I count myself among the multitude given an introduction to the history of economic thought through Bob Heilbroner’s *The Worldly Philosophers*. When I first read the book I was not sufficiently knowledgeable of foreign languages to recognize the distinguishing characteristic for those included in the book was having a unique *Weltanschauung*. These were not *worldly philosophers* in the sense of having experience of the world, but rather in the sense of having an individual *worldview* of economic development.

My recollection is that I had the book assigned as a basic text in the autumn of 1964. Most students of economics were then unaware of the implications of the UN Trusteeship Council’s rapid creation of new independent states from former colonies and the problems of economic development that they would face. But, the June 1963 preface to the revised edition of *The Worldly Philosophers* (despite several transoceanic moves I still have my original copy) already notes that this shift reflected the change in economics toward “more concern over the trend of economic development” (Preface, p. ii).

Most of the specific discussion of development issues is found in the concluding chapter, “Beyond the Economic Revolution,” which laments

*This contribution is made in the author’s personal capacity and should not be interpreted as representing official positions of the United Nations on the subject. I am grateful to M. Forstater, W. Milberg, and L. R. Wray for comments that have improved the text.
that economists are not “in general today keenly aware of the historic responsibilities and implications” of making policy recommendations on appropriate priorities and strategies for developing countries:

The trend in economic thought in our time is not towards the “grand dynamics” of the future, but turns aside from such speculative social forecasting to consideration of more “scientific” matters. Many economists build “models” . . . of an economy in growth, or concern themselves with complex quasi-engineering problems of labor inputs and commodity outputs. . . . But if the temper of most contemporary economists tends to be unadventuresome and academic there is no lack of prophecy and persuasion to which we can turn. Only they are not new voices. They go back—all of them—to the arguments and architecture of the great economists themselves” (290).

Heilbroner’s position reflects Adolph Lowe’s (1976) that “the standard works of the classical economists—Smith, Ricardo, Marx—not only contain but essentially are theories of economic growth” (Lowe, 1976: 5; emphasis in original). Returning to the book some 40 years later provides a range of alternative approaches, in contrast to the modern convergence of opinion on development issues and the basis for some reflection on the “trend of economic development” policy.

Today it is widely believed that economists know the right policies required for successful economic development; it is just a question of sufficient political will for governments to implement them. These basic policies largely reflect the principles put forward in the “Washington Consensus” policies applied in Latin America over the last two decades and the market “shock” approach to Eastern European transition. They do not, however, reflect the experience of the Asian economies. This alone should be cause for concern—since the 1960s Asia has far outstripped the performance of both Latin America and Eastern Europe.
This modern approach accepts what has been considered a given of development economics since the adaptation of the Harrod-Domar growth models of the 1940s and 1950s: the need to augment the resources available to support growth since developing countries lack the will or the ability to increase domestic savings or to attract foreign capital. Successful economies that have experienced growth have overcome this obstacle so that the sole aim of development policy can be reduced to the introduction and implementation of appropriate policies to improve the domestic mobilization of resources and to provide a hospitable domestic environment to attract the resources of foreign investors. The emphasis is on the implementation of domestic policies that will provide a sufficient flow of resources domestically or from abroad to be invested and produce higher growth. These policies are usually mirror images of the policies that are currently employed in successful developed countries.

However, if we use the worldly philosophers to investigate the earlier approach to economic development that Heilbroner and Lowe suggest contain the key to understanding the social and moral dimensions of development, this modern concentration of the lack of resources as the main obstacle to development is difficult to find. Adam Smith’s *Wealth of Nations*, probably the first comprehensive “how to” manual in the economic development literature, as Heilbroner points out, refers to the period before the Industrial Revolution. Yet the Industrial Revolution is used by many authors—Rostow (1960) being the most visible—as the reference point for insight into the development process. The modern emphasis on the lack of resources for investment comes from the belief that the Industrial Revolution was the result of a rapid increase in the rate of fixed capital accumulation.

Yet, what Smith identifies as the basic factor that would promote the Industrial Revolution is not the accumulation of fixed capital equipment, but technical progress. Indeed, Smith makes little reference to lack of resources as the basic obstacle to development. But unlike modern approaches to technical progress linked to the capital investment process, Smith emphasizes the importance of the organization of
production as representing the source of technical progress. It was the new methods of organization—the division of labor—that produced technical progress.

Every student knows Smith as the defender of free markets. But his support for markets is based on their importance in breaking down the system of royal patents and the guild system that not only prevented market competition, but more importantly stifled the introduction of new methods of organizing production through division of labor. Under the guild system a new method of organizing production could only be introduced by an existing producer and required consent of other members—not a great incentive to change.

Thus, although this new form of organization by division of labor required financial capital accumulation, primarily to provide for working capital to hold inventories of inputs and outputs to allow division of labor, more important was breaking down the regulations that prevented change. This did not necessarily require the accumulation of fixed capital equipment, which is usually linked to increasing productivity through scale economies. For Smith the key to higher productivity is the freedom to introduce new and more extensive forms of division of labor. The accumulation of savings by capitalists gave them the means to implement them, and eliminating regulation made it possible to do so.

But as Schumpeter (1961) pointed out, it was not the lack of capitalist’s accumulated savings that represented an obstacle to innovation, since it was lending by the banking system that allowed entrepreneurs to command existing resources they could organize in more productive ways. It was the scarcity of organizational ability and technical progress in the organization of production that provided the basic obstacle, not the scarcity of resources. For both Smith’s capitalist and Schumpeter’s innovating entrepreneur the better noun describing their function would be Marshall’s “undertaker,” for it places the stress on the ability to procure and organize the use of resources in new techniques of production, not necessarily to own or possess them. It was Marx who noted the positive economic and negative social implications of the ownership of resources.
Smith’s approach is also to be found in Chandler’s (1990) explanation of the successful development of the US economy when he notes the importance of new forms of managerial organization in the operation of the railway system and its extension to corporate forms of organization that gave US firms the first-mover advantage in operating over large geographical areas. It was not the iron and steel embodied in the locomotives and the rails or the savings necessary to build them that brought the increased productivity—it was the innovations in the managerial organization of the rail system. Chandler also notes the importance of financial institutions in this process, but points out that the example of the United States suggests that they are not a necessary condition:

In Britain and the US before the end of the 1890s, the first movers in the new industries rarely looked to established capital markets for funds. The initial capital that was not provided by an entrepreneur and his partners came from local investors, with some assistance from local financial institutions. In the US the first large-scale funding of industrial enterprises by investment banking houses and other financial institutions came only with the turn of the century merger movement. . . . In Germany, on the other hand, banks did play a significant role in providing capital for new ventures to entrepreneurs making the investment necessary to exploit the potential economies of scale and scope. Once the new consolidated enterprises in the US and the managerial enterprises in Germany were firmly established . . . retained earnings provided industrial managers with most of the funding needed to finance continuing growth (Chandler, 1990: 597).

Schumpeter (1961) called this process of development *creative destruction* because it broke down old ways of doing things and provided more productive organizations of resources in their place. But as
Hirschman (1958: 59) notes, initiating this type of change may be the most difficult part of the development process, especially in group-based cohesive societies or in planned economies since “it means self-destruction rather than destruction of somebody else.” Not only do developing countries lack the financial institutions that Schumpeter considered crucial to the process, the anticipation of social and economic change itself may be the biggest obstacle to change. Hirschman notes two different ways in which traditional societies may approach the image of change associated with the development process. In a communal, cooperative, cohesive type of society where “total productivity having long been stationary, individual improvement could only take place at the expense of other members and of the cohesiveness of the group. Exceptional performance is therefore discouraged” (1958: 11). He concludes that this “group-focused image of change is incompatible with any large-scale development aiming at a fundamental transformation and modernization of the economy” (13).

In contrast to this “change may be conceived as possible (and beckoning) for the individual while it is not visualized at all for the group” (14). “At first blush it might appear that this kind of society is favorable to economic growth. Everybody is ambitious, dissatisfied with his present lot, and believes in the possibility of change. . . . Most fundamentally it tends to obstruct a series of processes that are part of the entrepreneurial function” such as “the ability to engineer agreement among all the interested parties, such as the inventor of the process, the partners, the capitalists, the suppliers of parts and services, the distributors, etc, etc.; the ability—so important in underdeveloped countries today—to enlist cooperation . . . and a host of other managerial talents” (17).

Thus there are “two different kinds of images of change that are likely to arise in previously static societies . . . the group-focused image where change is conceived as affecting primarily the group while the individual’s relative position remains untouched; and the ego-focused image where the individual conceives change as something that is open to him, essentially at the expense of the rest of society. Both images have been shown to be inimical to genuine economic development,”
but the “cooperative component, which consists essentially of the agreement-reaching and decisions-making processes, was found to be a particularly strong need of the underdeveloped countries . . .” (23).

If backwardness is due to insufficient number and speed of development decisions and to inadequate performance of developmental tasks, then the fundamental problems of development consist in generating and energizing human action in a certain direction. This finding is at variance with much of the existing literature on development, which has largely concentrated on identifying various obstacles to economic progress (including) . . . lack of saving” (25)

Hirschman’s conclusion is that the “taking of development decisions is held back not by physical obstacles and scarcities, but by the imperfections in the decision-making process” (26).

A modern application of the same approach is found in Alice Amsden’s analysis and explanation of the rapid development of the South Korean economy. She notes that unlike the United Kingdom, Germany or the United States, South Korea did not, indeed could not, build on the basis of technical progress produced by entrepreneurs developing and introducing industrial innovations. Neither did it rely on extensive foreign borrowing, nor did it have high domestic saving rates. Rather its success was based on its ability to organize the reproduction and adaptation to local conditions of methods of production already in place in the developed countries. This is what she calls industrialization by learning. Following Chandler, she notes that the large-scale multidimensional enterprise administered by hierarchies and salaried managers is “the agent of expansion in all late-industrializing countries” (Amsden, 1989: 9). An important part of South Korea’s success is the Korean version of Chandler’s modern enterprise, the chaebol system of horizontal industrial organization that proved to have a comparative advantage in managing the process of learning, replicating, and then adapting existing technologies to local conditions and
local resources and operating with sufficient efficiency to compete in international markets. Obviously, saving and capital accumulation were important to this process, but the key was in the managerial organization of production. Indeed, South Korea started its industrialization process with extremely low savings rates (in 1962 personal savings were negative), but the success of its development process provided a rapid increase in personal savings to over 10 percent by the 1970s. Total savings rose from 12 percent of GDP in 1962 to 28 percent by 1984 (Amsden, 1989: 75). Rather than being a prerequisite for growth, savings were the result of growth.

Jung-Sup Shin and Ha-Joon Chang (2003) have noted that in the absence of the equivalent of Schumpeter’s financial institutions or of personal savings that allow individual entrepreneurs to engage in creative destruction, this role was taken over by a strong developmental state that provided the financing and risk sharing for the heavy capital investments undertaken by the chaebols through state-directed banks. In opposition to “import substitution” they call this a Gerschenkronian strategy of “finding functional substitutes for the institutions used for industrial financing” by the developed countries in their process of development. They argue that “the state-banks-chaebol nexus in the Korean model—often characterized as Korea Inc.—was such an institutional substitute” (Shin and Chang, 2003: 7).

Both Amsden and Robert Wade have stressed that the role of the state in directing the choices of the industrial sectors that would be supported implied ignoring traditional comparative advantage as a guide to their decisions. Wade notes that the state “aims to produce a different profile of industries compared to what would result from the decisions of the unguided, unstimulated market agents on their own” (Wade, 1990: 13), while Amsden calls this a process of “getting the prices wrong”:

Korea . . . provides supporting evidence for the proposition that economic expansion depends on state intervention to create price distortions that direct economic activity toward greater investment” (Amsden, 1989: 14).
While the Korea approach did not produce first-mover advantages associated with the introduction of new innovations and monopoly profits, its organizational comparative advantage in replicating technologies in those areas of heavy industry that produced large-scale economies and forward and backward linkages allowed relatively low real wages to be translated into international competitiveness and increasing profits and savings to support the investment process. Erik Reinert (2004) notes that government policies directing the economy toward industrialization and in particular those industrial sectors subject to increasing returns have been part of the history of every successful developed economy, while Ha-Joon Chang (2002) argues that the degree of protection that has historically been required for the success of these state-directed industrialization policies is difficult if not impossible to replicate within the trading framework set out in the World Trade Organization agreements that have recently been accepted by most developing countries.

This is consistent with Hirschman’s view that, while “Following Schumpeter’s lead, economists and historians alike have hitherto considered the innovating entrepreneur primarily as a strong individualist” willing “to assume risk,” this image probably more reflected “European societies during the first stage of the Industrial Revolution” (1958: 16) rather than backward economies attempting to catch up with those economies that have already developed. As Amsden also notes, “the private entrepreneur’s usefulness in the multidivisional enterprises of late industrialization appears much reduced when measured by the standards of the entrepreneurial histories of advanced countries” (1989: 9), in particular because “what is conspicuously absent from late industrialization is innovation” (141).

Hirschman finds an additional drawback to the idealized view of the individual entrepreneur as the agent of economic change in developing countries: “one frequently notices that investor-entrepreneurs in newly developing countries a phenomenon that has much in common with liquidity preference[;]... investor-entrepreneurs may hold their funds and themselves in ‘liquid’ or quasi-liquid readiness for a long time before
taken the momentous decision to sink their monies and energies in a new venture” (20, 21).

The basic problem then is one of providing the appropriate image of change, in Hirschman’s sense. The appropriate inducements since development in this view “is not concerned with the lack of one or even of several needed factors or elements to produce economic development, but with the deficiency in the combining process itself. Our diagnosis is simply that countries fail to take advantage of their development potential because, for reasons largely related to the image of change, they find it difficult to take the decisions needed for development in the required number and at the required speed. . . . [S]hortages in specific factors or “prerequisites” of production are interpreted as a manifestation of the basic deficiency in organization (25).

This approach is similar to that taken by Ronald Coase in a retrospective consideration of his views (in Williamson and Winter, 1991: 65) in which he notes that economists seem to have lost sight of a key idea: “the comparison of the costs of coordinating the activities of factors of production within the firm with the costs of bringing about the same result by market transactions.” He reiterates that the “basic reason” for the existence of firms is “the avoidance of the costs of contracting between factors of production” (67); that is, technical innovation in the form of managerial organization.

Penrose (1995 [1959]) highlighted the role of firms in creating an internal environment shielded from the instability that Coase associates with organization based on market transactions. Firms are thus organizations that provide “pools of relative certainty” within which resources can be combined and coordinated in order to react to external volatility and generate endogenous innovation. Firms are thus not only more efficient in organizing factors, they are more efficient in developing new techniques to cope with change in an uncertain environment. This approach is also compatible with Richardson’s insights on how the “development of capabilities” affects the “organization of industry” (Richardson, 1972).

While managerial organization can reduce the risk and instability facing individual production units, it can do little to mitigate the
systemic risks that condition investment decisions in developing countries. However, Hirschman notes that economists have long been aware of this type of situation in connection with the problem of getting an economy to move out of the depression doldrums. The weakness of monetary policy in this situation resides precisely in the fact that even a policy of extreme monetary ease is purely obstacle-removing; it is no more than permissive of the needed recovery decisions. Fiscal policy, on the other hand, is considered a more reliable means of curing a deficiency of demand because it can increase the economy’s spending stream directly and makes or forces re-deployment decisions in the process; it does so in the absence of any prior improvement in the “business climate.” In a situation of under development we are in even greater need of a mechanism of this type (26).

Thus there may be a parallel between policies that provide full utilization of resources in a developed country and those that provide full mobilization of domestic resources in a developing country. In this regard it is appropriate to recall that Prebisch’s main point concerning the decline in the terms of trade facing developing country exports was that it represented a transfer of the productivity—“the fruits of their own technical progress” (Prebisch, 1962) in the primary commodity sector to consumers in developed countries, depressing real wage growth and internal demand for domestically produced manufactured goods in developing countries, reducing the internal demand growth required for the domestic industrialization process.

Whether developed or developing, the economy can benefit from a reduction of systemic risks on decision making and this can usually be achieved by appropriate government policy. Indeed, according to Amsden one of the major roles played by the state in the South Korean development process was to share the risk of nonmarket-directed invest-
ments with the owners of the chaebols. It therefore was able to overcome the negative aspects Hirschman notes of the group-focused image of change. However, this appears to be an exception. Many of the newly created African states had boundaries that cut across existing cohesive social or tribal groups, or encompassed a number of such groups. In these conditions a government dominated by a single group applying group-focused development would appear as “ego-focused” to the other groups and might lead to “rent-seeking” activities that maintain the group’s dominant political position, rather than improving the conditions of all the members of the state. The appropriate role for the state thus relies on Keynes’s view that only the state can undertake certain activities because it is not profit driven and can take decisions that do not provide direct benefit to members of government, but rather to the nation as a group.

This leads to the conclusion that it is not so much lack of physical resources; indeed, most developing countries attracted the attention of developed countries precisely because of the abundance of their resources, or the inability to mobilize domestic savings, as much as a lack of managerial organization and decision making to produce technical progress that is the most important obstacle in the catch-up process. But, the type of technical progress and organization is also important. As Furtado notes, while “economic development is basically a process of capital accumulation” (Furtado, 1964: 69), in the growth of a developed economy it “is a matter of accumulating new scientific knowledge and advancing the technological application of such knowledge. . . . The growth of underdeveloped economies is a matter of assimilating techniques already extant” (61).

In the 50 years since The Worldly Philosophers was first published, the problem of “underdevelopment” has still not been solved. The current approach focuses on the inability to mobilize domestic resources and generate domestic savings, recommending market liberalization, foreign borrowing, and the introduction of developed country institutions in the form of common codes and standards of good practice. The other, rooted in the writings of the worldly philosophers and especially
Smith, Schumpeter, and Keynes, emphasizes the importance of technical progress in, and the form of, managerial organization and learning, supported by a framework of state support and direction that provides risk sharing to promote private sector investment in those sectors where productivity growth, and thus increases in real incomes, is highest. The growth of East Asia, the great developmental success of the past half-century, followed the latter model. Replicating that experience, with appropriate adaptation to regional differences, is the central challenge of twenty-first century capitalism.

REFERENCES


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