have argued that the assumption of perfect competition is no longer necessary. This is because calculating productivity growth using estimates of $\alpha$ and $\beta$ derived from the respective shares of the inputs in total costs, and assuming constant returns to scale, measures not only the actual growth in productivity, in other words the movement inwards of the production isoquant, but also any improvements in price efficiency, or movements along the isoquant, as the relative marginal products of the two inputs are brought more into line with the input price ratio facing the firm or country.

With the assumption of constant returns to scale, the difference between the relative marginal products of the two inputs and the input price ratio, is reflected in the difference between the 'actual' output elasticities of inputs ($\alpha$ and $\beta$) and their estimated values from the respective shares in total costs. For instance:

$$\beta = \frac{\partial Q}{\partial K} = \frac{K}{Q/\partial K}$$

and,

$$Q = K + L \frac{\partial Q}{\partial L}, \text{ from constant returns to scale,}$$

giving:

$$\beta = \frac{K}{K + L \left( \frac{\partial Q/\partial L}{\partial Q/\partial K} \right)} = \frac{K.P_K}{K.P_K + L.P_L \left( \frac{\partial Q/\partial L}{\partial Q/\partial K} \right)}$$

Clearly $\beta =$ share of expenditure on K in total cost, only if $\frac{\partial Q/\partial L}{\partial Q/\partial K} = \frac{L}{K}$ which is the standard requirement for price efficiency. From this Millward et al, argue that the degree to which price efficiency is attained is reflected in the degree to which the input's share in total cost corresponds to the output elasticity of the input. Millward et al. (1983), pp. 225-235 esp. pp. 229-31. For instance, price-inefficient overuse of capital, leads to the measured $\beta$, using factor shares, being more than the actual $\beta$. Thus, using the former, the contribution to output of a given growth of capital would be overestimated, in other words, the productivity growth measure would be adjusted downwards, which is what we would want if we want the growth in output resultant from an improvement in factor proportions to be captured in the residual.

Alternatively, growth under such conditions may justifiably be accounted as the contribution of capital, and this has been the objective of several attempts to estimate factor contributions under disequilibrium conditions. Bruno (1968) is an example. To avoid the estimation errors of $\alpha$ and $\beta$, using factor shares when factor and product markets are in disequilibrium, a production function is identified starting with a specific factor market relationship between real wages and productivity. This constant marginal share production function is estimated for Israel over 1953-64, and it is found that the contribution of capital is substantially increased (from 30-35% to 50-60%). Bruno (1968) p. 59. Such production functions, however, are not without their specification problems, see Kennedy & Thirlwall (1972) pp. 23-6, and comparable results are not available for other countries.


13. Tisdell & Kibria[1984] argue that "the government (specially that of the late President Zia) encouraged the nationalized jute mills to employ excess labour and maintain employment", p. 124.


15. Atiq Rahman[1985].

16. Two recent studies which both cover the period 1959-60 to 1969-70 are Cheema[1978] (Table 1), and Kemal[1983] (Table 5, p. 165). Both studies are based on Kemal's method of correcting CMI figures, which we have critically examined in Appendix 14-A. Norbve[1978a] and [1978b] has pointed out that Kemal's figures for output growth are overestimates because instead of 'Double Deflating', he deflates value added by using the wholesale (output) price index, at a time when value added was increasing as a share of gross output. This suggests that the gap between the Bangladesh and West Pakistani figures may not be as large as indicated, Cheema has calculated productivity using output instead of value added figures, and these are in general lower, but still better than the Bangladeshi figures. See his Table 1, Cheema has argued that productivity growth in Pakistan shows a break around 1962-3, the index falling in 11 out of 16 sub-sectors; Cheema[1978] p. 50, My argument that productivity growth in Pakistan then picked up is based on an inspection of Cheema's Appendix Table 2, pp. 56-7, which shows that after a period of stagnation over 1965-6 to 1967-8, the productivity index starts improving in quite a few sub-sectors, including, Food, Tobacco, Textiles, Printing, and Chemicals.

17. See Kaldor[1953] and Rowthorn[1975]. Such an error would, in a sense, be the mirror image of Kaldor's position in the Rowthorn-Kaldor exchange concerning productivity growth in the OECD countries, when the latter took output of, and ultimately the demand for manufacturing, as the independent variable, and explained its positive correlation with manufacturing productivity growth in terms of Verdoorn effects or dynamic economies of scale. Rowthorn's observations regarding the interdependence of demand, supply and productivity growth would be equally valid against the assertion of a unilinear relationship between investment-induced structural change and productivity growth.
Chapter Fifteen Constraints on the Growth of Output and Productivity

In this chapter we look at some of the factors which may explain the trends in output and productivity growth we discussed in Chapter Fourteen. We will look at alternative explanations of the determinants of the size and structure of industrial investment and employment growth in Bangladesh. In a poor economy like Bangladesh, explanations based on resource constraints on the one hand and lack of demand on the other have understandably been at the heart of most analyses of the poor performance of the industrial sector. The relevance of these factors in conditioning the performance of the industrial sector need not be denied. But we need to ask if such explanations are adequate for explaining the problem in its entirety, or whether it is necessary or justified to bring in other explanatory variables.

In section 15.1 we look at supply-side explanations of poor industrial performance. Resource constraints would be expected to slow down the long-term trend in industrial output and productivity growth if industrial investments were constrained as a result. Industrial investments however, seem to be more sensitive to variations in the release of funds by the financial institutions than to any indicators of aggregate resource availability. This suggests that factors which on the one hand account for a variation in the amount of resources industry is able to absorb, and on the other account for a variation in the efficiency of disbursement by state and commercial financial institutions may be more important than the actual quantity of resources which may in some sense be 'available'. This rather innocuous result is actually quite damaging for the resource constrained argument. In section 15.2 we briefly discuss the opposite argument, which looks at Bangladesh's poor performance in terms of the easy availability of aid. Section 15.3 looks at the evidence for a demand constraint operating on the industrial sector. Our analysis shows that during periods of industrial growth domestic demand not only kept up, domestic
producers faced increased competition as import liberalization led to a growth in imports capturing domestic markets. Once again, the picture of an industrial sector hemmed in by exogenous forces is not borne out by the facts.

Finally section 15.4 looks at some evidence which shows that clientelist processes operate in Bangladesh's industrial sector. We find that in Bangladesh an improvement in economic performance leads to the growth in the employment share of white collar employees which we can interpret as an indication of clientelist payoffs increasing. This process of attrition prevents virtuous cycles emerging with productivity improvements. Such a relationship between productivity growth and the labour market is found not to exist in South Korea. Organizational rights thus exist in Bangladesh which allow clientelist payoffs to be bargained and we should therefore expect the efficiency implications discussed in Part II. An estimation of the quantitative significance of clientelism in constraining growth is not however attempted.

§ 15.1 The Supply Side : Poverty and Investible Resources

The supply-side problem in an economy like Bangladesh has been conceived of both as an absolute scarcity of resources constraining the rate of growth of manufacturing (the savings constraint), as well as in 'structural' terms (a foreign exchange or foodgrain constraint). The transmission mechanism through which scarcity is usually perceived to affect industrial performance is through the constraints it imposes on aggregate investible resources, although in principle, scarcity could also affect the sectoral allocation of investible resources. How crippling a role has poverty played in determining the options available for industry? In table 15.1, some indicators of resource availability are presented. Looking at the most important transmission mechanisms linking scarcity with industrial performance, we find that the available data does not corroborate these hypotheses satisfactorily.
**TABLE 15.1: RESOURCE AVAILABILITY AND INDUSTRIAL INVESTMENT**

<table>
<thead>
<tr>
<th>YEAR</th>
<th>FOOD GRAINS</th>
<th>SAVINGS</th>
<th>FOREIGN CAPITAL INFLOW</th>
<th>INDUSTRIAL INVESTMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>MILLION TONS</td>
<td>PER CAPITA</td>
<td>AVAILABILITY GAP</td>
<td>MILLION TAKAS IN GNP</td>
</tr>
<tr>
<td></td>
<td></td>
<td>MILLION TONS</td>
<td>THOUSAND TONS</td>
<td></td>
</tr>
<tr>
<td>1961</td>
<td>8.35</td>
<td>0.164</td>
<td>1042.0</td>
<td>6.37</td>
</tr>
<tr>
<td>1962</td>
<td>8.33</td>
<td>0.160</td>
<td>1219.1</td>
<td>6.92</td>
</tr>
<tr>
<td>1963</td>
<td>7.67</td>
<td>0.143</td>
<td>1050.1</td>
<td>5.87</td>
</tr>
<tr>
<td>1964</td>
<td>9.20</td>
<td>0.167</td>
<td>1644.0</td>
<td>8.40</td>
</tr>
<tr>
<td>1965</td>
<td>9.43</td>
<td>0.167</td>
<td>1715.1</td>
<td>8.58</td>
</tr>
<tr>
<td>1966</td>
<td>9.40</td>
<td>0.162</td>
<td>1954.0</td>
<td>9.34</td>
</tr>
<tr>
<td>1967</td>
<td>9.20</td>
<td>0.155</td>
<td>1733.4</td>
<td>8.26</td>
</tr>
<tr>
<td>1968</td>
<td>10.44</td>
<td>0.171</td>
<td>1894.6</td>
<td>8.30</td>
</tr>
<tr>
<td>1969</td>
<td>9.99</td>
<td>0.169</td>
<td>1982.4</td>
<td>8.42</td>
</tr>
<tr>
<td>1970</td>
<td>10.55</td>
<td>0.164</td>
<td>2162.1</td>
<td>9.01</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>In Constant 1960 prices</td>
</tr>
<tr>
<td>1971</td>
<td>11.08</td>
<td>0.168</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>1972</td>
<td>9.89</td>
<td>0.146</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>1973</td>
<td>10.02</td>
<td>0.144</td>
<td>-171</td>
<td>516.0</td>
</tr>
<tr>
<td>1974</td>
<td>11.83</td>
<td>0.166</td>
<td>254</td>
<td>880.9</td>
</tr>
<tr>
<td>1975</td>
<td>11.22</td>
<td>0.153</td>
<td>-572</td>
<td>536.7</td>
</tr>
<tr>
<td>1976</td>
<td>12.78</td>
<td>0.169</td>
<td>100</td>
<td>-1056.8</td>
</tr>
<tr>
<td>1977</td>
<td>11.82</td>
<td>0.162</td>
<td>-923</td>
<td>2151.4</td>
</tr>
<tr>
<td>1978</td>
<td>13.11</td>
<td>0.164</td>
<td>-273</td>
<td>2051.1</td>
</tr>
<tr>
<td>1979</td>
<td>13.13</td>
<td>0.160</td>
<td>-180</td>
<td>2362.1</td>
</tr>
<tr>
<td>1980</td>
<td>13.35</td>
<td>0.158</td>
<td>26</td>
<td>2371.5</td>
</tr>
<tr>
<td>1981</td>
<td>14.74</td>
<td></td>
<td>3184.0</td>
<td>5.14</td>
</tr>
<tr>
<td>1982</td>
<td>14.37</td>
<td></td>
<td>-397.8</td>
<td>-0.65</td>
</tr>
<tr>
<td>1983</td>
<td>15.07</td>
<td></td>
<td>3924.7</td>
<td>5.73</td>
</tr>
<tr>
<td>1984</td>
<td>15.61</td>
<td></td>
<td>6161.8</td>
<td>6.92</td>
</tr>
</tbody>
</table>

**Notes:** Food production figures from Alamgir & Berlage(1974) Table C-9 and IRRI(1984) Table 7.3. Pre-1970 figures are for rice alone, subsequent figures for rice and wheat, but wheat production is generally well below ten percent of total output and was negligible in the earlier period. Annual total population was estimated by fitting log-linear trends between Bangladesh Bureau of Statistics Census figures for 1961, 1974 and 1981. Food Availability Gap is estimated by the World Bank as (total production + imports - exports + government distribution - procurements) - (population x 15.5 oz. of foodgrains per day). IRRI(1984) Table 10.1.

Savings, Foreign Capital Inflow and GNP figures from Alamgir & Rahman(1974) Table 2.5, IRRI(1984) Table 2.5 and IRRI(1986) Table 2.1. Investment figures from Appendix 14-8.

For deflators used in this table see Appendix 15-A.

Year to year variations in the share of savings and net foreign capital inflow in gross national product can be seen in Table 15.1. Changes in food availability are also shown, both in absolute terms, and relative to population growth. Alongside these figures we have figures for industrial investment in constant prices. Scarcity of resources could affect the trend in industrial performance (which we have measured in terms of productivity) in a number of...
ways. If it could be shown that industrial investments were related to some measure of scarcity, this would constitute the most convincing case for the scarcity constrained argument. This is because if supply-side scarcity were to affect the trends in productivity growth, we would expect it to do so primarily through its effects on the availability of investible resources.

An alternative mechanism through which scarcity could affect productivity would be through changes in raw material availability for existing enterprises. But while the availability of raw materials does fluctuate from year to year, this would explain not the trend rate of growth of productivity, but rather variations around the trend, unless it can be shown that raw material availability or the efficiency of raw material use has a long-term trend independent of embodied technology or organizational changes. The economic rationale for expecting scarcity to have a significant effect on overall productivity trends in this way is not obvious. Thus if scarcity is responsible for poor productivity performance, we would expect changes in industrial investment to be sensitive to changes in aggregate resource availability. Using our own and other available data we ran some simple regressions to see how some of the key variables were inter-related.

In the first set of hypotheses tested, gross national savings and net foreign currency inflows were taken as the explanatory variables and investment in manufacturing was made the dependent variable. Data for these variables and the appropriate unit value indices to get the constant price series were only available for two brief periods, 1961-70 (1963-70 where manufacturing output figures were required), and 1973-80.

As is to be expected, we observe some correlation between the variables, although the variance in the dependent variable which is 'explained' by the two resource availability variables is not very high. Two sets of regressions were
run, the first using the constant price series of each variable, and the second using constant price shares of each variable in the relevant total output.

**TABLE 15.2: MANUFACTURING INVESTMENT AND AGGREGATE RESOURCE AVAILABILITY**

<table>
<thead>
<tr>
<th>Period</th>
<th>Equation</th>
<th>$R^2$</th>
<th>$DW$</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961-70</td>
<td>$I_t = -101.2 + 0.34^a S_t + 0.06^a FC_t$</td>
<td>0.409</td>
<td>1.34</td>
</tr>
<tr>
<td></td>
<td>(1.27) (0.13)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1973-80</td>
<td>$I_t = -1313.3 + 0.53^** S_t + 0.45^* FC_t$</td>
<td>0.698</td>
<td>2.61</td>
</tr>
<tr>
<td></td>
<td>(4.24) (2.38)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1964-70</td>
<td>$I_t / M_t = 0.46 - 3.60^a S_t / Y_t + 0.04^a FC_t / Y_t$</td>
<td>-0.044</td>
<td>3.05</td>
</tr>
<tr>
<td></td>
<td>(-1.31) (0.02)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1973-80</td>
<td>$I_t / M_t = -0.04 + 1.39^* S_t / Y_t + 0.11^a FC_t / Y_t$</td>
<td>0.275</td>
<td>1.41</td>
</tr>
<tr>
<td></td>
<td>(2.16) (0.41)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

$I_t$ = Investment in manufacturing at base year prices,  
$S_t$ = Gross National Savings at base year prices,  
$FC_t$ = Net Foreign Capital Inflow at base year prices,  
$M_t$ = Gross Manufacturing Output at base year prices,  
$Y_t$ = Gross National Product at base year prices,  
$a$ is not significant at the 10 per cent level,  
$*$ is significant at the 10 per cent level,  
$**$ is significant at the 5 per cent level.  
$t$ values in brackets, $R^2 = R^2$ corrected for degrees of freedom, $DW$ is the Durbin-Watson statistic.

It is sometimes argued that manufacturing investment in a poor economy is critically affected by the availability of domestic and international savings. If this hypothesis were true and the relationship was approximately a linear one, we would expect the coefficients tested in Model I in Table 15.2 to be significant. The available data do not strongly support the hypothesis. In the first period neither coefficient is significantly different from zero, though in the second period significant coefficients of the expected sign are estimated.

Because of a strong time trend in all our variables, Model II estimates the relationship using the share of each of the variables in the relevant sectoral gross output figure. The hypothesis being tested is that the investment share in manufacturing is a function of the relative availability of domestic and foreign resources in the whole economy. The results for this model were even
poorer. The relative domestic resource availability variable in the first period now has a sign opposite to what we expected, but neither coefficient is significantly different from zero. In the second period the coefficient for the foreign resource availability index is not significantly different from zero.

Kaleckians would also expect variations in food availability in a resource poor economy to be fairly well correlated with industrial investment (see Chapter One). Once again testing a number of models shows that no simple linear relationship can be identified using the data available to us. The inclusion of either food production or per capita food production as a third variable in either model tested in table 15.2 was found to significantly worsen both the corrected $R^2$ 'fit' and the significance of all the $t$-values, and these results are therefore not reported. Table 15.3 presents some of the results of models testing hypothetical relationships between the food availability indices on their own, and industrial investment.

In the hypothesis tested in Model I of table 15.3, we found the variations in food production to be significantly correlated with the variations in industrial investment. However, since both the dependent and independent variable had strong time trends, we tried two alternative hypotheses which eliminated the effects of time trends in the data. In Model II, a time variable is incorporated, while in Model III, first differences are used. In both cases, the food production variable is rejected at the ten per cent level of significance. In Model IV, we found the Food Availability Gap (defined as in table 15.1) to be not significant at the ten per cent level. Per capita food production performed far worse than total food production or the availability gap as an explanatory variable, and the results are not reported. Hypotheses involving lagged variables were not better validated and are also not reported.
TABLE 15.3: INDUSTRIAL INVESTMENT AND AGGREGATE FOOD AVAILABILITY

<table>
<thead>
<tr>
<th>Model</th>
<th>Period</th>
<th>Equation</th>
<th>R²</th>
<th>DW</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ia</td>
<td>1961-70</td>
<td>( I_t = -1134.0 + 176.4^{**} F_t )</td>
<td>0.63</td>
<td>1.86</td>
</tr>
<tr>
<td>Ib</td>
<td>1973-80</td>
<td>( I_t = -4460.5 + 437.5^{**} F_t )</td>
<td>0.53</td>
<td>1.53</td>
</tr>
<tr>
<td>IIa</td>
<td>1961-70</td>
<td>( I_t = -276.9 + 59.7^{o} F_t + 40.6^{o} t )</td>
<td>0.68</td>
<td>1.77</td>
</tr>
<tr>
<td>Iib</td>
<td>1973-80</td>
<td>( I_t = 844.5 + -80.6^{o} F_t + 278.7^{**} t )</td>
<td>0.31</td>
<td>1.33</td>
</tr>
<tr>
<td>IIIa</td>
<td>1961-70</td>
<td>( \Delta I_t = 34.03 + 85.6^{o} \Delta F_t )</td>
<td>0.06</td>
<td>2.32</td>
</tr>
<tr>
<td>IIIb</td>
<td>1973-80</td>
<td>( \Delta I_t = 212.0 + 22.1^{o} \Delta F_t )</td>
<td>-0.19</td>
<td>1.61</td>
</tr>
<tr>
<td>IV</td>
<td>1973-80</td>
<td>( I_t = -192.2 + 0.3^{o} F_{6t} + 249.8^{***} t )</td>
<td>0.85</td>
<td>1.99</td>
</tr>
</tbody>
</table>

I, = Investment in manufacturing at base year prices,
F, = Total production of Foodgrains
\( t \) = Time variable,
FGt = Foodgrain Availability Gap,
\( \Delta \) is the operator giving first differences,
\( o \) is not significant at the 10 per cent level,
** is significant at the 5 per cent level,
*** is significant at the 1 per cent level.

These poor results are not surprising for two reasons. First, the relatively small size of the industrial sector in the overall economy means that unless excess demand for investible resources in the industrial sector was consistently high, changes in overall resource or food availability need not have a direct impact on actual year-to-year variations in investments. Such a persistent state of 'suction' (to use Kornai's metaphor), clearly has not existed in Bangladesh's industrial sector. In table 15.2 Model II, we have seen that the investment share in manufacturing was not significantly related to changes in relative resource availability.

Secondly, the models we have tested make no allowance for the investment functions which may operate in the predominant agricultural sector. If the
demand for agricultural investment was strongly dependent on aggregate resource availability, the simultaneous determination of industrial investment may appear to be not significantly related to total resource availability, but may still be a function of resource availability net of agricultural demand. There are no strong reasons for expecting such a strong functional relationship between agricultural investment and, say, foreign capital inflows, but unavailability of acceptable data for agricultural investment prevented us from estimating a simultaneous model. We did try to estimate the importance of the Food Availability Gap, which takes account of net food availability after imports, changes in foodstocks and in demand assuming constant per capita consumption, but this variable was not significant.

This is not to say that scarcity is unimportant, only that the transmission mechanisms may be more complex. Scarcity could have an effect on institutional evolution and the emergence of alternative surplus appropriation mechanisms inimical to growth, but these mechanisms have other determinants too, and resource availability may not be necessary or sufficient for the explanation.

This view is corroborated by another set of regressions, presented in table 15.4, this time using the domestic and foreign currency loans of the two largest industrial banks as the independent variables. The public sector Bangladesh Shilpa Bank (Industrial Bank of Bangladesh) and Bangladesh Shilpa Rin Shangstha (Bangladesh Industrial Credit Corporation), are the two most important industrial lending banks in the country. On the basis of loan applications received and the availability of resources, these financial institutions sanction local and foreign currency loans on an annual basis. Figures for annual sanctioned loans are available from the banks.

Only a part of the sanctioned loans however are disbursed each year, for a number of reasons. Large investment projects normally have the total
sanctioned amount disbursed over a number of years, some sanctioned loans may not be taken up by applicants, and bureaucratic procedures may hold up disbursement. Figures are also available for the loans actually disbursed every year by these two institutions. Once again, the data, (see Appendix 15-B) were consistently available for a relatively short period, 1973-80. Two hypotheses were tested. Model I has domestic and foreign currency loans sanctioned as the explanatory variables, while Model II has disbursed loans as the explanatory variables. Industrial investments were the dependent variable.

Model I in table 15.4 tests the hypothesis that aggregate industrial investment is a function of the total loans sanctioned by Bangladesh Shilpa Bank (BSB) and Bangladesh Shilpa Rin Shangstha (BSRS). The hypothesis would be validated if a) industrial investments in each year were a function of aggregate resource constraints and b) the loans sanctioned by the two loan agencies were good indicators of the overall tightness of the resource constraint in any year. We find, however, that the two estimated coefficients are not significantly different from zero. This does not necessarily allow us to reject part a) of the hypothesis since we are not sure that part b) was true.

On the other hand, Model II gives very satisfactory results. The composite hypothesis being tested is that a) aggregate industrial investment is a function of actual resource allocation from the state to industry, and b) the loan disbursements of these two agencies are good indicators of year-to-year variations in the latter. The loans disbursed by these two institutions accounted for a variable proportion of annual industrial investment over this period, ranging from 8-50% in the private sector and 70-90% in the public sector. The coefficients for both the local and foreign currency disbursed loans are statistically very significant. Since the hypothesis is not rejected, it directs our attention to the question of what factors affect the disbursement of resources to industry.
TABLE 15.4: INDUSTRIAL INVESTMENT AND BSB / BSRS CREDIT : 1972-80

<table>
<thead>
<tr>
<th>Model</th>
<th>Loans Sanctioned</th>
<th>( I_t = 214.62 + 2.80^{o} SL_t + 3.15^{o} SF_t )</th>
<th>( R^2 = 0.662, )</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>( (1.65) )</td>
<td>( DW = 2.20, )</td>
</tr>
<tr>
<td>Model</td>
<td>Loans Disbursed</td>
<td>( I_t = 180.73 + 3.94^{<em><strong>} DL_t + 16.93^{</strong></em>} DF_t )</td>
<td>( R^2 = 0.942, )</td>
</tr>
<tr>
<td></td>
<td></td>
<td>( (4.53) )</td>
<td>( DW = 1.65, )</td>
</tr>
</tbody>
</table>

\( I_t \) = Investment in manufacturing at base year prices,
\( SL_t \) = Local currency loans sanctioned by both institutions at base year prices,
\( SF_t \) = Foreign currency loans sanctioned by both institutions at base year prices,
\( DL_t \) = Local currency loans disbursed by both institutions at base year prices,
\( DF_t \) = Foreign currency loans disbursed by both institutions at base year prices.

\( ^{o} \) is not significant at the 10 per cent level,
\( ^{***} \) is significant at the 1 per cent level.

We would expect a priori that resource availability would be an important factor, but we have seen from the regressions in tables 15.2 and 15.3 that aggregate resource availability in the economy is not very significantly correlated with investment. What seems to be more important is the ability of the industrial sector to get access to resources which are potentially available. This would depend on the one hand, on the effective demand from the industrial sector for resources, and on the other, on the relative ability of the allocating mechanism to deliver. The allocating mechanism in the case of Bangladesh is, as we have seen, dominated by the state, the two industrial loan agencies we looked at being a part of the overall system of state controlled allocation of investible resources. Thus the relationship observed in table 15.4 Model II could be the result of variations in the state's ability to allocate resources to investors. On the other hand, it could equally be the result of exogenous variations in the industrial sector's demand, or resource absorption capacity. The regression result of course does not by itself tell us the direction of causality.

While it is no doubt true that a greater availability of domestic savings and foreign exchange would improve to some extent the prospects for growth, the stress given to this factor in most policy statements is probably misplaced.
There have been very few detailed empirical studies of resource availability in industry, and the factors constraining investment decision, despite the prevalence of the resource-constrained perception. An exception is the study by Amjad of industrial investment in both wings of Pakistan in the period 1960-70. For this reason, Amjad's conclusion, that investment in Pakistan over that period was very sensitive to foreign aid availability, needs to be examined in terms of its relevance for the modern Bangladesh economy.

Amjad's statistical conclusions are primarily based on the results from his data for thirty-nine firms in both wings of Pakistan over the period 1961 to 1970. Amjad tests conventional explanatory factors for industrial investment at the microeconomic level, such as profitability and growth in sales, but finds the foreign exchange loans disbursed by the two major Pakistani industrial credit institutions, to be much more significant explanatory variables for industrial investment. The two credit institutions happen to be the precursors of the Bangladeshi institutions we looked at, but Amjad was only able to look at their foreign currency loans because figures for domestic currency loans were not made available by the Government of Pakistan for that period.

If figures for disbursed domestic currency loans were available for this earlier period, I suspect they too would be a significant explanatory variable for industrial investment, just as we found in the subsequent Bangladesh experience. In other words, then as now, industrial investment seems to have been subject to changes in the effective direction of resources to industry, as measured by the credit disbursement performance of two of the most important credit agencies. Perhaps because Amjad did not have the data for domestic currency loan disbursements, and also because he did not look at the significance of resource availability as opposed to disbursement, he concludes that the slowdown in industrial investments in West Pakistan in the latter half of the sixties was due to the drying up of aid availability.
While it is true that following 1965, aid to Pakistan was substantially reduced, there were other concurrent changes in the economic climate which Amjad does not test. These changes were probably as important as aid availability in explaining the slowdown in investment performance in West Pakistan in the late sixties. This argument is even more true in the subsequent Bangladesh period, when, though a substantial amount of aid was to be potentially available, this often remained in the pipeline or was misallocated, while the economy stagnated.

Under pressure from the Bengali nationalist movement in the late sixties, state decision-makers undertook a dramatic readjustment in resource allocation. East Pakistan was allocated an increasingly large share, so that according to Amjad's own statistics, using which table 12.2 was constructed, public and private industrial investment in East Pakistan shows a rising trend in the post-1965 period, while in West Pakistan, investments were falling. Partly because the Bengali capitalist class was underdeveloped, partly because the state had been totally disinterested in building efficient allocative institutions in East Pakistan, the pressures which led to the direction of resources to East Pakistan also led to a decline in efficiency as we saw in Chapter Twelve. This does not mean that the pattern of development of the early sixties was desirable, but it does mean that the efficiency consequences of the clientelist pressures of the late sixties were predictable.

The decline in industrial investment in the mostly West Pakistani companies which Amjad looked at, and the broader issue of the decline in productivity performance in both wings of Pakistan in the latter half of the sixties is thus closely tied with the question of the pressures behind state allocative decisions. The attribution of the fall in investment in Amjad's sample largely to the fall in aggregate foreign resource availability in the late sixties is misleading because it diverts attention away from quite important endogenous
changes in the political economy of the state and emphasises a secondary exogenous development which could almost certainly have been absorbed without such far-reaching consequences by a more efficient state.

§ 15.2 Resource Constraints and Dependency
In contrast to the arguments relating poor industrial performance directly to resource constraints, an influential body of thinking in countries such as Bangladesh stresses the external dependence brought about by scarcity as a major factor in explanations of poor economic performance. This set of arguments however stresses the easy availability of, and the conditions attached to, a specific type of resource: foreign aid.

The steady growth in the aid share in gross domestic product over the last two decades seems to have stabilised at around 10% of GDP by the late seventies. This includes food aid, commodity aid and soft loans and grants, arranged bilaterally or through international organizations. The political economy of the donors is an interesting question on which not enough is known, but what concerns us here are the consequences for the recipient. As a result of the aid regime, the state along with a number of key sectors has access to resources which it would not otherwise have had. Rehman Sobhan has made a powerful case arguing that injections of resources on this scale have had a structural effect on the economy, in the sense of creating classes and institutions geared to reproducing the dependence. Sobhan demonstrates the inefficiencies in the disbursement and negotiation of aid with a wealth of empirical evidence.

While this is an important contribution, Sobhan's direction of causality is from dependence to distortion, pointing out the ways in which aid dependence prevents the state from identifying domestic resources and opens it to outside pressure. The policy conclusion following from this analysis is that aid
dependence should be reduced in the interests of further or faster economic development. This assumes a substantial degree of resilience and flexibility of the class and institutional structures internal to the economy. It also assumes that these adverse structures were caused by aid dependence.

In fact, the experience with aid in Bangladesh could also be used to support the rather different proposition that the motivations and practices of decision-making institutions and classes are at least as relevant for economic growth as the amount of resources being allocated. While the last decade and a half of large aid inflows undoubtedly made some institutional responses more viable than they would otherwise be and allowed a faster growth of some classes of agents, the aid regime was clearly not operating in an institutional and social vacuum. The non-optimal outcomes which were in fact established should therefore be seen as particular modifications to an ongoing and indigenous historical evolution, rather than entirely the result of an interaction with external forces.

In Part I we argued that even within the 'capitalist' developing countries, there exists a variety of patterns of internal social and economic organization which are still not well enough understood for us to make generalizations. In South Korea, for instance, foreign savings in the sixties and seventies were often around 10% of GNP. In the much more favourable international market and political context of the fifties and sixties, American aid supplied a large part of the government budget and met the huge gap between exports and imports, so much so that South Korea is said to have received the largest amount of non-military aid per capita of any LDC. Whether or not this foreign inflow helped Korean industrialization, it certainly did not prevent it.

One quantifiable indication of the relevance of institutional efficiency in this area is the figure for aid disbursement as a proportion of aid committed. From
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So Sobhan’s own figures, performance here has been poor, with disbursement of commodity aid often less than 50% and project aid even less. We saw in Chapter Three the sectoral rigidity in the allocation of resources through the state’s Annual Development Programme through which a large part of foreign currency resources are allocated, despite changes in underlying demand and supply conditions. As for the allocation of foreign currency to the private sector through the process of investment sanctioning and subsidized loans through the development finance institutions, Akhlaqur Rahman points out that information available with the Shilpa Bank and other loan-giving institutions indicates [private entrepreneurs] have tended to utilize a major proportion of loans disbursed for purposes other than the sanctioned projects.

If the state’s sectoral sanctioning was not very rational to start with, a deviation from the sanctioned structure of investments does not necessarily imply a misallocation of scarce foreign currency resources or a worsening of the growth prospects of the economy. But there is a growing body of journalistic evidence which suggests that the diversion of resources by capitalists in connivance with the financial institutions has been through their involvement in political lobbies which could actually or potentially put pressure on decision-makers, in other words through clientelist surplus appropriation. This would lead to a loss of investible resources and set constraints on the efficiency of the state in the way described in Part II.

Sobhan, and those on the left who counsel the reduction or removal of aid, have ironically been joined recently by ‘Raeganomists’ persuaded by liberal market doctrines. If these propositions have any validity, they must suppose that cutting aid will force the appropriate class and institutional changes, and presumably there are differences in the changes that are envisaged by either side. But because the real problem and its solution remain implicit, further analysis is pre-empted in favour of the assumption that the changes
will be 'appropriate'. In fact, in the absence of good reasons to the contrary, or systematic institutional counter-measures, it is more reasonable to expect the result to be industrial stoppages or maybe even widespread scarcity in sensitive markets accustomed to aid-based supplies at the margin, such as those for food, oil and other primary commodities. On the other hand, while aid is surely neither politically neutral nor freely available in all scenarios, if more 'efficient' institutions could be arrived at, the availability of aid, as such, would ceteris paribus improve the possibilities of growth.

§ 15.3 Demand Side Constraints on Investment and Growth

An evaluation of the supply-side processes of surplus allocation and the implications for industrial growth clearly cannot proceed by ignoring the relationships between demand and structural change. It is also particularly in the disequilibrium or non-steady-state growth paths typical in developing countries that demand conditions can have important facilitating or destabilizing effects. In an apolitical model of an abstract capitalist economy, demand is the direct product of production, so demand-side problems can only be contingent on disproportionalities. However, even the latter may well be important, particularly in developing countries.

Unfortunately, considering the demand side of the development problem has become rather unfashionable as a result of the untenable claims of some of its advocates. Nevertheless, 'underconsumptionist' theories, even if they do not live up to their claim of establishing the necessity of crisis, often point out interesting and plausible contingent disproportionalities.

In the political world of nation-states, demand in a particular national capitalism can be gained from or lost to the external world, 'non-capitalist' sectors, or the state. The facilitating (or crippling) effect of such injections or leakages on supply-side adjustments in the context of disproportionality
have historically been the subject of much confusion and debate. Going back to Lenin's critique of Sismondi and the Bukharin-Luxemburg exchanges, we find some very convincing arguments against the necessity of capitalist growth being crippled by demand problems. But a sympathetic reading of Sismondi or Luxemburg, and particularly the latter, confirms that they were in fact concerned with some of the critical links between demand and structural change, which without the incubus of necessity are quite plausible.¹¹ In a development context, the demand conditions created by a combination of the foreign trade regime, the fiscal and monetary policies of the state, and growth or stagnation in the non-industrial sectors would plausibly have important implications for the ease of structural change, and so should be allowed for in our assessment of performance in investment allocation.

Chenery and others have shown that by decomposing the growth in domestic industrial production into components approximating to the growth in domestic demand, the growth in export demand, and the growth in the share of domestic production in total domestic demand (import substitution), useful insights may be gained regarding demand-side constraints facing industrial production in different periods.¹² Table 15.5 was estimated using the usual decomposition equation:

\[ \Delta X_i = u_i \cdot \Delta D_i + \Delta E_i + \Delta u_i \cdot D_{i2} \]

where the subscript \( i \) refers to the sector, \( X \) is domestic production, \( D \) is domestic demand, \( E \) is exports, and \( u \) the share of domestic production in the domestic market. \( \Delta \) is the difference operator, and the subscript 2 refers to the time period. (For a discussion of the methodology and the data see Appendix 15-C). In table 15.5 the percentage growth of each sector is decomposed into the growth of domestic demand, the growth of export demand and the percentage absorbed as import substitution.
TABLE 15.5: DECOMPOSITION OF INDUSTRIAL OUTPUT GROWTH BY KEY SECTORS

| SECTOR/PERIOD  | OUTPUT GROWTH (Percent change) | DECOMPOSED INTO |  |  |  |  |
|----------------|---------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
|                |                                  | Δ Domestic Demand | Δ Export Demd | Import Subst     |                 |                 |                 |
| 1954/55-59/60  |                                  |                 |                 |                 |                 |                 |                 |
| Consumption Gds| 110.1                           | 61.3            | 18.1            | 30.7             |                 |                 |                 |
| Intermediate Gds | 212.7                      | 72.3            | 123.1           | 17.3             |                 |                 |                 |
| Investment Gds  | 204.7                          | 147.0           | 2.1             | 55.6             |                 |                 |                 |
| 1959/60-63/64  |                                  |                 |                 |                 |                 |                 |                 |
| Consumption Gds | 61.2                           | 67.4            | -0.7            | -5.5             |                 |                 |                 |
| Intermediate Gds | 80.8                          | 38.5            | 17.6            | 24.8             |                 |                 |                 |
| Investment Gds  | 132.4                          | 143.7           | 1.6             | -12.7            |                 |                 |                 |

PART II: EAST PAKISTAN / BANGLADESH AT CONSTANT 1965 PRICES

| 1964/65-76/77 | Food Manufacturing | -17.1 | -22.4 | -1.0 | 6.2 |
|              | Tobacco           | 284.6 | 269.8 | -0.3 | 15.0 |
|              | Textiles         | -10.1 | -10.7 | -9.0 | 9.5 |
|              | Paper             | -9.0  | 8.8   | -73.7 | 56.0 |
|              | Leather          | 284.7 | 262.5 | 0.0  | 22.2 |
|              | Chemicals        | 49.7  | 22.6  | -7.7 | 34.8 |
|              | Non-metal Minerals | 241.7 | 55.9   | 0.0 | 185.9 |
|              | Basic Metal Ind   | 119.7 | -24.7 | 0.0 | 144.4 |
|              | Metal Manufacture | 17.4  | 80.4  | 0.0 | -62.9 |
|              | Machine Manufacture | 290.8 | -34.4 | 1.6 | 323.6 |
|              | Transport Equipment | 647.7 | 81.2   | 5.5 | 561.0 |

| 1976/77-81/82 | Food Manufacturing | 68.8  | 71.2  | 0.0 | -2.4 |
|              | Tobacco           | 12.4  | 12.5  | 0.0 | -0.1 |
|              | Textiles         | 13.2  | 5.5   | 4.7 | 3.0 |
|              | Paper             | 89.7  | 74.6  | 1.7 | 13.5 |
|              | Leather          | 9.6   | 9.5   | 0.0 | 0.1 |
|              | Chemicals        | 88.6  | 97.6  | -0.2 | -8.8 |
|              | Non-metal Minerals | 53.1  | 48.2   | 0.0 | 4.9 |
|              | Basic Metal Ind   | 20.7  | 42.2  | 0.0 | -21.5 |
|              | Metal Manufacture | 4.7   | -46.4 | 0.2 | 50.8 |
|              | Machine Manufacture | -25.4 | 33.4   | 2.8 | -61.5 |
|              | Transport Equipment | 22.5  | 19.4  | 1.8 | 1.2 |

Source: Part I has been calculated from Lewis & Soligo [1965] Tables A.2, A.3, B.2 and B.3. Their figures are at current market prices. Part II is calculated using statistics as explained in Appendix 15-C, and the figures here are at constant 1965 prices. For the difference between the two methodologies see Appendix 15-C.

Studies of a large number of countries have shown that domestic demand generally accounts for a very large part of the total demand absorbing a growth in domestic output. The question though is whether domestic demand acts as a constraint, that is whether its faster growth could accelerate the growth in output. Using their decomposition which we have reproduced in Part I
of table 15.5, Lewis and Soligo had argued that even in the early, so called 'import-substituting' phase of Pakistan's industrialization, the growth of domestic demand played an important part in absorbing the growth in domestic production. This was even more true for the post-1960 period, after the initial growth in market share had been achieved by local capital. Lewis and Soligo's method (see Appendix 15-C) may have led to an underestimation of imports in earlier years, thus underestimating later import substitution, but it is unlikely this error would change their results qualitatively.

What is interesting is that import substitution was important in the mid to late fifties which were as we have seen, years of low productivity growth. This is not surprising because industry was heavily protected at that time. In the early sixties, in contrast, productivity growth picked up but the import liberalizations which followed led to negative import substitution except in the intermediate good sector which was dominated by jute products. What this suggests is that even the productivity growth achieved in the early sixties was insufficient for international competition and the early gains in exports from a negligible base could not be extended.

Our results for East Pakistan/Bangladesh for the subsequent fifteen year period corroborates these observations regarding the role of the different components of demand. The first of our two periods, 1965-77 includes the trough in production around 1970-71. Many sectors had recovered by 1977, but a few, including the vital food and textile sectors, had not. Once again this was a period of poor productivity performance and the scarcity of foreign exchange meant that import substitution played a large role as imports were curtailed. Where output fell, domestic demand fell further. The difference was made up by import substitution. The real value of food and textile imports fell more than in proportion to the collapse in domestic output, resulting in an arithmetic 'growth' in import substitution. In sectors where output growth did take place,
this too was to a large extent absorbed by import substitution. Given what we know about productivity performance over this period, import substitution was not a result of the greater competitiveness of domestic production, but rather the outcome of scarce foreign exchange resources and the curtailing of imports.

This situation changed with the return to another 'normal' period after 1976/77. Domestic demand growth in two of the three largest sectors, food and chemicals, not only absorbed output but also sucked in imports, resulting in negative import substitution, in other words a fall in the share of domestic production in the domestic market. In most important sectors, domestic demand performed better than before but import substitution was lower. Once again this was a period of improved productivity performance and some liberalization, and once again, domestic demand outstripped production with imports being sucked in. The poor performance of exports is also consistent with an interpretation which says that poor competitiveness is the primary constraint on the growth of domestic industrial production.

Looking at the demand problem period-wise suggests that although domestic demand is undoubtedly the largest component of total demand, it would be wrong to conclude that it is therefore the major constraint. Even in periods when productivity performance was relatively good, liberalization of demand led to negative import substitution. Bangladesh has thus exhibited for a long time the classic symptoms of supply-side constraints.

§ 15.4 Clientelist Surplus Appropriation and Productivity Performance

An empirical evaluation of the resource constrained and demand constrained theses suggests that while these arguments may not be misplaced, they are insufficient to explain why the rate of growth of output and productivity in Bangladesh could not have been higher than the dismal performance actually observed. While it may not have been possible for Bangladesh to have achieved
the rates of growth enjoyed by East Asian NICs under any conceivable political regime, the evidence of resource use and demand growth suggests that the latter were not binding constraints. One of the factors limiting the performance of Bangladesh's industrial sector to a position below a loosely defined 'production possibility frontier' could have been an unfavourable 'political frontier' facing the institution of efficient rights. We will not try to quantify at this stage the gap between the two 'frontiers', but only attempt to show the ways in which allocative outcomes indicate differences in the operation of industrial sectors across countries.

Looking at the labour market, we ask if the pattern of outcomes observed suggest that rights at the micro-economic level in Bangladesh are different from those in more efficient economies. Ideally, we would have resorted to enterprise-level case-studies, where enterprise operation in general and changes in enterprise operation under different political regimes could be looked at in sufficient detail. However, using secondary statistics we can investigate the nature of rights over resources using employment trends, and in particular employment trends of different categories of employees.

We have argued that given the nature of clientelist surplus appropriation, an improvement in the maximum potential payoff (see figure 6.2) would result in the coalition being able to negotiate higher payoffs from existing right-holders. Of the classes of agents directly involved in the industrial production process, the group with the greatest ability to defend organizational rights and bargain for payoffs is the group classified as 'employee'. This includes clerical, professional and managerial workers, the majority of whom are members of the 'educated' middle class. It is not the case that all employees have jobs because of clientelist pressure, since it is obvious that modern industrial production could not be organized without a substantial employment of employees. However, since a higher percentage of
employees may have their jobs as a result of a negotiated payoff, their employment may give us an indication of the extent of clientelism.

In a study of the corporate accounts of sixteen jute mills over the period 1965-69, Habibullah presents evidence which may be re-interpreted to show a link between performance at the firm level with the relative strength of white collar workers. Enterprises were divided into three groups in terms of their profitability rank, each enterprise being classified as a member of the High, Moderate or Low profitability groups. A breakdown of their production costs is also provided, which we reproduce in table 15.6. Habibullah's evidence shows that at least for these mills, the lower profits of the last group could not be explained in terms of a higher share of labour cost in manufacturing cost. If we can assume a uniform level of state subsidy for these mills, this suggests that the bargaining strength of workers was more than in proportion to their productivity in the high profit firms. In other words, higher profitability could not be explained by some mills having higher labour productivity at a constant level of money wages. In fact the opposite was true, they had to pay more than in proportion to their productivity advantage (if any) to workers, so that their wage share was larger.

<table>
<thead>
<tr>
<th>TABLE 15.6: COST STRUCTURE OF 16 JUTE MILLS 1965-69</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating Expenses as % of Sales Revenue</td>
</tr>
<tr>
<td>High Profit Group</td>
</tr>
<tr>
<td>Moderate Profit Group</td>
</tr>
<tr>
<td>Low Profit Group</td>
</tr>
</tbody>
</table>


What is significant is that high profit firms had lower operating expenses which is defined in the study as primarily selling, administrative and establishment costs. Here the opposite must have been true. White collar workers had less bargaining power proportionate to their productivity in the
more profitable firms. In other words, if white collar productivity was equal across firms, this amounts to saying that white collar workers had more bargaining power in lower profitability firms, and this seems to correlate quite well with profitability performance.

It is also true that high profit firms made better use of raw materials so their relative performance was the outcome of these two factors. Better raw material use could be the result both of a technical advantage, or better management. In the latter case, superior control over managerial inefficiency would again enter into an explanation of better performance. We do not have time series data from Habibullah, but if the observations reveal structural patterns, the decline in performance of many industries from the mid-sixties onwards could have been partly the result of a growing bargaining strength of white collar workers at the enterprise level coupled with a loss of capitalist control over managers.

The manufacturing census (CM1) figures we used in Chapter Fourteen also gives us a breakdown of total employment into production workers and 'employees'. Production workers are those directly engaged in production, including processes of manufacturing, assembling, packing, repairing, and also including working supervisors. Employees are all salaried persons excluding working proprietors and unpaid family workers. The figures for productivity growth by sub-periods presented in Chapter Fourteen were calculated using the total of production workers and employees, E, as the denominator for the productivity index. If we call this 'labour productivity', denoted by \( \Pi \), we can see that

\[
\Pi = \frac{Y}{L} \cdot \frac{L}{E}
\]

where \( Y \) is real output, \( L \) is the number of production workers and \( E \) is total employment, that is production workers plus employees. The first term on the right hand side, \( Y/L \) is the productivity of production workers alone, which we
can denote by $\lambda$, to distinguish it from labour productivity $\Pi$. The second term $L/E$ is the share of production workers in total employment which we can denote by $\sigma$. Thus labour productivity $\Pi$ is the product of production worker productivity and production workers' share in employment.

If we write

$$\Pi = \lambda \cdot \sigma,$$

it can be easily shown by differentiation that

$$g\Pi = g\lambda + g\sigma,$$

where $g\Pi$ is the rate of growth of labour productivity, $g\lambda$ is the rate of growth of production worker productivity, and $g\sigma$ is the rate of growth of the share of production workers in total employment. This equation allows us to arithmetically decompose the rate of growth of labour productivity into two parts. The first component, $g\lambda$, shows what the rate of growth of labour productivity would have been if production workers and employees grew at the same rate, in other words if the share of production workers in total employment, $\sigma$, stayed constant. The second term on the right hand side, $g\sigma$, shows the arithmetic effect of 'divergences' between the rate of growth of production workers and employees on the labour productivity growth rate $g\Pi$. If the employment of employees grows faster than that of production workers, $g\sigma$ will be negative, and the rate of growth of labour productivity, $g\Pi$, will be lower than it would otherwise have been and vice versa.

The relative movement of the two components of labour productivity could give us two sorts of information. First trends in the movement of relative employment of production workers and employees which may be compared with other countries to see if production worker productivity and hence labour productivity growth has been achieved at a lower 'cost' elsewhere in terms of the growth in the share of employees in total production. For any given growth in production worker productivity, if the growth in the share of employees is lower, the rate of growth of labour productivity, $\Pi$, will be arithmetically higher. Secondly, and directly related to the first type of question, if we
expect trends in \( g_w \), \( g_\lambda \) and \( g_\sigma \) to be interrelated for technical or other reasons, alternative hypotheses regarding the nature of the inter-relationship may be tested.

To see the trends in the components of labour productivity, the sectoral labour productivity growth rates presented in table 14.7 are decomposed in table 15.7 into \( g_\lambda \) and \( g_\sigma \). For the purposes of comparison, the labour productivity figures for South Korea in table 14.9 are similarly decomposed in table 15.8, while trend rates of change in \( g_\sigma \) in two advanced capitalist countries, the United States and the United Kingdom are presented in table 15.9.

After the mid-sixties, \( g_\sigma \) has been consistently negative in Bangladesh manufacturing. In contrast in South Korea \( g_\sigma \) has been positive, becoming negative only in the early eighties when a substantial structural change away from heavy industry took place, together with an upsurge in the political power of organized urban coalitions. The trend in \( \sigma \) in Bangladesh has in contrast been similar to that in the two advanced countries, the UK and the USA. If we remember that technology in the advanced countries would require a faster growth in employee share compared to developing countries introducing downstream technology, and that this was a period of industrial contraction when the cyclical contraction of employment would have led to a decline in \( \sigma \) in any case, the rate of decline of \( \sigma \) in Bangladesh can be put in perspective.

While \( g_\sigma \) is not arithmetically significant in explaining poor productivity performance in Bangladesh, being relatively small in absolute terms, it directs our attention to the nature of the relationship between \( \Pi \), \( \lambda \) and \( \sigma \) over time. Before we test this statistically, we need to analytically distinguish between a number of possible relationships between \( \Pi \) and \( \sigma \).
### TABLE 15.7: DECOMPOSITION OF LABOUR PRODUCTIVITY - BANGLADESH

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Source: Estimated from CMI data, see Appendix 14-A. Logarithmic OLS growth rates.
TABLE 15.8: DECOMPOSITION OF LABOUR PRODUCTIVITY: SOUTH KOREA

\[ g_r, g_\lambda, \text{ and } g_\tau \text{ defined as in Table 15.7.} \]

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**Sources:** Productivity growth rates from Table 14.9, Share of operatives calculated from annual figures for operatives and employees in United Nations: Industrial Statistics Yearbook, New York, various years. \( g_r \) figures in the third column are for 1980-84, UN sectors aggregated as necessary, Log OLS growth rates.

---

TABLE 15.9: RATES OF CHANGE IN THE SHARE OF PRODUCTION WORKERS IN TOTAL EMPLOYMENT: US AND UK

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**Source:** Estimated from annual figures for operatives and employees in United Nations: Industrial Statistics Yearbook, New York, various years. UK figures in third column are for 1980-84, Log OLS growth rates.
Case I: Technological Determination of $\tau$  

Technical progress may dictate more capital and skill-intensive production which results in a trend decline in $\tau$ as a concomitant of productivity growth. In an advanced economy we would expect $g_\tau$ to be negative because of the continuous introduction of skill intensive technology where 'production workers' are a progressively smaller part of the production process, but we would expect the technically necessary decline in $\tau$ to be much smaller in a developing economy, and particularly in one where production processes are fairly 'downstream' in technical terms. Looking at South Korea's early growth for instance, productivity growth was very high while $\tau$ was growing.

Nevertheless, if $\sigma$ and $\Pi$ were co-determined by skill-intensive technical requirements we would expect a negative relationship between the two indices. The relationship need not be an immediate one, it is quite likely for instance, that productivity lags changes in the productive structure indicated by a fall in $\tau$. We would not however expect $\sigma$ to change after a change in productivity if the relationship between them was technically specified.

Case II: Cyclical Variations in $\tau$  

Cyclical movements in $\tau$ may result as a consequence of cyclical movements in output and employment since the costs of hiring and firing different categories of employees are not the same. Thus $\tau$ may decline during periods of slump since the cost of firing employees in the same proportion as production workers may be prohibitive if search and retraining costs of new employees during the upswing are taken into account. Similarly, the employment of new employees may lag behind that of production workers during an upswing resulting in a growth in $\tau$ above its trend value.

In this case we would expect $\tau$ and $\Pi$ to positively related. The growth in productivity during upswings would be associated with a rising share of production workers, while during downswings both productivity and the share of
production workers would decline. Once again, there may be leads and lags, since cycles of productivity, output and employment need not coincide.

In Bangladesh however, the changes in $\sigma$ seem to occur quite independently of cyclical industrial expansions and contractions. While $\sigma$ was growing (table 15.7) during the first period of rapid growth in the early sixties, it has declined consistently thereafter. From the CMI data it also appears that the decline in $\sigma$ actually accelerated during the upswing of 1975-80, and was lower during the downswings of 1970-75 and 1980-82. This tends to contradict the cycle hypothesis, but we would have to allow for the operation of lags before reaching a verdict. Moreover, cyclical movements in $\sigma$ associated with cycles in output and employment would not be sufficient to account for a long term trend decline in $\sigma$.

Case III: Clientelist Bargaining Power and $\sigma$ Finally, trend movements in $\sigma$ may reflect autonomous changes in employment due to pressure from workers and employees. The inequality in the bargaining power of production workers and employees for job creation or job protection would then show up as an autonomous trend in $\sigma$. The index for $\sigma$ could be an indicator of clientelism since although we would expect a growth in clientelism to be reflected in a growth in the employment of all groups participating in the 'clientelist coalition', we would nevertheless expect higher levels in the pyramid to gain relatively more in relation to their size, so that $\sigma$ would decline.

Looking at relative employment shares may however be misleading as an indicator of clientelism for several reasons. First, if the employment share, or any index of the share of relative benefits at different levels of the clientelist coalition is to change as a result of an increase or decrease in clientelist pressure, we require that individuals at higher levels gain more than those at lower levels. The share measure may therefore be too restrictive.
in that it would not pick up instances of increased clientelism if clientelist pressure actually increased the share of production workers in total employment. This is unlikely but it could happen if the structure of lobbies and the competition between them led to greater concessions to lower levels as the price for their continued support.

Secondly, while payoffs to the clientelist coalition would include employment creation, this is not the only form of payoff, since salaries, wages, and perhaps most important of all, undeclared income flows constitute an important part of the explicit and implicit payoffs which the clientelist coalition seeks to maintain. Looking only at changes in the employment share may therefore be a misleading indicator of changes in the clientelist context, and may once again be too restrictive as an indicator of changes in the payoff bargained by the clientelist coalition.

If however clientelist surplus appropriation has a noticeable effect on $\sigma$, we would expect $\sigma$ and $\Pi$ to be negatively related, with $\sigma$ lagging $\Pi$. Given a distribution of organizational rights, an increase in the income from an asset would increase the maximum potential clientelist payoff ($P_{\text{max}}$ in figure 6.2) and therefore the per capita payoff per organizer. The probability of organizers organizing to acquire the potential payoff would consequently increase. Improvements in productivity result in precisely such increases in potential returns for those with rights over assets, and if clientelist surplus appropriation is important, we could ceteris paribus expect payoffs to increase. To the extent that $\sigma$ was an indication of changes in the payoff, increases in productivity should lead to decreases in $\sigma$.

In each of the cases discussed, leads and lags may operate in the relationship between $\Pi$ and $\sigma$. On the basis of this argument, we test two models for the manufacturing sectors of Bangladesh and South Korea. Model I tests the
hypothesis that current productivity II is a function of current production worker share v, and the lagged share v-1. A priori, the lag structure of this form of the relationship corresponds best to Case I, since technology could be expected to affect v either simultaneously with, or prior to, II. Model II tests the hypothesis that the current production worker share v is a function of current productivity II and lagged productivity II-1. Similarly, with the right signs, the lag structure of this form would be better suited for testing the relationship if Case III was appropriate.

Tables 15.10 and 15.11 look at the sub-sectoral relationship between v and II in Bangladesh and South Korea. Only the signs of the coefficients and their level of significance is reported, the regression results are in Appendix 15-D. Several variants of the two basic models were tested, and the results are reported for the 'best' model in each case, in terms of the corrected $R^2$ fit and the t-ratios of the coefficients. This was to take into account the possibility that the time trend may be more or less significant for some sub-sectors, and we also tried a first difference version of the interaction. In a very few cases, multicollinearity affected the estimated significance of lagged and unlagged variables taken together, and in those cases the regressions dropped the lagged variable. Four variants of each of the models were tried:

**MODEL I**

\[ \Pi = \text{a} + \text{b} \sigma + \text{c} \sigma_{-1} + \epsilon \]
\[ \Pi = \text{d} + \text{e} \sigma + \text{f} \sigma_{-1} + \text{g} T + \epsilon \]
\[ \Pi = \text{h} + \text{i} \Delta \sigma + \epsilon \]
\[ \Pi = \text{j} + \text{k} \Delta \sigma + \text{l} T + \epsilon \]

**MODEL II**

\[ \rho = \text{m} + \text{n} \Pi + \text{o} \Pi_{-1} + \epsilon \]
\[ \rho = \text{p} + \text{q} \Pi + \text{r} \Pi_{-1} + \text{s} T + \epsilon \]
\[ \rho = \text{t} + \text{u} \Delta \Pi + \epsilon \]
\[ \rho = \text{v} + \text{w} \Delta \Pi + \text{x} T + \epsilon \]

$\Pi$ and $\Pi_{-1}$ are the productivity and lagged productivity index for the sub-sector $\sigma$ and $\sigma_{-1}$ are the current and lagged share of production workers in total employment $T$ is an index of time, $a - x$ are estimated coefficients, $\epsilon$ is the error term.
### TABLE 15.10 PRODUCTIVITY AND SHARE OF PRODUCTION WORKERS IN BANGLADESH
(SIGN AND SIGNIFICANCE OF REGRESSION COEFFICIENTS)

<table>
<thead>
<tr>
<th>SECTORS</th>
<th>1971 - 82</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Model I</td>
</tr>
<tr>
<td></td>
<td>$\Pi = f(\sigma_t)$</td>
</tr>
<tr>
<td></td>
<td>$\sigma$</td>
</tr>
<tr>
<td>Food</td>
<td>-</td>
</tr>
<tr>
<td>Sugar</td>
<td>+</td>
</tr>
<tr>
<td>Tobacco</td>
<td>-</td>
</tr>
<tr>
<td>Textiles</td>
<td>-</td>
</tr>
<tr>
<td>Jute</td>
<td>+</td>
</tr>
<tr>
<td>Cotton</td>
<td>-</td>
</tr>
<tr>
<td>Paper</td>
<td>-</td>
</tr>
<tr>
<td>Printing</td>
<td>+</td>
</tr>
<tr>
<td>Leather</td>
<td>-</td>
</tr>
<tr>
<td>Chemicals</td>
<td>-</td>
</tr>
<tr>
<td>Minerals</td>
<td>-</td>
</tr>
<tr>
<td>Basic Metals</td>
<td>+</td>
</tr>
<tr>
<td>Metal Products</td>
<td>+</td>
</tr>
<tr>
<td>Machines</td>
<td>-</td>
</tr>
<tr>
<td>Electrical Equipment</td>
<td>-</td>
</tr>
<tr>
<td>Transport Equipment</td>
<td>+</td>
</tr>
</tbody>
</table>

| Source: | + Sugar 1974-85, Jute 1973-85, Cotton 1973-87, Basic data from CMI except for Sugar, Jute and Cotton, for which see Table 14.8, Regressions reported in Appendix 15-0. |
|         | * significant at 10 % level, ** significant at 5 % level, *** significant at 1 % level, **** significant at 0.1 % level. Coefficients without asterisks are not significant at 10 % level. |
### TABLE 15.11: PRODUCTIVITY AND SHARE OF PRODUCTION WORKERS IN SOUTH KOREA (SIGN AND SIGNIFICANCE OF REGRESSION COEFFICIENTS)

<table>
<thead>
<tr>
<th>SECTORS</th>
<th>1970-85</th>
<th>Model I $\Pi = f(\sigma_t)$</th>
<th>Model II $\sigma = f(\Pi_t)$</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$\sigma$</td>
<td>$\sigma_1$</td>
<td>$\Pi$</td>
</tr>
<tr>
<td>Food</td>
<td>+</td>
<td>+</td>
<td>****</td>
</tr>
<tr>
<td>Tobacco</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Textiles</td>
<td>+</td>
<td>+</td>
<td>****</td>
</tr>
<tr>
<td>Paper</td>
<td>-</td>
<td>-</td>
<td>**</td>
</tr>
<tr>
<td>Printing</td>
<td>+</td>
<td>+</td>
<td>****</td>
</tr>
<tr>
<td>Leather</td>
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<td>+</td>
<td>****</td>
</tr>
<tr>
<td>Industrial Chemicals</td>
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<td>-</td>
<td>****</td>
</tr>
<tr>
<td>Other Chemicals</td>
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<td>****</td>
</tr>
<tr>
<td>Pottery</td>
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<td>+</td>
<td>****</td>
</tr>
<tr>
<td>Glass</td>
<td>-</td>
<td>-</td>
<td>****</td>
</tr>
<tr>
<td>Other Minerals</td>
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<td>-</td>
<td>****</td>
</tr>
<tr>
<td>Iron and Steel</td>
<td>-</td>
<td>+</td>
<td>****</td>
</tr>
<tr>
<td>Metal Products</td>
<td>-</td>
<td>-</td>
<td>****</td>
</tr>
<tr>
<td>Machines</td>
<td>-</td>
<td>-</td>
<td>****</td>
</tr>
<tr>
<td>Electrical Equipment</td>
<td>-</td>
<td>-</td>
<td>****</td>
</tr>
<tr>
<td>Transport Equipment</td>
<td>-</td>
<td>+</td>
<td>****</td>
</tr>
</tbody>
</table>

Source: As in Table 14.9, Regressions reported in Appendix 15-D.
* significant at 10% level, ** significant at 5% level, *** significant at 1% level, **** significant at 0.1% level. Coefficients without asterisks are not significant at 10% level.
Model I performs poorly for Bangladesh and rather better for South Korea. In South Korea productivity has a very significant time trend but $\varphi$ or lagged $\varphi$ is not in general significant. In two sectors $\varphi$ has a significant negative coefficient consistent with the Case I assumption of a technical determination of $\Pi$ and $\varphi$. In contrast in Bangladesh $\Pi$ does not in general have a significant time trend. In the large textile sector, the time trend is significant and negative. In four sectors $\varphi$ has a significant negative coefficient consistent with Case I.

Model II on the other hand performs well for Bangladesh but not at all for South Korea. In the latter case, variations in $\varphi$ are not in general related to variations in $\Pi$ or lagged $\Pi$. In two sectors $\Pi$ has a significantly positive coefficient and in two others a significantly negative coefficient, but in most sectors there is no relationship. In contrast in Bangladesh, $\Pi$ or lagged $\Pi$ had a significant negative coefficient in eleven out of sixteen sectors. Improvements in productivity were thus strongly linked immediately or with a lag with an increase in the employment share of white collar workers (a decrease in $\varphi$). The evidence is thus consistent with Case III being applicable for Bangladesh while we find no evidence for such an interaction between productivity growth and adjustments in employment patterns in South Korea.

We have tried to draw conclusions from the evidence of employment structure largely because this information is readily available. In fact the employment structure is possibly one of the less important ways in which clientelist pressure could be expected to manifest itself. Payoffs to clientelist coalitions involving employees include not just employment creation, but also access to unrecorded benefits (clientelist corruption), pay increases and more rapid upward mobility through the pay scales. Clientelist surplus appropriation involving capitalists is no less important, but statistically more difficult to detect since it involves the joint diversion of resources by capitalists.
participating in clientelist networks. Needless to say more work needs to be done but the results so far should at least indicate the importance of further efforts.

The observed interaction between the productivity index and the employment structure does not immediately allow us to quantify the loss of productivity due to clientelism, but this is larger than the arithmetic measure of $g_s$. This is because the loss due to clientelism is not only that the same productivity growth required a larger rate of growth in the share of 'employees'. From the argument of Part II we would expect that the trend for $\Pi$ would be different when clientelism operates. Analytically, this amounts to the observation that $\Pi$, $\lambda$ and $\sigma$ are not independent variables, and the microeconomic allocation of rights and the attendant bargaining power which allows a particular trend for $\sigma$ may also be responsible for the trend of $\lambda$ and $\Pi$.

**Conclusion**

In Part IV we have looked at the productivity performance in Bangladesh's manufacturing sector and found that in contrast to more successful countries, productivity follows a cyclical path around a stagnant trend. The cycles also coincide with the phase changes in the political settlement we identified in Part III. In this chapter simple versions of supply-constrained and demand-constrained theories were found to be wanting when confronted with the evidence. On the other hand there is evidence that clientelist processes do operate in the manufacturing sector in Bangladesh. We need to direct our attention in further work to the nature of rights underlying clientelist payoffs of various kinds and investigate the ways in which payoffs are bargained and delivered. This is important given the analytical implications of clientelist payoffs for the efficiency of the system which we explored in Part II. Improving industrial performance would then require political, institutional and contractual responses which could curtail these processes.
DEFLATORS FOR GNP, SAVINGS AND FOREIGN CURRENCY INFLOWS

The implicit GNP deflator for 1961-70 was available from Alamgir & Berlage (1974), Appendix C, Tables 1 and 2. The deflator was obtained by a comparison of their figures for gross national product in current and in constant 1959/60 factor costs. Alamgir and Berlage had to estimate the current factor cost figures for GNP by adding together annual constant factor cost sectoral figures, inflated by the sectoral price index (see Footnote 7 to their Table 3, Appendix C), so our method gives a weighted average of the sectoral price indices they used.

We used the GNP deflator for savings as well. This could be justified if expenditure from savings were more or less spread out over purchases which covered the whole range of products covered by GNP, but if savings were spent in a 'biased' way, this method would not be accurate.

For the two years 1971 and 1972, no statistics are available on which a GNP deflator could be reasonably estimated. Moreover, the economic dislocation caused by the breakup of Pakistan would in any case have made it meaningless to include the pre-1971 years with the post-1971 years in an unbroken series for regression analysis. For 1973 and subsequent years, a GNP deflator is provided by the Bangladesh Bureau of Statistics, as a weighted average of the price indices available in the production account. See for instance BBS Statistical Yearbook, Dhaka 1984, Table 12.10. The index for the GNP deflator used in this chapter is presented in Table 15-A.1.

The price index for investment used in this chapter is the one presented in Table 14-A.2. The manufacturing price index used in this chapter is also from Table 14-A.2.

The foreign currency inflow deflator was obtained by combining two indices. The first is the index for the Unit Value of Imports for Least Developed Countries, available from UNCTAD Handbook of International Trade and Development Statistics, New York 1986, which is a dollar index. For years subsequent to 1970, UNCTAD has prepared a unit value of imports index specifically for Bangladesh, but this moves almost identically with the LOC index. To convert these into taka indices, they were divided by the index showing changes in the dollar value of the Taka (or Rupee before 1971), obtained from the Trade Conversion Factor for Imports for converting the dollar value of imports into Takas (or Rupees before 1971).

Annual Trade Conversion Factors are available from the United Nations International Trade Statistics Yearbook, New York, various years, and United Nations Monthly Bulletin of Statistics, New York, various years. Since the UN statistics measure changes in the official exchange rate, and since foreign inflows are given a taka value at the official exchange rate, this method may be expected to be quite accurate. The series is presented in Table 15-A.1.
Table 15-A.1 also gives annual deflators for exports, which will be used later. These deflators are calculated in the same way as the foreign currency inflow or import deflators, this time using the Dollar Unit Value Index for Least Developed Country Exports, available from the same UNCTAD source, and the Annual Trade Conversion Factors for Taka Exports, available as before from the United Nations. The Deflator for the Taka Value of Exports is obtained as before by dividing the Dollar Unit Value Index for Exports by the annual index for the Trade Conversion Factor.

**TABLE 15-A: DEFLATORS FOR GNP / SAVINGS, FOREIGN CURRENCY INFLOWS AND EXPORTS**

<table>
<thead>
<tr>
<th>YEAR</th>
<th>G.N.P (Base 1961)</th>
<th>G.N.P (Base 1973)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961</td>
<td>100,000</td>
<td></td>
</tr>
<tr>
<td>1962</td>
<td>99,253</td>
<td></td>
</tr>
<tr>
<td>1963</td>
<td>103,611</td>
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<tr>
<td>1964</td>
<td>95,559</td>
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</tr>
<tr>
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<td>103,432</td>
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<td>1966</td>
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<td>1968</td>
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<tr>
<td>1984</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>YEAR</th>
<th>FOREIGN CURRENCY INFLOWS Denominated in Takas (Base 1961)</th>
<th>EXPORTS Den. in Takas (Base 1961)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961</td>
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<td>1984</td>
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</tbody>
</table>

*Source:* As in Text.

When used in calculations, all price indices were recalculated to the appropriate base year, whenever this was required.
Appendix B Chapter Fifteen

LOANS SANCTIONED AND DISBURSED BY B.B.S & B.S.R.S.

Data for loans sanctioned and disbursed by the Bangladesh Shilpa Bank (B.S.B.) and the Bangladesh Shilpa Rin Shangstha (B.S.R.S.) are available from the *Ministry of Finance Resume of the Activities of the Financial Institutions in Bangladesh 1983-84*, Dhaka 1984.

Figures for the public and private sector were aggregated for each year. Figures separately provided for BBS and BSRS were also aggregated. The available data are in current prices. To deflate them to a constant price series, we used the investment price deflator from Table 14-A.2 for the local currency loans sanctioned and disbursed, for foreign currency loans sanctioned and disbursed, we used the foreign currency inflow deflator developed in Table 15-A.1, since this essentially adjusts for movements in the unit cost of imports and the exchange rate. A more precise deflator would require us to use the dollar unit cost of capital goods imports as the numerator to get the appropriate taka deflator for foreign currency loans, after dividing by the index for the dollar price of the taka (See Appendix 15-A). However a capital goods unit import value index was not available for the least developed countries over a reasonable spread of years, so we have assumed that significant changes in the relative import price of capital compared to other imported goods have not been large over time.

<table>
<thead>
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<th>YEAR</th>
<th>LOCAL CURRENCY LOANS</th>
<th>FOREIGN CURRENCY LOANS</th>
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</thead>
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<tr>
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<td>Sanctioned</td>
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<td>112,50</td>
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<td>409,50</td>
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<td>1983</td>
<td>175,31</td>
<td>557,94</td>
</tr>
<tr>
<td>1984</td>
<td>57,46</td>
<td>307,86</td>
</tr>
</tbody>
</table>

*Source: Ministry of Finance, Government of Bangladesh, see Text.*
Appendix C - Chapter Fifteen

DATA AND METHODOLOGY USED IN OUTPUT DECOMPOSITION

The decomposition is based on the ex-post supply demand identity for domestic production for every sector: \( X = Z \), where \( X \) is supply and \( Z \) is demand. Demand for domestic production, \( Z \) is composed of domestic and net foreign demand: \( Z = D + E - M \), where \( D \) is domestic final and intermediate demand, \( E \) is exports, and \( M \) is imports. The share of domestic production in total domestic demand in each sector is given by \( u \), where

\[
\begin{align*}
\text{u} &= \frac{(X - E)}{(X + M - E)}. \\
\end{align*}
\]

From the ex-post identity, we then have,

\[
\begin{align*}
X + M - E &= D, \\
X - E &= u, D + E, \\
\text{Giving,} &\quad \Delta X = u, \Delta D + \Delta E + \Delta u, \Delta D, \\
\end{align*}
\]

The first item on the right hand side corresponds to the part of output growth absorbed by the growth of domestic demand, the second item to the part absorbed by the growth in exports and the third item to the absorption of domestic output in domestic demand as a result of a change in the share of domestic production in domestic demand, domestic demand remaining unchanged, or pure import substitution. Since the changes are not infinitesimal, demand in period 2 is taken for maintaining additivity of the decomposition equation. \( \Delta X \) and its components are expressed in Table 6.6 as percentages of base year output \( X \).

Clearly the equation may be interpreted in product terms or in market prices, but decompositions assuming the latter would be sensitive to changes in relative prices. Lewis & Soligo (1965) use the market price approach but the major problem with this is that commodities, and particularly imports have large retail markups on their production prices due to scarcity premiums. Using CIF prices and adding tax and trade markups thus underestimates the final expenditure on imports. Lewis & Soligo recognize this problem (Lewis & Soligo (1965) p. 119) but offer no solution. Scarcity premiums are not only high, they are also very variable, both across sectors and over time. This was found in a study commissioned by the Bangladesh Planning Commission while preparing the Second Five Year Plan, Bhuyan, A.K., Haque, A.Z.M. & Rashid, M.A.: Domestic Prices of Imports in Bangladesh: An Analysis of Trading Margins under Exchange Controls, Unpublished Manuscript in Library of Planning Commission, n.d. They present scarcity markups on selected imports for 1979 and 1984. We decided not to use these markups to get market prices from CIF prices (together with tax and trade markups), not only because the coverage is incomplete, but also because it is not reasonable to assume that these markups will be even approximately correct for other years.

Consequently, we applied the decomposition in product terms. Corrected factory production figures were available to us from the CMI, together with deflators for gross output, (See Appendix 14-A for our correction factors and price indices). The sectors we used for the decomposition correspond to the CMI sectors, except that machinery and electrical machinery are aggregated. The price index for the combined sector was obtained as a weighted average of the sectoral indices with weights corresponding to those used by BBS in their aggregation (0.39695 for machinery, and 0.60305 for electrical machinery). Correction factors for the joint sector was...
separately estimated using aggregated figures for reporting and registered firms. Very good statistics are available for sector-wise imports at cif prices and exports at fob prices from the Bangladesh Bureau of Statistics: Foreign Trade Statistics of Bangladesh, BBS Dhaka, various years. For the earlier year of 1964/65, BBS statistics were not available, but cif import and fob export figures for that year for East Pakistan were available from MacEwan (1971). Appendix A, MacEwan's figures are particularly convenient because he gives East Pakistan's imports and exports with the rest of the world and with West Pakistan, which is important to make these figures consistent with later ones. The BBS data and MacEwan's data are classified into narrower sectors, and these had to be aggregated for use with the CHI manufacturing output figures. The aggregation procedure adopted for sectors is shown in Table 15-C.1. For MacEwan's data, figures for manufactured tobacco and manufactured leather were not available separately from figures for aggregate tobacco and leather, a large part of exports and a substantial part of imports in these commodities being however in raw material form. To make MacEwan's import and export figures comparable with those for subsequent years, they were in each case adjusted by being marked down by the share of manufactured tobacco and leather in total tobacco and leather imports and exports in 1977, the terminal year for the first period.

### TABLE 15-C.1: SECTORAL AGGREGATION USED IN DECOMPOSITION

<table>
<thead>
<tr>
<th>CHI</th>
<th>MAC EWAN'S SECTORS</th>
<th>BBS SECTORS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leather</td>
<td>15. Leather (adjusted)</td>
<td>61t. Leather Manufactured.</td>
</tr>
</tbody>
</table>

Price deflators for cif imports and fob exports are available from Table 15-A.1, Appendix 15-A. These are however for aggregate imports and exports, sectorally disaggregated deflators were impossible to obtain. As a second best solution, we assumed that sectoral relative prices for imports and domestic production moved together, in other words, if domestic textiles doubled in price relative to domestic food products, traded textiles would also double in price relative to traded food products. This is not an unreasonable assumption if we can argue that relative prices across sectors is determined by overall demand and supply conditions, where supply includes imported as well as domestic production. This implicitly assumes that commodities within a
sector, whether imported or domestically produced are in some sense more substitutable than commodities across sectors, so that imported commodities enjoy a common proportional markup due to foreign exchange scarcity at an aggregate level. This assumption is the most 'neutral' assumption we can make under the circumstances, and in any case, the assumption of greater substitutability within sectors (commodities within a sector are 'similar') is implicit in this kind of exercise. Thus we assume that sectoral relative prices of imports and exports are the same as those for domestic manufactured products, but their absolute level is different, and we estimate this premium by the ratio of the taka import or export unit cost index to the aggregate price index for the domestic manufacturing sector.

Taking 1965 as the base, we see from Tables 14-A,2 and 15-A,1 that the ratio
\[
\frac{\text{Export Unit Price Index 1977}}{\text{Domestic Manufacturing Price Index 1977}} = 2.30258,
\]
\[
\frac{\text{Export Unit Price Index 1982}}{\text{Domestic Manufacturing Price Index 1982}} = 2.03289,
\]
\[
\frac{\text{Import Unit Price Index 1977}}{\text{Domestic Manufacturing Price Index 1977}} = 1.96198, \text{ and}
\]
\[
\frac{\text{Import Unit Price Index 1982}}{\text{Domestic Manufacturing Price Index 1982}} = 2.46802.
\]
Again taking 1965 as the base, these factors can be used to mark up the domestic sectoral deflators presented in Table 14-A,2, to bring them into line with the changes in the overall export and import price levels.

To see whether the results presented in the text are sensitive to the particular assumptions we have made, we estimated the growth decomposition under alternative assumptions. First we assumed that domestic and foreign trade price levels did not move apart in the way suggested by our comparison of the price indices of domestic manufacturing production and the import and export unit cost indices. The markup of import and export relative price movements by these factors was abandoned and the decomposition estimated. It was found that despite quantitative changes, there were no qualitative change in the results presented in the text relating to the relative contribution of import-substitution and demand growth in the two periods. This suggests that the underlying real changes were sufficiently large so as to be fairly robust even when substantial changes in the assumptions regarding price movements are made.

The decomposition was also carried out without the use of our correction factors on CMI output, and once again there were no important qualitative changes in the results. However, without the use of correction, we find a large growth in the real value of textile output over the period 1964/5-1976/7, but in fact the Bangladesh Bureau of Statistics' own quantum production index for textiles (which covers a narrower section of productive units) shows that by 1976/7 production had not recovered to the pre-war level. Thus our corrected figure which shows a drop in real production is more credible.
Table 15-C.2 shows the raw figures for output (uncorrected and at current prices), imports and exports, on which the decomposition exercise was based.

**Table 15-C.2: Output, Imports and Exports 1965, 1977, 1982**
(In Millions of Rs / Tk at Current Prices without Correction)

<table>
<thead>
<tr>
<th></th>
<th>1965</th>
<th>1977</th>
<th>1982</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food</td>
<td>625,297</td>
<td>2808,514</td>
<td>6337,277</td>
</tr>
<tr>
<td>Tobacco</td>
<td>130,734</td>
<td>1896,121</td>
<td>3162,27</td>
</tr>
<tr>
<td>Textiles</td>
<td>791,221</td>
<td>5239,918</td>
<td>12436,6</td>
</tr>
<tr>
<td>Paper</td>
<td>120,296</td>
<td>460,95</td>
<td>1581,838</td>
</tr>
<tr>
<td>Leather</td>
<td>36,867</td>
<td>673,996</td>
<td>1321,462</td>
</tr>
<tr>
<td>Chemicals</td>
<td>315,396</td>
<td>1950,715</td>
<td>5886,322</td>
</tr>
<tr>
<td>Non-Met Minerals</td>
<td>23,741</td>
<td>398,068</td>
<td>928,469</td>
</tr>
<tr>
<td>Basic Metals</td>
<td>102,159</td>
<td>2016,881</td>
<td>4201,875</td>
</tr>
<tr>
<td>Metal Manufacture</td>
<td>77,224</td>
<td>458,387</td>
<td>785,635</td>
</tr>
<tr>
<td>Machinery inc Elecr</td>
<td>35,701</td>
<td>643,65</td>
<td>676,755</td>
</tr>
<tr>
<td>Transport Equipmt</td>
<td>19,068</td>
<td>391,737</td>
<td>732,796</td>
</tr>
</tbody>
</table>

Appendix D Chapter Fifteen

REGRESSION EQUATIONS USED IN TABLES 15.10 AND 15.11

(\(\Pi\) is the index of labour productivity, \(r\) is the share of production workers in total employment. Significance of coefficients: * is significant at the 10 per cent level, ** is significant at the 5 per cent level, *** is significant at the 1 per cent level, **** is significant at the 0.1 per cent level. The models have been described in the text.)

<table>
<thead>
<tr>
<th>Country</th>
<th>Period</th>
<th>Model</th>
<th>Equation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh</td>
<td>Food 1971-82</td>
<td>Model I</td>
<td>(\Pi = 1.69 - 4.21 r + 2.73 r_{-1})</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(1.59) (0.87)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Model II</td>
<td>(r = 0.77 + 0.06 \Pi - 0.12*** \Pi_{-1} - 0.003 \Pi)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(1.47) (4.08) (1.83)</td>
</tr>
<tr>
<td></td>
<td>Sugar 1974-85</td>
<td>Model I</td>
<td>(\Pi = -1.12 + 61.65 r - 51.20* r_{-1})</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(2.00) (2.24)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Model II</td>
<td>(r = 0.75 - 0.01* \Pi)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(1.83)</td>
</tr>
<tr>
<td></td>
<td>Tobacco 1971-82</td>
<td>Model I</td>
<td>(\Pi = 3.88 - 1.47 r - 2.46 r_{-1})</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(1.02) (1.76)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Model II</td>
<td>(r = 0.89 - 0.16** \Pi - 0.0004 \Pi_{-1})</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(2.75) (0.01)</td>
</tr>
<tr>
<td></td>
<td>Textiles 1971-82</td>
<td>Model I</td>
<td>(\Pi = 4.38 - 1.60 r - 2.24 r_{-1} - 0.04* T)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(0.87) (1.09) (2.07)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Model II</td>
<td>(r = 0.96 - 0.09 \Pi + 0.03 \Pi_{-1} - 0.007*** T)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(1.29) (0.79) (4.13)</td>
</tr>
<tr>
<td></td>
<td>Jute 1973-85</td>
<td>Model I</td>
<td>(\Pi = -6.16 + 7.75**** r)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(6.85)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Model II</td>
<td>(r = 0.86 - 0.05**** \Pi)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(6.99)</td>
</tr>
<tr>
<td></td>
<td>Cotton 1973-87</td>
<td>Model I</td>
<td>(\Pi = 9.20 - 8.31*** \Pi - 1.40 \Pi_{-1})</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(3.11) (0.68)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Model II</td>
<td>(r = 0.85 - 0.04*** \Pi - 0.002*** T)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(3.18) (4.24)</td>
</tr>
<tr>
<td></td>
<td>Paper 1971-82</td>
<td>Model I</td>
<td>(\Pi = 2.62 - 2.58 r - 0.51 r_{-1})</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(1.62) (0.31)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Model II</td>
<td>(r = 0.73 - 0.18** \Pi + 0.05 \Pi_{-1})</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(2.78) (1.42)</td>
</tr>
<tr>
<td></td>
<td>Printing 1971-82</td>
<td>Model I</td>
<td>(\Pi = -0.93 + 0.98 r + 1.30 r_{-1} + 0.01 T)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(0.59) (0.83) (1.10)</td>
</tr>
</tbody>
</table>
### Part IV

#### APPENDIX

(Appendix Fifteen - D)

<table>
<thead>
<tr>
<th>Section</th>
<th>Model</th>
<th>Equation</th>
<th>R²</th>
<th>DW</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>LEATHER 1971-82</strong></td>
<td>Model I</td>
<td>$\Pi = 35.57 - 15.33 \varpi - 25.26 \varpi_{-1}$</td>
<td>0.68</td>
<td>1.19</td>
</tr>
<tr>
<td></td>
<td>Model II</td>
<td>$\varpi = 0.84 - 0.002 \Pi - 0.001 \Pi_{-1} - 0.01^{***} T$</td>
<td>0.90</td>
<td>1.75</td>
</tr>
<tr>
<td><strong>CHEMICALS 1971-82</strong></td>
<td>Model I</td>
<td>$\Pi = 7.83 - 5.47 \varpi - 3.38 \varpi_{-1} - 0.06 T$</td>
<td>0.77</td>
<td>2.37</td>
</tr>
<tr>
<td></td>
<td>Model II</td>
<td>$\varpi = 0.84 - 0.07^* \Pi + 0.01 \Pi_{-1} - 0.01^{***} T$</td>
<td>0.91</td>
<td>2.01</td>
</tr>
<tr>
<td><strong>MINERALS 1971-82</strong></td>
<td>Model I</td>
<td>$\Pi = 0.78 - 3.46 \varpi + 3.76 \varpi_{-1} + 0.36^{***} T$</td>
<td>0.72</td>
<td>1.78</td>
</tr>
<tr>
<td></td>
<td>Model II</td>
<td>$\varpi = 0.87 + 0.01 \Pi - 0.04^{***} \Pi_{-1}$</td>
<td>0.66</td>
<td>2.74</td>
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<tr>
<td><strong>BASIC METALS 1971-82</strong></td>
<td>Model I</td>
<td>$\Pi = 0.76 + 1.05 \varpi - 1.44 \varpi_{-1} + 0.08^* T$</td>
<td>0.54</td>
<td>2.63</td>
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<tr>
<td></td>
<td>Model II</td>
<td>$\varpi = 0.89 - 0.15^{**} \Pi - 0.03 \Pi_{-1}$</td>
<td>0.40</td>
<td>1.33</td>
</tr>
<tr>
<td><strong>METAL PRODUCTS 1971-82</strong></td>
<td>Model I</td>
<td>$\Pi = -1.22 + 3.40 \varpi - 0.79 \varpi_{-1}$</td>
<td>0.17</td>
<td>2.32</td>
</tr>
<tr>
<td></td>
<td>Model II</td>
<td>$\varpi = 0.84 + 0.01 \Pi - 0.03 \Pi_{-1} - 0.003^* T$</td>
<td>0.17</td>
<td>2.19</td>
</tr>
<tr>
<td><strong>MACHINES 1971-82</strong></td>
<td>Model I</td>
<td>$\Pi = 34.32 - 13.12 \varpi - 28.91 \varpi_{-1} - 0.286 T$</td>
<td>0.64</td>
<td>2.56</td>
</tr>
<tr>
<td></td>
<td>Model II</td>
<td>$\varpi = 0.80 - 0.02^* \Pi + 0.01 \Pi_{-1} - 0.006^{**} T$</td>
<td>0.77</td>
<td>2.02</td>
</tr>
<tr>
<td><strong>ELECTRIC-AL EQPT 1971-82</strong></td>
<td>Model I</td>
<td>$\Pi = -5.26 - 0.87 \varpi + 8.13 \varpi_{-1} + 0.14 T$</td>
<td>-0.04</td>
<td>1.36</td>
</tr>
<tr>
<td></td>
<td>Model II</td>
<td>$\varpi = 0.83 + 0.002 \Pi - 0.02 \Pi_{-1} - 0.02^{***} T$</td>
<td>0.90</td>
<td>2.40</td>
</tr>
<tr>
<td><strong>TRANSPORT EQUIPMENT 1971-82</strong></td>
<td>Model I</td>
<td>$\Pi = -6.90 + 3.99 \varpi + 5.15 \varpi_{-1} + 0.56^{**} T$</td>
<td>0.67</td>
<td>2.31</td>
</tr>
<tr>
<td></td>
<td>Model II</td>
<td>$\varpi = 0.77 + 0.004 \Pi - 0.00009 \Pi_{-1} - 0.02^{**} T$</td>
<td>0.72</td>
<td>2.06</td>
</tr>
<tr>
<td>Industry</td>
<td>Model</td>
<td>( \Pi = \alpha + \beta \sigma + \gamma \sigma_{-1} + \delta \Pi_{-1} + \epsilon T )</td>
<td></td>
<td></td>
</tr>
<tr>
<td>----------------</td>
<td>-------</td>
<td>---------------------------------------------------------------------------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>FOOD</strong> 1970-85</td>
<td>MODEL I</td>
<td>( \Pi = -3.14 + 2.73 \sigma + 1.76 \sigma_{-1} + 0.26 \epsilon )</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>((1.50)) ((0.94)) ((7.06))</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>MODEL II</td>
<td>( \sigma = 0.79 - 0.02 \Pi + 0.10 \Pi_{-1} - 0.02 \epsilon )</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>((0.24)) ((0.91)) ((2.08))</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOBACCO</strong></td>
<td>MODEL I</td>
<td>( \Pi = -0.33 + 0.68 \sigma + 0.67 \sigma_{-1} + 0.22 \epsilon )</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>((1.65)) ((1.85)) ((18.00))</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>MODEL II</td>
<td>( \sigma = 0.70 + 0.39 \Pi - 0.15 \Pi_{-1} - 0.06 \epsilon )</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>((2.12)) ((0.88)) ((1.52))</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TEXTILES</strong></td>
<td>MODEL I</td>
<td>( \Pi = -4.16 + 3.12 \sigma + 2.17 \sigma_{-1} + 0.23 \epsilon )</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>((1.33)) ((1.05)) ((10.25))</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>MODEL II</td>
<td>( \sigma = 0.93 + 0.11 \Pi - 0.09 \Pi_{-1} - 0.01 \epsilon )</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>((1.98)) ((1.56)) ((1.64))</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>PAPER</strong></td>
<td>MODEL I</td>
<td>( \Pi = 5.14 - 2.43 \sigma - 2.72 \epsilon \sigma_{-1} + 0.16 \epsilon )</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>((2.17)) ((2.45)) ((13.07))</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>MODEL II</td>
<td>( \sigma = 0.86 + 0.003 \Pi - 0.02 \Pi_{-1} )</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>((0.03)) ((0.21))</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>PRINTING</strong></td>
<td>MODEL I</td>
<td>( \Pi = 0.18 + 0.14 \sigma + 0.49 \sigma_{-1} + 0.16 \epsilon )</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>((0.19)) ((0.65)) ((10.39))</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>MODEL II</td>
<td>( \sigma = 0.70 + 0.21 \Pi - 0.25 \Pi_{-1} )</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>((1.18)) ((1.32))</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>LEATHER</strong></td>
<td>MODEL I</td>
<td>( \Pi = -1.52 + 0.13 \sigma + 2.17 \sigma_{-1} + 1.91 \epsilon )</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
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<td>((0.01)) ((0.25)) ((11.62))</td>
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</tr>
<tr>
<td></td>
<td>MODEL II</td>
<td>( \sigma = 0.93 - 0.0004 \Pi - 0.003 \Pi_{-1} )</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>((0.04)) ((0.33))</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>INDUSTRIAL CHEMICALS</strong></td>
<td>MODEL I</td>
<td>( \Pi = 0.84 - 0.09 \sigma - 0.10 \sigma_{-1} + 0.23 \epsilon )</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>((0.16)) ((0.20)) ((24.34))</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>MODEL II</td>
<td>( \sigma = 0.79 - 0.24 \Delta \Pi )</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>((2.11))</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>OTHER CHEMICALS</strong></td>
<td>MODEL I</td>
<td>( \Pi = 1.51 - 0.53 \sigma - 1.22 \sigma_{-1} + 0.35 \epsilon )</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>((0.34)) ((0.78)) ((8.69))</td>
<td></td>
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<tr>
<td></td>
<td>MODEL II</td>
<td>( \sigma = 0.68 - 0.10 \Pi + 0.09 \Pi_{-1} )</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>((1.31)) ((1.14))</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>POTTERY</strong></td>
<td>MODEL I</td>
<td>( \Pi = -0.22 + 0.12 \sigma + 0.81 \sigma_{-1} + 0.04 \epsilon )</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>((0.20)) ((1.21)) ((2.31))</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>MODEL II</td>
<td>( \sigma = 0.82 - 0.21 \Pi + 0.13 \Pi_{-1} + 0.02 \epsilon )</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>((0.72)) ((0.66)) ((1.70))</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>GLASS</strong></td>
<td>MODEL I</td>
<td>( \Pi = 2.09 - 0.44 \sigma - 0.55 \sigma_{-1} + 0.07 \epsilon )</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>((0.56)) ((0.71)) ((7.15))</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
OTHER MINERALS

MODEL I  \( \Pi = 3.17 - 1.24 \sigma + 2.35\sigma_{-1} + 0.16\sigma_T \)
\( (1.65) \quad (3.27) \quad (12.18) \)
\( R^2 = 0.94 \)
\( DW = 1.26 \)

MODEL II  \( \sigma = 0.78 - 0.17 \Pi + 0.05 \Pi_{-1} + 0.03\sigma_T \)
\( (1.09) \quad (0.31) \quad (2.63) \)
\( R^2 = 0.41 \)
\( DW = 3.07 \)

IRON & STEEL

MODEL I  \( \Pi = 2.41 - 2.04 \sigma + 0.05 \sigma_{-1} + 0.40\sigma_T \)
\( (0.93) \quad (0.02) \quad (11.97) \)
\( R^2 = 0.92 \)
\( DW = 0.71 \)

MODEL II  \( \sigma = 0.88 + 0.04 \Pi - 0.05 \Pi_{-1} \)
\( (0.72) \quad (0.89) \)
\( R^2 = -0.06 \)
\( DW = 3.08 \)

METAL PRODUCTS

MODEL I  \( \Pi = 10.22 - 4.98 \sigma - 5.52 \sigma_{-1} + 0.56\sigma_T \)
\( (1.19) \quad (1.70) \quad (7.48) \)
\( R^2 = 0.95 \)
\( DW = 1.03 \)

MODEL II  \( \sigma = 0.96 - 0.00004 \Delta \Pi - 0.012\sigma_T \)
\( (0.001) \quad (2.90) \)
\( R^2 = 0.48 \)
\( DW = 2.91 \)

MACHINES

MODEL I  \( \Pi = 3.89 - 1.35 \sigma - 1.52 \sigma_{-1} + 0.25\sigma_T \)
\( (0.60) \quad (0.78) \quad (5.95) \)
\( R^2 = 0.84 \)
\( DW = 1.23 \)

MODEL II  \( \sigma = 0.96 - 0.03 \Pi - 0.01 \Pi_{-1} \)
\( (0.64) \quad (0.22) \)
\( R^2 = 0.23 \)
\( DW = 3.25 \)

ELECTRICAL EQPT

MODEL I  \( \Pi = 11.52 - 6.86 \sigma - 5.69 \sigma_{-1} + 0.65\sigma_T \)
\( (1.33) \quad (1.27) \quad (6.89) \)
\( R^2 = 0.91 \)
\( DW = 0.63 \)

MODEL II  \( \sigma = 0.93 - 0.08\Delta \Pi \)
\( (3.22) \)
\( R^2 = 0.42 \)
\( DW = 2.98 \)

TRANSPORT EQPT

MODEL I  \( \Pi = 2.30 - 2.75 \sigma + 1.58 \sigma_{-1} + 0.26\sigma_T \)
\( (1.16) \quad (1.03) \quad (6.58) \)
\( R^2 = 0.82 \)
\( DW = 1.76 \)

MODEL II  \( \sigma = 0.87 - 0.04 \Pi + 0.02 \Pi_{-1} \)
\( (1.34) \quad (0.77) \)
\( R^2 = 0.02 \)
\( DW = 2.31 \)
Notes to Chapter Fifteen

1. See for instance successive World Bank country reports on Bangladesh, for instance:
   "...as repeatedly demonstrated in the past, the potential for economic growth in the medium-term is likely to be constrained by a less than adequate availability of foreign exchange for essential imports, and by a relatively low level of domestic savings and investment." IBRD[1986] p. iii.


3. Anjad estimates loan disbursement by the Pakistan Industrial Credit and Investment Corporation (PICIC), and the Industrial Development Bank of Pakistan (IDBP). See Anjad(1982) note 26 p. 124. The two institutions we looked at earlier were the Bangladesh Shilpa Rin Shangsttha (BSRS), or Bangladesh Industrial Credit Corporation and the Bangladesh Shilpa Bank (BSB), or Bangladesh Industrial Bank.

   BSRS was formed after independence by amalgamating PICIC and two smaller institutions, the Investment Corporation of Pakistan and the National Investment Trust. BSB was formed by amalgamating IDBP with another smaller institution, the Equity Participation Fund.


5. See for example Tables 1, 1 & 1,2 of Sobhan(1982); 'External Resource Inflow', as percentage of GDP were:
   0.7% 4.2% 12.2%.

   From World Bank figures, 'Net External Economic Assistance' as a percentage of GDP at market prices was 11.95% in 1982-3, and averaged 9.63% over the period 1972-3 to 1982-3. Calculated from IBRD[1984] Vol.II Table 2.5.


8. Sobhan(1982), Table 3, p. 63, figures for 1971-2 to 1980-1. Disbursements of course depend on many factors including donor policy, but institutional efficiency is clearly one of them. Knowledge of bureaucratic obstacles in this as in other fields is so commonplace in practice, if not in theory, that it is rarely reported except in striking cases. One such case was that of two 'soft' loan allotments, one of the ADB, the other of the IDA, in 1984. The $50m IDA loan was unused to the extent of $16m and the $25m ADB loan to the extent of $10m when the callup deadline ran out. This in the context of a resource starved economy. See the daily Shongbad, 14 Nov. 1984, front page article entitled 'Bureaucratic Controls and Donor Delays: IDA & ADB Loans Unused', (in Bengali). Another report calculates that between 1971 and 1985, of $8,963m of project aid allocated, $4,512m was used, giving a utilization figure of 49.2%. The article identifies complex procedures of
bureaucratic approval and the absence of overall supervision of ministries as the main reasons. See the daily Shonghad, 31 Mar, 1986 p.6: 'Not Even Half of Foreign Aid Used in Project Sector', in Bengali.


10. See the collection of articles in Rahman, Matjir & Hug, S.A. [1987], which appeared over 1983 and 1984 in the Communist Party of Bangladesh's newspaper Ekola, (Unity). The articles traced the accumulation process of some of the largest business houses of contemporary Bangladesh. They show how what we termed the 'symbiotic relationship' between clientelism and capitalism operated in practice to create these fortunes.


13. For instance the work of Ballance Ansari & Singer[1982]. See in particular Table II.2 pp. 56-7.

14. For an account of the liberalization attempted in the early to mid sixties, see Anjai[1982] pp. 31-40. For an account of some aspects of the liberalization attempted in the late seventies and early eighties see our Chapter Thirteen.


16. Correcting for undercoverage does not affect the figures for λ and ε since both numerator and denominator will be corrected by the same factor in each case. The subsequent decomposition is thus independent of the method of correction.
CONCLUSION

The thesis has tried to address an important question. Why has a country like Bangladesh failed to generate rapid industrial growth despite low wages, a skilled professional and managerial class and substantial inflows of investible resources? Our explanation emphasized the efficiency of the state and looked at the political constraints which obstructed successive attempts by the state to improve its economic viability conditions. Our analysis of state efficiency was contrasted with the neoclassical approach to rent-seeking which stresses the inefficiency implications of state intervention in general. The growth of democracy was also analysed as a process whose implications for economic efficiency depended on the structure of democracy (in our simple model in Chapter Six, on the relative numbers of organizers and organized) and the level of democracy already achieved in a particular society.

Some policy implications have been discussed in the course of the argument which provided a framework to examine the consequences of particular kinds of liberalization or democratization. We identified mechanisms rather different from the ones put forward by neoclassical theory (Chapter Ten). One implication of our argument has been that the economic success or otherwise of liberalization or democratization strategies in the context of a clientelist economy would depend on the effects of such strategies for clientelist surplus appropriation and the efficiency of the state.

Institutional, contractual and political responses which address the problem of clientelist bargaining would therefore be a precondition of successful strategies. One way of looking at the problem is in terms of the externalities of clientelist bargaining. If the costs of such strategies were internalized by lobbies, clientelist strategies would clearly end. This is because clientelism is not simply a zero-sum distributional struggle, it also lowers the efficiency
and rate of growth of the system so that in the long run everybody is worse off, including members of clientelist lobbies.

Clientelist surplus appropriation is clearly based on the distribution of organizational rights and in the past attempts to control clientelism have periodically led states of various persuasions to restrict the distribution of organizational rights. We have also seen that in the social and political context of Bangladesh such strategies have failed in the long run.

Policy makers therefore have the challenge of devising contractual and institutional responses which can internalize the costs of clientelist lobbying. A minimum precondition for such work is however a widespread recognition of the nature of the problem. Without such a recognition, the costs of policing would be prohibitive. Let us assume that this recognition can be achieved. A number of strategies would then become possible for the state.

For instance, the state could establish and then provide the governance mechanism for intra-enterprise contracts between asset owners and employees of various categories. The success of such contracts would require that the costs and benefits of productivity growth which possibly results from state intervention are explicitly divided between capital and labour and that such contracts are enforceable by the state. This implicitly makes the property rights of the capitalist less challengeable once a settlement has been arrived at and reduces the possibility of clientelist bargaining. In terms of the model of Chapter Six, this amounts to the creation of a lower potential total payoff curve (figure 6.2) by improving the legitimacy of a given structure of property rights. If the beneficiaries of such strategies constitute a large enough political constituency, this amounts to the state operating along a higher tradeoff curve (figure 8.2) such that the system can attain greater efficiency at any given level of political stability.
If the problem was widely understood, the tasks of policing would also change. Instead of the state having to intervene in the interests of capitalist property rights, if clientelist lobbies were persuaded that there was a conflict between their short and long run economic interests, the task of the state would simply be to ensure that there were no free-riding lobbies. This outcome amounts to the clientelist coalition fracturing and a new political settlement emerging, which implicitly shifts up the tradeoff curve (figure 8.2) to a higher position in the north-east.

It would be fair to say that these sorts of outcomes are unlikely since they require a degree of sophistication on the part of state decision-makers which has not been forthcoming in the past. It also assumes that enough members of potential clientelist lobbies can be persuaded of the externalities of their activities. But potentially the gravest problem is that in a distributional system which is not perceived as just, legitimacy is very easy to challenge. On the other hand it is difficult to conceive of a distribution of income in a country with the per capita income of Bangladesh which would be perceived as just and which would still leave resources available for investment. This is probably why the response of successive states in Bangladesh and elsewhere has been simply to attempt periodic restrictions on organizational rights.

Our analysis of the organizational rights which support clientelism in Chapter Six showed that more egalitarian distributions of organizational rights would initially (and perhaps for a substantial range) have a negative effect in terms of controlling clientelism, but in the long run egalitarian distributions of organizational rights may be more conducive for efficient state intervention. Radical moves towards democratization could therefore be another solution but there are problems here too. The transition may not be economically feasible since strategies which attempted to be efficient through democratization may
have to be abandoned because of the initial gains for clientelism which could persist over a period of many years.

On the other hand, an understanding of the nature of the problem may allow the mobilization of alternative groups in society who would potentially gain from economic growth if the process of democratization could be speeded up. Thus while egalitarian redistributions of organizational rights alone would initially and perhaps for a long period push the tradeoff curve (figure 8.2) down, alternative political mobilizations may change the political settlement and prevent the tradeoff from descending to quite the same extent or at all. The overall change in the tradeoff may therefore be minimized. This amounts to the state being able to maintain economic efficiency because the creation of new political constituencies (say of workers and peasants) allows it to overcome the increased incentives of clientelism and therefore the increased resistance of clientelist lobbies to efficiency enhancing changes in rights. This strategy could probably be described as a 'left' strategy and needs to be distinguished from the usual response of the state described in Part III which amounts to the perpetual balancing of older clientelist lobbies through the creation of new ones.

Viable strategies must clearly combine contractual, ideological and institutional elements together with appropriate distributions of the right to organize. Since enterprise efficiency is of critical concern in all developing country social systems where scarcity is the dominant economic problem, these responses would have to be forthcoming regardless of whether the social system was described as 'socialist' or 'capitalist'. If either system is to succeed, it would have to provide viable answers to clientelist inefficiency which we feel is the dominant constraint on industrial and hence economic growth in many developing countries. The answers possible within each system would of course be very different.
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