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Entrepreneurship and Economic Development: The Problem Revisited

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I. Introduction

EARLY DISCUSSIONS of economic development in the postwar period attributed considerable importance to the problem of entrepreneurship in the underdeveloped countries. Entrepreneurship was clearly essential if the investment, innovation, and structural changes required for economic development were to be achieved. But both on the supply and on the demand sides, entrepreneurship seemed to constitute a serious problem for the underdeveloped countries. Because of the deficiencies of organized factor and product markets in "obstructed, incomplete and 'relatively dark' economic systems" [46, Harvey Leibenstein, 1968, p. 77], the entrepreneurship requirements per unit of incremental output would appear to be higher in underdeveloped than in more-developed economies. At the same time, research on

the socio-cultural conditions associated with the emergence of entrepreneurship suggested pessimism concerning the prospects for less-developed countries' (LDC's) generating sufficient entrepreneurship to achieve high rates of economic development. The ensuing concern with entrepreneurship as a problem for economic development was demonstrated by the large volume of professional literature, both from economists and from other social scientists, which was addressed to the subject.¹

As we shall see, however, the actual experience of most LDC's in the postwar period has belied expectations that lack of entrepreneurship would prove a con-

¹ An excellent selected bibliography of this voluminous literature on problems of entrepreneurship and economic development is presented in Flavia De-rossi [15, 1971, pp. 409-23]. For a good sample of the treatments by the different social sciences in this area, see Peter Kilby [37, 1971].

straint on economic development. And since approximately the early 1970's, the topic of entrepreneurship has virtually disappeared from the literature, suggesting that in some sense the problem has been "solved." It is rare for a problem that had evoked considerable analytical interest and policy concern to recede from professional attention. Consequently, this paper examines what has happened in this field. We will first consider the nature of the problem and then discuss the evidence that it has been "solved"; how this has been achieved; and finally, the ways in which the problem has been transformed, to reappear in new forms with important implications for the development process.

We will consider both private and state entrepreneurship in the LDC's. The discussion is confined, however, to the uncertainty- and risk-bearing features of entrepreneurship, which affect the capacity for investment and innovation. Space limitations preclude a treatment of managerial efficiency and performance, issues that have sometimes also been included under the general heading of entrepreneurship (see, *e.g.*, Thomas Cochran [11, 1968, pp. 89-90]).

II. *Clarifying the Concept and the Problem*

As William Baumol has noted [5, 1968, p. 64], the subject of entrepreneurship is conceptually elusive, and the term has not always had clear theoretical content. Indeed, in recent years the term entrepreneur has sometimes been used as a synonym for the firm, or for management in general, with little regard for special "entrepreneurial" qualities. Because of this analytical vagueness, it is useful to begin with a brief clarification of the concept of entrepreneurship and particularly of the special features that it is likely to involve in LDC's.

Entrepreneurship clearly refers to the

capacity for innovation, investment, and activist expansion in new markets, products, and techniques. As such, entrepreneurship may reflect superior information and, perhaps more importantly, imagination, which subjectively reduces the risks and uncertainties of new opportunities, which are ignored or rejected by other investors (see Joseph Schumpeter [72, 1934] and Israel M. Kirzner [39, 1973]). Alternatively, the entrepreneur has special aptitudes for bearing risk and uncertainty, which permit him to act as the promoter and catalytic agent who seizes new investment and production opportunities [40, Frank H. Knight, 1921]. These traits, in effect, shift the opportunity set, and increase the probability that a new project will in fact be implemented [30, John Harris, 1973]. Viewed in these terms, entrepreneurship is so important for economic development that it has sometimes been conceptualized as a "fourth factor of production."

In an underdeveloped country, entrepreneurship may take on dimensions that are absent or less important in more-developed economies. Thus, Harvey Leibenstein has emphasized that entrepreneurship in LDC's involves the creation of channels for input supply and/or for sale of outputs, in conditions where routinized market mechanisms such as exist in the more-developed economies are not available [46, 1968]. Consequently, without entrepreneurship, some input or output quantities, qualities, and costs would be so beclouded by risk and uncertainty that investment in these activities would not take place.

Leibenstein's definition of entrepreneurship in terms of its role in overcoming factor- and product-market failures is clearly very suggestive for the LDC's.² To

² Following this conceptual approach, one cannot invoke "capital market imperfections" to explain deficiencies of entrepreneurship in developing countries; for part of the role of an entrepreneur

appreciate the special significance of this aspect of entrepreneurship for these economies, consider the contrast with some conceptualizations of entrepreneurship that have been formulated in the context of the more-developed economies. For example, in her discussion of the social productivity of entrepreneurship, Joan Robinson [68, 1934, p. 409] suggested that:

The marginal productivity to the industry of entrepreneurship is the difference which would be made to output if one entrepreneur were withdrawn. . . . The number of firms in the industry being n , it is necessary to assume that n is so large that the difference between the marginal physical productivities of the *constant* [my italics] amount of other factors when they are working with n entrepreneurs and when they are working with $n - 1$ [entrepreneurs] may be neglected.

The contrast with the situation in the less-developed countries is striking. In the modern sector of the less-developed economies, oligopoly often prevails, so that the number of firms is *not* so large that the presence or absence of a single firm makes no difference to marginal productivities. Further, in the less-developed economies, Mrs. Robinson's assumption that the amount of factors is "constant" does not hold. Indeed, a key function of entrepreneurship in developing economies is precisely to mobilize factors such as capital and specialized labor which, being imperfectly marketed, might otherwise not be supplied or allocated to the activities where their productivity is greatest.

Not only does the greater prevalence of incomplete and imperfect markets in the LDC's lead to a greater significance for entrepreneurship's factor-mobilization role in the LDC's, but another major difference lies in the importance of risk and uncertainty bearing. Entrepreneurial

is precisely to overcome such factor-market imperfections. Lance Davis has observed that this capacity was in fact central to the achievements of some major entrepreneurs in the nineteenth-century United States [13, 1972, p. 137].

needs in the developing countries contrast sharply with the conceptualization that Joseph Schumpeter [72, 1934] and Nicholas Kaldor [36, 1934] proposed in the context of the more-developed economies. Thus, Kaldor considered the "entrepreneurial function" as [36, 1934, pp. 67-68]:

(1) risk—or rather, uncertainty-bearing; or
(2) management. . . . The first of these functions—uncertainty-bearing—can be dismissed offhand, from our point of view. . . . The mere fact that with the rise of joint-stock companies it was possible to spread the bearing of uncertainty over a great number of individuals and to raise capital for an individual firm from far beyond the limits of an individual's own possession, excludes that possibility.

Kaldor's "offhand dismissal" of the importance of uncertainty-bearing may be appropriate for the context that he explicitly considered, a situation of well-developed capital markets. Similarly, Schumpeter also distinguished emphatically between entrepreneurship and risk-bearing [72, 1934, pp. 75, 89]. He, too, however, dealt with an environment with "share-holders," and one in which "the only man the entrepreneur has to convince . . . is the banker who is to finance him." But what if, as in the case of the LDC's, well-developed capital markets do not exist, so that the entrepreneur must be his *own* banker?

Finally, not only are the markets for bearing risk and uncertainty even less complete in less-developed than in more-developed economies, but the absolute amount of uncertainty may be greater because of poorer information and rapid structural change. These considerations suggest that entrepreneurship in the LDC's is likely to involve more than the psychological capacity for perceiving new economic opportunities and entering them with an aggressive investment policy. The special conditions affecting risk and uncertainty, and the need to open new channels for factor mobilization and

product supply are likely to impose additional requirements.

The early postwar concern with lack of entrepreneurship as a special problem for the underdeveloped countries stemmed from such perceptions, which led to the conclusion that the demand for entrepreneurship in economic development would be particularly high. The concern was intensified because, on the supply side, the under-developed countries often appeared to be relatively lethargic, "tradition-bound" societies, whose cultures seemed inimical to innovation and vigorous economic expansion. This approach derived further plausibility from another observation. Per capita income levels in the LDC's were manifestly low; hence these economies must have been experiencing stagnation, or, at best, low rates of economic development in the past. Scarcity of entrepreneurship was among the barriers to development proposed as explanations. Entrepreneurship could indeed be seen as the most crucial scarce input, for it could be cast as the "prime mover" necessary to initiate the development process by mobilizing supply of other "prerequisites."

This view of the development problem was epitomized in Albert Hirschman's focus on the capacity to take development decisions—a concept encompassing political as well as economic entrepreneurship—as the "one basic scarcity," and the starting point for development strategy [31, 1958, pp. 24–28, 73]. Writings by economists, historians, sociologists, and psychologists gave additional force and content to this approach by emphasizing the importance of entrepreneurship for economic development and analyzing the conditions governing its supply. One can readily accept the view that entrepreneurship is essential for economic development. Such an emphasis need not imply, however, that lack of entrepreneurship has constrained the pace of ex-

pansion in most LDC's during the postwar period.

III. *Indications That the Problem Has Been "Solved"*

As is now well known, the experience of the postwar period has not confirmed this view of the underdeveloped countries as condemned to economic stagnation because of lack of entrepreneurship or of other preconditions for development. Most LDC's have demonstrated sustained high rates of real output growth (see TABLE 1). Moreover, the rates of output growth have been highest in manufacturing, the sector where entrepreneurship constraints had been expected to be most severe.³ And in accordance with familiar patterns of income-elasticities and inter-industry relations [42, Simon Kuznets, 1971; 10, Hollis Chenery and Moises Syrquin, 1975], economic growth in the LDC's has involved successive entry into new activities rather than simply a scalar expansion of the economy.⁴

³ The rates of output growth in developing countries are lowered if one makes allowance for the effects of domestic tariff protection to compute the growth rates of value-added at world market prices. For the period 1950–52 to 1964–66, Ian M. D. Little, Tibor Scitovsky, and Maurice Scott have presented estimates of the rates of growth of GDP and of manufacturing output evaluated at world market prices in Argentina, Brazil, Mexico, Pakistan, the Philippines, and Taiwan [49, 1970, p. 75]. The unweighted averages for these countries indicate a correction factor of 94 percent for the rates of growth of GDP computed in constant local-currency prices; and for manufacturing output, 66 percent. Applied to the figures of TABLE 1, these correction coefficients still indicate development performance far greater than might have been expected on the basis of the early writings on the problem of entrepreneurship in underdeveloped countries.

⁴ Growth rates such as those of TABLE 1 have sometimes been dismissed as irrelevant because "the figures prosper while the bottom 40 percent of the population suffers." The impressive rates of development recorded, however, do indicate that lack of entrepreneurship has not operated as an effective constraint on the LDC's during the postwar period. The extent to which entrepreneurship has been at fault in contributing to the conditions of the lower-income population is another question, to which we return below.

TABLE 1
AVERAGE ANNUAL RATES OF GDP AND MANUFACTURING OUTPUT GROWTH IN DEVELOPING AREAS
DURING THE POSTWAR PERIOD
(Percent)

AREA	PERIOD	GDP	MANUFACTURING
Africa ^a	1950-59	4.8	6.9
	1960-73	5.3	7.4
Latin America and Caribbean	1950-59	5.0	6.6
	1960-73	6.0	7.3
Middle East	1950-59	9.0	13.5
	1960-73	8.1	10.6
Asia ^b	1950-59	4.1	7.2
	1960-73	4.7	7.3
All Developing Market Economies	1950-59	4.6	6.9
	1960-73	5.7	7.5

SOURCE: United Nations, *Yearbook of National Income Statistics*, 1967 [83, 1968] and *Yearbook of National Income Statistics*, 1975 [84, 1976].

NOTE: The year 1973 was selected as the end-point for the figures of TABLE 1 because the rise in oil prices created a new structural situation for economic growth in the oil-importing LDC's; resolution of these problems is beyond the scope of microeconomic entrepreneurship.

^aExcluding South Africa

^bExcluding Japan

The experience of rapid economic development and structural change in the developing countries may not, however, be considered conclusive evidence of the absence of entrepreneurial constraints. For it may be suggested that with more entrepreneurship, these economies might have grown at a pace even higher than the 5 to 6 percent annual rates of real GDP increase shown in TABLE 1. However, as Donald McCloskey notes in his analysis of the British economy's performance in the years 1870-1910 (a period often cited for "entrepreneurial failure"), structural conditions such as the growth of factor supply are also important determinants of an economy's rate of output growth [53, 1970]. Following our earlier emphasis on the role of entrepreneurship in increasing factor supply, however, one might discern a problem of entrepreneur-

ship in the failure of LDC's to mobilize inputs at a higher rate, to permit even more rapid growth. Little can be said in response to such a hypothetical conjecture. But it is worth noting that the data compiled by Chenery and Syrquin show that even the LDC's with a per capita income as low as \$100 have raised their aggregate domestic savings ratios above 12 percent of GDP [10, 1975, pp. 200-207]. Thus even these less-developed countries have attained, at least in gross terms, the target for rapid accumulation of capital in underdeveloped countries proposed by W. Arthur Lewis [47, 1955, pp. 225-26].

Policy makers in the LDC's have also displayed diminishing concern about a possible shortage of entrepreneurship in their countries. Enhanced self-confidence about local entrepreneurial capacity is implicit in policies that increasingly screen

foreign-investment proposals and limit multinational corporations to high-technology activities where local entrepreneurs cannot compete. More generally, the policies that governments in many LDC's often impose on entrepreneurs who come from ethnic, communal, or tribal groups other than those of the country's political leaders also indicate an absence of concern with lack of entrepreneurship as a problem for economic development. I refer here to the restrictions, expulsions, and massacres perpetrated against East Asians and Lebanese in various African countries, overseas Chinese ethnic minorities in Asian countries, and entrepreneurial tribes like the Ibos in their own country. Similarly, development strategies in many Third World countries that proclaim a devotion to "building socialism" often have to do less with vertical income redistribution than with restricting the activities of private-sector entrepreneurs. Such policies seem to imply that policy makers believe the supply of entrepreneurship from other indigenous groups is highly elastic. Alternatively (in a point to which we will return below), the problem of entrepreneurship in development has been significantly redefined: the concern in these LDC's is now that some people have performed *too* well as entrepreneurs.

Finally, the perception that lack of entrepreneurship is no longer a serious problem for most current LDC's has also been reflected in the recent professional literature. In the past decade, journal articles and books on the subject have been rare. This is not necessarily an unhealthy development, but does show a receding concern with the subject (this phenomenon has also been noted by David Morawetz [58, 1977, p. 70*n*]). And as another indicator of the subjective disappearance of the problem, recent textbooks in the area of economic development give little atten-

tion to entrepreneurship, either absolutely or in comparison with earlier texts in this field (see, for example, Charles Kindleberger and Bruce Herrick [38, 1977]; Theodore Morgan [62, 1975]; Pan Youtopoulos and Jeffrey Nugent [89, 1976]; and Michael Todaro [82, 1977]).

As discussed below, the general observation that entrepreneurship is not a relevant constraint on the pace of development in most LDC's must be qualified in some respects. Nevertheless, recognition that lack of entrepreneurship had earlier been exaggerated as a problem has permitted a new "image" of the nature of the development problem [8, Kenneth Boulding, 1956]. This perceptual shift has occurred not only because of the actual development experience of the LDC's, but also, following an internal intellectual dynamic, because of new research in two related fields. First, the earlier picture of less-developed economies as characterized by pervasive rigidities has been sharply revised. Research by Edwin Dean [14, 1966], Theodore W. Schultz [71, 1964], Jere Behrman [6, 1968] and others has shown abundant evidence of price responsiveness and microeconomic rationality in the LDC's. Second, revisionist economic history has displaced the entrepreneur from his central role as determinant of a country's economic performance and placed greater emphasis on structural macroeconomic conditions [53, McCloskey, 1970; 54, McCloskey and Lars Sandberg, 1971]. A telling indication of this intellectual shift was the 1968 editorial decision of the journal that had been the central forum and leading proponent of research on the importance of entrepreneurship, *Explorations in Entrepreneurial History*. Reflecting the changed intellectual perspective within the profession, the journal's name was changed to *Explorations in Economic History*. Before we turn to the analytical and policy impli-

cations of the new perspective on current economic development, however, let us consider how the problems of entrepreneurship that had earlier been anticipated have in fact been overcome.⁵

IV. *Overcoming Problems of Entrepreneurship*

Entrepreneurial constraints have been relaxed in the LDC's by a combination of different conditions. First, government tariff, pricing, and resource allocation measures have operated to raise returns and reduce the risk and uncertainty facing potential investors in many new activities. *Ex post*, these policy measures may appear to have eliminated any need for entrepreneurship. *Ex ante*, however, with the uncertainties of possible supply or demand disruptions looming before the nascent activity, the prospects may have looked very different to the aspiring investor [51, Edward Mason, 1967, p. 82]. In addition, public-sector corporations with ample resources have been established in many LDC's to initiate production in activities where private investment (domestic or foreign) was not forthcoming, or was considered politically objectionable. The performance of these public-sector corporations has been mixed; see, *e.g.*, Charles Frank [23, 1971]; and John Sheahan [74, 1976]. But in many cases they have unquestionably had the effect of launching production and generating externalities in activities where entrepreneurship from other sources was unavailable or was politically undesirable.

Further, with expanding demand and

favorable incentives in product markets, the supply of entrepreneurship turned out to be highly elastic even in cultures and societies on which social scientists and other observers had earlier been pessimistic. Thus, field research has disclosed abundant evidence of entrepreneurial behavior in such areas as manufacturing in Pakistan, Nigeria, and Mexico (see, respectively, Gustav Papanek [67, 1967, chap. 2]; Wayne Nafziger [64, 1977], and F. Derossi [15, 1971]. See also the numerous works cited in Derossi [15, 1971, pp. 419–23]). More disaggregated studies have revealed similar behavior in such activities as steel in India [35, William A. Johnson, 1966, chap. 2], capital goods in Brazil [43, Leff, 1968, chap. 2], cocoa in Ghana [28, Reginald H. Green and Stephen Hymer, 1966], and consumer durables in Argentina [12, Thomas Cochran and Ruben Reina, 1962]. Moreover, in addition to entrepreneurship supplied by gifted individuals, entrepreneurial problems in the LDC's have also been eased by the emergence of a new institution, the "Group" (see Harry Strachan [78, 1976], Lawrence White [87, 1974], and N. H. Leff [45, 1978]). Somewhat similar to the Japanese *zaibatsu* and the American conglomerate, the "Group" is a large-scale firm that invests and produces in several product lines that involve vertical integration or other economic and technological complementarities. Much of the private and domestically-owned advanced sector in the LDC's is in fact organized in the Group pattern of industrial organization.

The Groups mobilize capital from wealthy people linked by family or other personal ties; in addition they often possess their own banks and other financial intermediaries. The Groups allocate this capital among their diversified activities in a manner that approximates within the firm the functioning of a capital market [44, Leff, 1976]. The Groups also move other primary inputs as well as intermedi-

⁵ This experience also sheds light on the conditions that determine shifts in the profession's research interests. The major cause of the decline of analytical interest in the entrepreneurship problem seems to have been the change in objective conditions—what Harry Johnson called "the apparent real world" [34, 1977, p. 501]. But the movements cited in related intellectual fields appear to have been important for facilitating changes in perception, the "apparent" in Johnson's phrase.

ate products within their firms to overcome imperfections in the factor and product markets. Finally, the Groups' participation in many different activities increases internal information flows and reduces the uncertainty surrounding investment and production decisions. Thus, quite apart from any special personality traits of the Groups' owner-managers, the Group *structure* performs many of the special functions required for entrepreneurship in underdeveloped economies.⁶

The appearance of the Groups and of entrepreneurs with a marked capacity for innovation and risk-bearing in the LDC's may conflict with standard generalizations concerning managerial preferences for the "quiet life" in the LDC's and, especially, with often-expressed contrasts with the more-developed countries. One of the implications of this research, however, is the need to revise such stereotypes. As just noted, firms in the LDC's have in fact often demonstrated a marked capacity to act in an entrepreneurial manner. And strengthening the revisionist comparative perspective is a study by John Meyer of U. S. firms in the 1950's [56, 1967]. Analyzing balance-sheet data, Meyer found ample evidence of American companies in almost every industry, which "undertake the 'easy life' not out of compulsion but because they simply prefer it" [56, 1967, p. 315].

The emergence of the Groups and of the other responses we have discussed suggests that pessimism about entrepreneurship in the LDC's was caused by a serious identification problem. Absence of

entrepreneurship in earlier periods was generally attributed to deficiencies in the supply of entrepreneurship due to alleged socio-cultural rigidities. In the postwar (and increasingly postcolonial) period, however, structural changes occurred, notably with more buoyant aggregate demand and heightened government support for development. With these new conditions generating a sharp rightward shift in the demand schedule for entrepreneurship, the supply response has been sufficiently elastic to permit the high rates of economic development that we have noted. This supply response has come either directly with authentic entrepreneurs or, indirectly, via the emergence of the Groups and of government policies which, in good Gerschenkronian manner [27, 1968] reduced the demands for entrepreneurship as a rigid "prerequisite" for development.

V. *Continuing Problems*

Although sufficient entrepreneurship has been available in the developing countries to permit high rates of economic growth and investment in new activities, other problems have emerged and have indeed been highlighted by the accomplishments in output expansion.

Thus widespread success has not been achieved in technological entrepreneurship. In the area of industrial technology, LDC firms often find it more economical to import off-the-shelf knowhow via licensing agreements rather than "reinvent the wheel." Because of widespread technological importation and imitation, however, the call for development of new technologies adapted to LDC factor endowments, production scales, and indigenous consumption needs has been a continuing theme in the literature (see David Felix [21, 1977]). Some results have been achieved in "descaling" production techniques and in economic substitution of labor for capital (see, for example, Howard

⁶ As emphasized below, the Group mode of industrial organization can easily give rise to other market distortions. Note, however, that because the Group is a pattern of industrial organization in which ownership and control have not been separated, static and dynamic efficiency losses attributable to shirking and to monitoring or agency costs are also reduced. For analysis of such efficiency losses in the modern corporation, see Michael Jensen and William Meckling [33, 1976]; and Armen Alchian and Harold Demsetz [2, 1972].

Pack's research on Kenyan manufacturing [66, 1976], as well as the earlier studies discussed in Morawetz [57, 1974, pp. 512, 522]). Similarly W. Paul Strassman [79, 1968] recounts successes in adapting process technology to local materials; *e.g.*, using bagasse for paper production. By contrast, attempts at technological innovation by the Indian fertilizer industry were not successful [55, Stephen Merrett, 1972, p. 403]. The general picture has been a failure to achieve major breakthroughs in innovating "appropriate technologies" [18, Richard Eckaus, 1977].

It may be inappropriate, however, to charge LDC firms with entrepreneurial incapacity in this area. The performance of multinational corporations here affords some comparative perspective. Multinational corporations have two important advantages relative to local firms in the development of "appropriate" technologies: greater experience in the management of R&D and a lower cost of capital and discount rate for evaluating the present value of such efforts. Nevertheless, multinational corporations, too, have achieved only marginal successes in developing new technologies appropriate for the LDC's (see, for example, Richard Moxon [63, 1977]; and Samuel Morley and Gordon Smith [60, 1977; 61, 1977]). This experience suggests that conditions other than possible entrepreneurial failure are also relevant. For example, the small stock of complementary basic knowledge available about these environments as a public good raises the costs of developing "appropriate technologies." And, as has often been noted, the inability of private firms to appropriate the full social benefits of innovations [3, Kenneth Arrow, 1962] and the structure of relative prices facing entrepreneurs on the LDC's [88, White, 1978] may mean that the private returns to R&D efforts in this area are in fact low.

Furthermore, the achievements of LDC entrepreneurship in promoting output growth and structural change have them-

selves led to new economic distortions due to market power [51, Mason, 1967]. This familiar phenomenon of successful entrepreneurship creating economic distortions is likely to have consequences that are particularly serious in the LDC's, for two reasons. First, monopoly power exacerbates situations of income distribution that were already highly unequal and thus aggravates social and political tensions. Second, the economic distortions engendered by successful entrepreneurship are especially severe in the LDC's because of the predominance of the Groups in the modern sector and because of the far-reaching government interventionism in these economies.

Thus, government policies designed, *inter alia*, to overcome problems due to incomplete and imperfect markets have themselves often created or reinforced positions of market power. For example, such policies have led to prices for capital and foreign exchange that diverge sharply from social opportunity costs [49, Little *et al.*, 1970] with ensuing losses in allocational efficiency. Similarly, government measures to accelerate industrialization have also distorted relative prices in the product market, particularly as between agriculture and industry [48, Michael Lipton, 1976]. At a more disaggregated level, Jeffrey Nugent's 12-sector programming study of the Greek economy disclosed that the divergences between market and shadow prices were closely related to government allocation policies (and to private monopoly power) [65, 1970, pp. 847-51]. And Joel Bergsman's study of Brazil, Mexico, Pakistan, and the Philippines [7, 1974] showed that restrictive import policies had a large quantitative impact in the creation of *x*-inefficiency and monopoly profits.⁷ More generally, substantial dead-

⁷ For the late 1960's, Bergsman's estimate of the annual magnitude of these effects amounted to some 2.2 percent of GNP in Mexico; 2.6 percent in the Philippines; 5.4 percent in Pakistan; and 6.8 percent in Brazil [7, 1974, p. 419].

weight losses are caused by the LDC bureaucratic structures and incentives, which Anne Krueger [41, 1974] has analyzed as “the rent-seeking society” (see also Nachum Finger [22, 1971]). Thus partly in an effort to counteract market imperfections of the sort that inhibit entrepreneurship, government action has often created new distortions of its own.

The Groups’ success in overcoming problems of entrepreneurship has also led to serious economic distortions. In effect, the Groups have taken factor-market imperfections in the LDC’s and transmuted them into product-market imperfections. In the process, rapid economic growth has occurred, but the Groups have also created a special form of oligopoly capitalism in the developing countries. The Groups’ pattern of vertical integration and multi-activity operations in fact aggravates problems of market power. For, with this structure, they face little of the countervailing power that mitigates product-market distortions in the more-developed economies [26, John Kenneth Galbraith, 1952]. Thus, in input-output notation, in an economy with i supplier activities and j client activities, the countervailing power facing a firm with an oligopoly in one activity may be conceptualized as a function of the market power of the oligopolists in the $(i - 1) (j - 1)$ activities. In the case of a Group operating in $k \leq (i, j)$ activities, however, countervailing power is a function of $(i - k) (j - k)$. Hence, countervailing power declines exponentially with k , the number of activities in which a Group operates. Because of the Groups’ multi-activity operations, market power within individual activities is not reduced by countervailing power, but rather is amplified within the economy.

The economic consequences of this situation are serious, for market power enables the Groups to withhold from other firms and from consumers the pecuniary

external economies that are an important feature of the development process [69, Paul Rosenstein-Rodan, 1943]. More generally, the success of the Groups and of other private-sector individuals in overcoming microeconomic problems of entrepreneurship poses an acute dilemma for government: to permit the entrepreneurs’ unrestricted expansion or to attempt to correct the economic distortions and the associated social imbalances such as widening disparities in the distribution of income.

Such problems are well-known to economic theory, for the topic of entrepreneurship has never fit easily into a framework of competitive market equilibrium (see Robinson [68, 1934]; Kaldor [36, 1934]; but see also Kirzner [39, 1973]). In the development literature, these distortions have sometimes been attributed mainly to an import-substitution pattern of development; and it would be tempting to treat them as endogenous to that particular development strategy. Similar distortions and the associated social tensions have also been noted, however, in countries such as South Korea and Malaysia, which have followed an export-promoting orientation. This observation is in one sense encouraging, for it suggests that entrepreneurs in developing countries may be neutral with respect to specific exchange-rate regimes and development strategies. Thus entrepreneurs in the LDC’s appear to respond to whatever incentives are available and can therefore be used as an instrument for implementing alternative development strategies. At the same time, however, the social and economic problems created by successful entrepreneurship—monopoly profits and widening income disparities—appear to be general to LDC’s and are not limited to the particular case of an import-substitution pattern of development. Note further that the capacity to resolve such social tensions is of more than marginal relevance for economists interested in de-

velopment. As Carlos Díaz-Alejandro has noted, the failure to deal effectively with such problems early in the development process was a major factor in the subsequent economic retardation of a once-promising LDC, pre-Peron Argentina [16, 1970, pp. 55–66, 106–40].

VI. *The Entrepreneurship Problem and Macro Development Patterns*

These externalities of private entrepreneurial performance have effects on economic development that differ sharply in contemporary LDC's from the pattern of the United States during the late nineteenth century. This is because private entrepreneurs in the contemporary LDC's possess little of the social and ideological legitimacy that protected the robber barons in the United States. On the contrary, the ideological and political climate is often markedly against private capitalists; see, for example, Edward Shils [75, 1961] and Yair Aharoni [1, 1977, pp. 167–69].⁸ Further, the practice of utilizing imported technology, noted above, also has important political side-effects. Because of the entrepreneurs' technological dependency, the local intelligentsia tend to regard domestic industrialists as an up-dated version of Paul Baran's comprador puppets of foreign capitalist interests [4, 1957, pp. 194–97]. Consequently, not only are private entrepreneurs denied credit for their achievements in industrial development, but their legitimacy and broader political support are seriously compromised. Finally, hostility toward private-sector entrepreneurs is further exacerbated, as noted earlier, when the entrepreneurs come from ethnic, communal,

⁸ Some additional contrasts with the situation of the U.S. robber barons are the lack of constitutional limitations in the LDC's on government involvement in the economy; and the much greater degree to which power is concentrated in the central government in contemporary LDC's. These conditions extend the scope for the redistribution possibilities of state action against private-sector entrepreneurs.

or tribal groups different from the political leadership.

Under these conditions, government is likely to take strong action to restrict the activities of private entrepreneurs. In its milder forms, such restrictions have taken the form, as in India, of having an Anti-Monopolies Commission curtail private sector investment in certain activities. In some African countries, where much of the entrepreneurial activity takes place in the export agricultural sector, state marketing boards with monopsony power have played a similar restrictive role. In some cases (*e.g.*, some African countries) where income redistribution dominated concern for economic growth, entrepreneurial groups have been expelled, with negative consequences for economic growth (see the analysis of James Tobin [81, 1974]). Even in less drastic cases, however, governmental hostility and political risks may determine a flow of private, domestic entrepreneurship which, in equilibrium, is low.

Investment by state-corporations has also been used as a policy tool in this context. Policy here has not been oriented by the often-cited (and often-justified) rationale for public-sector investment—overcoming capital market deficiencies and sluggishness of private entrepreneurship [74, Sheahan, 1976, pp. 206–10]. Rather the objective has been preemption of domestic private capitalists, to forestall the expansion of the local bourgeoisie's economic base.⁹ The economic impacts of such a strategy at the micro level vary. Creation of state-owned corporations is no guarantee of Schumpeterian entrepre-

⁹ Interpretations of individual cases may of course differ, for it is often difficult to distinguish between the rationale and the effective cause for such measures. Further, in some instances a self-fulfilling prophecy may be involved: government preemption of scarce capital and foreign exchange resources leads to unimpressive investment performance by private entrepreneurs—which is then invoked to justify further state-enterprise expansion.

neurship, of static efficiency, or of attaining broader social goals [74, Sheahan, 1976, pp. 210–27; 1, Aharoni, 1977, pp. 170–71, 245–80]. Such concerns may indeed miss the essence of the story: formation of a dominant “new class” [17, Milovan Djilas, 1958] in nascent regimes of state capitalism. At the macro level, David Morawetz’s survey [59, 1977] indicates undistinguished performance of such regimes with respect both to economic growth and to social objectives.

Further, in light of our earlier discussion, it should not be surprising that governments as different as those of Allende in Chile and Bhutto in Pakistan attempted to expropriate *en bloc* the Groups in their countries. The existence of the Groups as large-scale, coordinated enterprises subject to deeply-felt social and political hostility, indeed, creates a situation potentially ripe for socialization. Thus we observe in many contemporary LDC’s an unanticipated transplant: a constellation of political-economy forces that can lead to a scenario similar to the one that Joseph Schumpeter envisioned for the more-developed countries in his *Capitalism, Socialism, and Democracy* [73, 1942].

Two conditions, however, operate against such a development path in the LDC’s where Groups are well established. The institution of the Group has permitted the expansion of large-scale industry without the separation of ownership from control. Moreover, because of the Group framework, the decline of family participation and interest in the business, which Schumpeter stressed as a motivational precondition facilitating socialization, has not occurred. Because of these conditions, efforts at socializing Group activities must contend with serious resistance, as well as the uncertainties involved in managing the Groups’ operations if they are taken over. Consequently, although pressures for socialization are present in many LDC’s, such a development pattern lead-

ing to state-capitalism dominance is by no means certain.

The actual outcome seems to depend on specific historical and social conditions. Pressures for socialization are mitigated if the Groups are of the same ethnic group as the political elite; or, alternatively, if they have been socially assimilated in a society with a degree of cultural pluralism. Another key variable is the length of time elapsing since the onset of industrialization and urbanization in the LDC. This condition helps determine the size of the middle class, which can be mobilized in support of Group interests. Differences in these conditions appear to explain the disparate evolution toward state-capitalism dominance or toward maintenance of the Groups in, for example, Chile and Brazil, as contrasted with, say Uganda and Tanzania.

Finally, the problems created by entrepreneurial success in the LDC’s have also led to alternative development patterns in countries where private entrepreneurs have persisted. In Brazil, the willingness (under an authoritarian regime) to accord private capitalists a legitimate place in the development process has led to a pattern of fruitful coexistence with state corporations. In Mexico, efforts to deal with social tensions by means of redistributive taxation in the early 1970’s led private entrepreneurs to reduce their investment in the face of political uncertainties; the ensuing economic slowdown blocked the reform measures [77, Leopoldo Solís, 1976]. In Chile, Argentina, and Uruguay, the pattern has been a stalemate between private entrepreneurs and groups seeking to alleviate social imbalances. Endemic political crisis, in turn, has been a major cause of chronic inflation [32, Hirschman, 1963, pp. 161–223]. And economic development has been stunted in the ensuing balance-of-payments difficulties and import constraints. Thus, the problem of entrepreneurship in these countries has not

been “solved,” but has rather been transformed and displaced to the macro level.¹⁰

VII. *Implications for Research on Entrepreneurship and Economic Development*

Questions of political integration such as those just raised may best be treated by political scientists. But our discussion also suggests that important topics remain for economists in future research on entrepreneurship and development.

In view of the importance that public-sector corporations have assumed in supplying entrepreneurship or in substituting for private entrepreneurship, it would be helpful to have a theory of the behavior of such firms in the special conditions of the LDC's. A rare analytical-empirical study in this context is the paper by Richard Funkhouser and Paul MacAvoy, who analyzed and modelled the comparative performance of Indonesian government and private firms that operate in the same activities [25]. Productivity was generally much lower in the public-sector corporations, partly because of their more lavish use of labor inputs. Such behavior may reflect a managerial objective function which, due to political pressures, includes arguments other than profit maximization. More generally, this pattern suggests interesting analogies to the models of “expense preference” behavior of regulated firms in the United States (see, *e.g.*, Franklin Edwards [19, 1977]). Such models may well prove useful for future research in an unexpected context, state corporations in the LDC's.

The behavior of state corporations that

¹⁰ Note that many LDC's have thus arrived at a conflict and trade-off situation, which was implicit in Hirschman's emphasis on a society's “capacity to take development decisions” [31, 1958]—a concept that included political as well as economic entrepreneurship. What has happened is that private entrepreneurs' success in taking economic decisions so exacerbates social dissension that the country's capacity to take political decisions is thereby inhibited.

are monopolists in their activities raises other questions to which only tentative hypotheses can be proposed. Government take-over and operation of *existing* activities seems often to be associated with non-entrepreneurial behavior; the example of the Argentina railways comes readily to mind. By contrast, government entry into new activities that are highly capital-intensive and utilize advanced process-technology may be associated with more entrepreneurial behavior (see Judith Tandler [80, 1968] on electricity and Peter Evans [20, 1977] on petrochemicals in Brazil). The abundant resources that are usually allocated to such state companies, however, and the poor performance of the numerous white elephants in Nkrumah's Ghana preclude any facile generalizations. The need for more research in this area is evident, particularly to clarify the conditions under which the operation of state rather than private domestic enterprises makes an economic difference.

Further, as noted earlier, entrepreneurship in the LDC's involves a special emphasis on risk and uncertainty because of the deficiencies of formal capital markets in those countries. Consequently, this subject is particularly appropriate for study by economists, with their comparative advantage in the analysis of risk and uncertainty. Sociologists and psychologists may be better able to answer such questions as the social conditions and personality traits that affect the capacity for bearing risk and uncertainty. But economists are needed to take account of the economic conditions under which preferences are transformed into actual investment behavior.

For example, most entrepreneurs in the LDC's (including the Groups) have highly-leveraged firms, which must rely heavily on self-finance for capital. Because of their close connections with their own financial intermediaries, they may optimize with high gearing ratios. And with the degree

of leverage determined endogenously, such firms may behave more “entrepreneurially” than would firms with an identical degree of risk aversion in the more-developed countries. Similarly, because of capital-market imperfections, entrepreneurs in the LDC’s lack a continuum of investment opportunities that is smooth in terms of trade-offs between risk and returns. Consequently, they may be forced to corner solutions in which they choose riskier investments than they would, given their degree of risk aversion, if they had the same opportunities available to investors in the more-developed countries. The attention that much earlier research on entrepreneurship has given to psycho-cultural values can hardly substitute for economic analysis of investment behavior.

In addition, as we have seen, institutions such as the Groups can substitute for the personality traits of individual entrepreneurs. Much of the research on entrepreneurship has focused on this latter topic. Our discussion, however, suggests that more attention be given to the possibility that innovations in firm (or market) institutions can reduce the entrepreneurial requirements per unit of innovative decision-making. Such institutional innovations are especially important because they are more easily subject to imitation and to a high rate of diffusion than are pure personality traits. In this perspective, economic theories of the demand and supply of institutional innovations (see, for example, William Silber [76, 1975]) have a central place in future research on entrepreneurship.

Further work by psychologists and other social scientists on the social-psychological conditions leading to entrepreneurship may also yield new scholarly insights. Although I have emphasized the importance of demand conditions, this is not meant to imply that the supply of entrepreneurship is equally elastic in all

countries and cultures.¹¹ In this supply context, an indication that the line of research opened by David McClelland [52, 1961], Everett Hagen [29, 1962], and others was not a dead end comes from an unexpected source: a cross-section aggregate production-function study [24, Katherine Freeman, 1976]. Regressing observations of net national product against observations of labor and electricity inputs (a proxy for capital services) in 21 countries, Freeman obtained statistically significant parameter estimates of the usual magnitudes. She then added to the regression McClelland’s observations of “need achievement” in these countries a generation earlier as an index of the level of entrepreneurial values present in these societies when the labor force was in its formative years. Not only was the entrepreneurship variable highly significant, but its inclusion reduced the variance of the other coefficients and increased the measure of the economy-wide returns to scale [24, 1976, p. 823, Table 2].

In addition, research on the social-psychological conditions that permit entrepreneurial “empire builders” to build firms that also function rationally and productively may also be fruitful (see, for example, Reeve D. Vanneman [83, 1973]). The availability of routinized management techniques for monitoring and managing large-scale organizations, however, may now reduce the needs for special personality configurations in this area. Finally, most studies of entrepreneurship in LDC’s have focused on the manufacturing sector. In view of the importance of risk-bearing, innovation, and expansion in agriculture for economic development,

¹¹ Some observers of Southeast Asia have even discerned a significant correlation between the percentage of overseas Chinese in the local population and economic growth rates in, respectively, Singapore, Malaysia, Thailand, the Philippines, and Indonesia. Familial (as opposed to social or cultural) conditions may, of course, also affect the supply of entrepreneurs. For an analysis in the American context, see Bernard Saracheck [70, 1978].

more work on entrepreneurship in agriculture would be especially welcome. (See, for example, Wayne G. Broehl [9, 1978].)

VIII. *Conclusions*

As this research agenda indicates, major components of the entrepreneurship problem clearly remain important, while new questions have emerged to stimulate future intellectual effort in this field. These analytical interests, however, should not divert attention from an important fact: earlier theoretical concerns that lack of entrepreneurship would prove a serious barrier for economic development have turned out to be much exaggerated. Not only was a serious identification problem overlooked, but the various responses we have discussed permitted the impact of entrepreneurial constraints to be relaxed at the micro and industry level.

In an ideal-type market system, without uncertainty, factor-market imperfections, and externalities, entrepreneurship would not be necessary. These conditions are clearly not satisfied in the LDC's. But government interventionism and the Groups (which internalize uncertainty, information, and factor-market flows) have emerged to substitute both for a perfect market and for pure entrepreneurship. Indeed, the very success of LDC robber barons in dealing with difficulties of entrepreneurship has led to a re-definition of the difficulty: the problem has now become the new economic distortions, social imbalances, and political dissension engendered by successful entrepreneurial performance. As a result of this transformation, Schumpeter's *Capitalism, Socialism and Democracy* [73, 1942] has become more relevant for many current LDC's than the entrepreneurship sections of his *Theory of Economic Development* [72, 1934].

Recognition that public and private responses have largely overcome the origi-

nal problems of entrepreneurship has permitted a new perspective on the nature of the development problem. Most importantly, it has become clear that economic development in most current LDC's can proceed without these countries having to wait for a psycho-cultural transformation that would increase the supply of entrepreneurs. Moreover, taken in conjunction with widespread evidence of price-responsive behavior in the LDC's, relaxation of entrepreneurial constraints implies that these economies are far less "fragmented" and beset by rigidities than had earlier been assumed. Consequently, economic development in most LDC's can be analyzed and promoted with the economist's standard tools (including oligopoly theory for the distortions created by the Groups, and monopoly theory for state enterprises). More exotic perspectives are not needed.

Economists working on the less-developed economies have followed this approach in practice. In omitting specification of entrepreneurship in recent development models, they have in effect treated entrepreneurship as a slack variable. Consequently, it is well to bring the literature up-to-date on the reasons for this radical departure from earlier perspectives.

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