How Does Development Happen?

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This conference would seem to have two purposes. First, we are celebrating the memory of a great economist who was also a personal friend of many of us here—I had the remarkable privilege of having Peter Bauer as a close friend for nearly half a century. Second, we are examining a very central issue in the theory and the practice of development: How does development happen?

Happily—and not of course by accident—a good way of addressing that question is to ask what made Peter Bauer such an exceptional economist. How development happens was indeed one of the questions that engaged Peter profoundly, and in many ways, he devoted a large part of his life to clarifying how that question may be answered.

I start, however, not with Peter Bauer's intellectual contributions, but with his remarkable character, in particular his self-confidence in sticking to his deep skepticism, his courage in being a lonely voice in expressing disagreement with the then intellectual establishment, and also—no less important—his willingness to try to understand and to respond to arguments on the other side. When I first met Peter during my first undergraduate year in Cambridge, England (it was 50 years ago), Peter was recognized as a challenging thinker but often described around the cloisters as being "way out." He certainly found what we may call "the Cambridge consensus" to be basically wrongheaded.

Bauer's Unconventional Views

Peter Bauer was convinced that there was (1) an overemphasis on the limitation of resources in the poorer countries, a limitation he thought could be overcome much more easily than the established

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views tended to assume, (2) an underemphasis on the role of exchange, both in general and domestic trade in particular, and (3) an inadequate recognition of how institutions influenced economic behavior, with profound effects on the economy and the society. It was clear to me—even as a radical student who was on the "left" of the Cambridge consensus and had some other reservations about it—that Peter Bauer stood, through his insights and vision, head and shoulders above all the others who were teaching development economics in Cambridge at that time.

I learned, of course, much from Peter's ideas, both in general and in the field of my own work, particularly from the institutional insights in his earliest book, *The Rubber Industry*, which greatly influenced my Ph.D. thesis on "choice of techniques." But there was also an extraordinarily important lesson that I got from Peter on why one must not be overpowered by what looks like the formidable force of seamless consensus.

Peter was quite unusual in his willingness to give a remarkable amount of time to an unknown undergraduate with very different political persuasions and who—we must not forget—was a student at a different college from his own (the gap between Caius College and Trinity was no less important than the political chasm). My conversations with Peter were educational both in terms of economic understanding and in what they taught me about character and behavior, in particular the importance of not allowing oneself to be overawed by established fashions of thought. But Peter was also insistent that one must remain genuinely willing to listen to arguments on the other side and to respond to them with involvement and patience. Dialectical engagement was very important for Peter, not just for the pleasure it gave him (it was always wonderful to see Peter's face light up when he detected a new argument), but he also had a strong belief that this is exactly how we come to understand better the world in which we live (I shall return to that general issue presently, in the context of considering different ways of thinking about "how development occurs").

Many years later, but still more than 45 years ago, I encountered the chairman of today's session, Jim Buchanan, and had a similar sense of rapid learning. One of the things I learned from Jim is that political democracy is really about arguing, and that this process must not be seen as a meeting of an irresistible force with an immovable object. As Jim Buchanan put it in an article published exactly half a century ago, called "Social Choice, Democracy, and Free Markets" (it was published in the *Journal of Political Economy* in 1954): "The definition of democracy as 'government by discussion' implies that individual values can and do change in the process of decision-making." The constructive role of argument that Jim saw in *democracy* (indeed, that he saw as a central feature of democracy), Peter found in *epistemology*. If democracy is "government by discussion," the knowledge and understanding of the world in which we live—Peter taught us—is, to a great extent, "learning from discussion."

What Have We Learned?

So, what have we learned from discussion about how development happens? What makes the critical difference: resources, institutions, or attitudes? It is not hard to argue that all of them are important. It would be amazing if they were not. Rather, the question is, as Peter would say, what is *overemphasized* in the literature, and what is *understressed*? On what should the "dissent on development" concentrate (to quote the engaging title of an excellent book by Peter)?

Peter himself concentrated greatly on the ongoing underemphasis on institutions and the oversimplifications that followed from it. In particular, he thought that the institutions of the market system and the role of domestic as well as international trade were thoroughly underappreciated. He was a great champion of international trade, even when it used to be viewed with great skepticism by most developmental theorists (and when even the defenders of international trade seemed to be more engaged in identifying contrary cases—in which more trade and more growth caused more misery—rather than in showing the basic rationale of exchange). The mainstream in development economics has largely caught up with Peter Bauer on international trade, even though I personally think—though Peter would most probably not have agreed with me on this—that distributional issues related to trade still receive far less attention than they deserve.

The field in which the lessons from Peter's work continue to be most underappreciated is that of *domestic* trade. Bauer has investigated in a definitive way the general importance of the incentive to produce and consume, even in the most primitive societies. On more specific issues, he showed in his early works the crucial importance of small-scale trade, the significance of capital formation by farmers and traders (often unrecorded in official statistics), and the positive contributions of cash crops (such as rubber, cocoa, and nuts) in promoting exchange and prosperity. In the process, Bauer also clarified the far-reaching economic importance of what is now called the "informal sector."

The Importance of Trade

The importance of domestic trade and its far-reaching influence are still underrecognized. Let me give two examples. First, from 1979 through the late 1980s, the Chinese economic reforms were massively successful in raising incomes, and the engine of that success was, to a great extent, the impact of incentives produced by the so-called responsibility system in Chinese agriculture and the rural economy. Later, however, the focus shifted to a great extent away from domestic trade toward international trade, which, of course, has also been radically productive. Indeed, if China has grown faster than any other country in history, international trade has certainly played a big part in that wonderful achievement. And yet the shift in emphasis from domestic to international trade has also meant a slowing down of the growth of rural income and a deceleration of the reduction of poverty in China. Income inequalities have also jumped as China has focused beyond its borders rather than within them. For example, the Gini coefficient for income inequality in China (as estimated by Ravi Kanbur and Xiaobo Zhang) went up from 0.217 in 1985 to 0.303 in 1999—something of a record-breaking jump.

While this increase in inequality has been seen by many as a subject for "anti-trade" criticism, the right diagnosis surely is to take a leaf from Peter's book, and to focus instead on the importance of the domestic economy and the exchanges that make the poorest a great deal richer—what we may call the "classic Peter Bauer territory." Even as China's participation in global trade has grown dramatically, the emphasis on incentives for production for the domestic market has considerably slackened. As it happens, there is concern in China today also about falling output of food grains, and that too links with the focus of public policy, in which its relative neglect of production for domestic use and within-border trade has played a substantial part—even as China has climbed altogether new heights in international trade.

The second example concerns the importance of microcredit, including the role of new initiatives, such as the Grameen Bank of BRAC in Bangladesh. The unsung hero in the ideas behind this movement is surely Peter Bauer. Through the 1950s to 1970s, Peter's was the lonely voice arguing for the economic role and business responsibility of the poorest people in the world. If the role of microfinance in development is seen today as something of a radical departure (and this it certainly is in terms of institutional development), it must also be seen as being entirely in line with Adam Smith and

Peter Bauer, in its emphasis on the massive promise of domestic trade, based on the responsibility of the resource-poor underdogs of society who can, given supportive institutions, make great use of trade—with dignity, wisdom, and trustworthiness.

Peter Bauer was not only a great champion of trade, he was also a strong defender of *trade for all*—not just for the fortunate few. Peter was not at all an egalitarian in political philosophy. That, in fact, is a considerable understatement (we often argued on that subject), but he was very clear—as Adam Smith had also been—on the constructive role of *shared* opportunities in vastly broadening the domain of fruitful trade. The so-called left-right divide has been epistemologically counterproductive in clouding this issue. Trade is not just what the bankers and industrial magnates seek—it is sought, among other things, by the poorest in the world, in their efforts to make themselves a little less miserable.

Conclusion

The Chinese cultivator, left somewhat behind in the rush for modern industrial prosperity, and the Bangladeshi rural housewife, seeking a foothold in the market economy, have reason to be grateful for Peter's vision and ideas. And so have we all. Peter Bauer has deeply enriched our understanding of economics—and of the world. We have much reason to be grateful to that extraordinary thinker—and wonderful human being.