SELF-HELP, TRADITIONAL INVESTMENT AND FOREIGN ECONOMIC AID

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Introduction

If one cuts beneath the luxuriant underbrush of words and figures on the economic development of underdeveloped countries, he finds that the issues involved largely boil down to the age-old economic problem of making the best use of resources. Another related generalization that may help to put the issues in perspective is this: Every economy that classifies itself as underdeveloped, and most of the world's nation states so regard themselves, is making a poorer use of its resources on the average than it is capable of making in the light of usable, low-cost techniques of production and economic organization. The economic performance of such economies leaves something, often much, to be desired. In the typical case, such an economy actually is capable unaided of effecting substantial improvements in its economic performance both over the short and long run.

Resources made available from the outside are welcome, of course, either as supplements to a feasible local effort or as substitutes for it. This raises a key question: Under what conditions are outside resources likely to supplement, rather than work as a substitute for, an appropriate local effort? I contend that we stand the best chance of avoiding a (wasteful) substitutionary role only if our scarce resources are made available, save in genuine case of emergency, on the basis of the same market-type tests as those which have governed international long-term capital movements in the past.

The above remarks are intended both as a summary of, and introduction to, my position regarding the general problem of underdeveloped areas and America's economic relations with them. Field work abroad, including an advisory role with respect to the development policy of foreign governments, and a study of the relevant literature persuade me that it is in such a general context that we should view the question of foreign aid in relation to the growth and stability of the American economy.

Generalizations About Resource Use

In the profusion of analyses of economic development, perhaps more so than in other areas of economic discourse during recent years, it has been common to find writers and speakers mixing basic and side issues in all manner of combinations. Let me indicate some typical

[1] Statements in this paper do not necessarily reflect the views of the institutions with which the author is affiliated.

side issues. They would include such matters as comparative national economic wellbeing and related discourses on the numerous variants of egalitarianism,[2] the much-exaggerated problem of disguised unemployment,[3] the country distribution of the more valuable manufactured exports in world trade, the largely irrelevant and unmeasurable secular terms of trade,[4] and balance of payments considerations, including that hardy perennial, the so-called dollar problem. These steadfastly must be viewed for what they really are—side issues and thus items which have little or no place in the basic discussion.

What do the underdeveloped countries require in the way of resources from us? In attempting to answer this question we have been writing developmental prescriptions without having completed proper and thoroughgoing diagnoses. The World Bank, to be sure, has pointed up a number of important things. And some independent analysts have likewise done useful work of a limited sort. Still, Americans have failed to take a sufficiently hard look at the basic issue, which is whether the underdeveloped countries have been doing all they can reasonably be expected to do to help themselves both at the individual producer level and in the sphere of government-producer relationships.

American analysts must know a great deal more than they now know about the main technical aspects of the economic performance of the underdeveloped countries. In particular, we need to know a lot, country by country, concerning the effectiveness with which the countries are using their own resources. To this end, I would like to point up some relevant considerations, which will be set forth as generalizations for the sake of brevity. Generalizations, in this as in other contexts, do not, of course, fit all cases. In framing the following interrelated comments, I have sought to throw light on the way resources are used today in a typical underdeveloped nation and to indicate, at least by implication, that which has to be done to improve economic performance. Lest my position be misunderstood, let me add that I do not counsel perfectionism before action is taken in the financing of economic development.

First, we must not lose sight of the fact that the great bulk of the people make a living in agriculture. Let us note that which is usually emphasized in this connection: It is that per capita output is low,

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[2] Numerous difficulties, as yet not sufficiently appreciated by many writers, stem from international comparisons based on the concept of income as conventionally measured. For instance, the much-lamented widening of the inequality of (conventionally measured) income per head as between the underdeveloped countries and the developed ones disregards the benefits stemming from a reduction in the death rate. A reduction in this rate, of course, increases the ratio of productive to unproductive workers in the society, an obviously beneficial change.

Comparisons of income per capita can be seriously misleading in another respect. Improved economic conditions may easily result in the death rate declining more rapidly in the underdeveloped countries where per capita income conventionally measured is less than the median or average for all nations. A discussion in such situations which centers only on the conventional measurement will be quite misleading because it will emphasize the analyst's (statistical) fabrication, namely, widening inequality, rather than the important change—the real economic improvement in the countries in question.

Among recent works, Dr. G. Myrdal's An International Economy is open to a great number of objections of this kind.

[3] The latest writer to make exaggerated statements about this (emotionally charged) issue is R. Nurkse, Reflections on India's Development Plan. Quarterly Journal of Economics, May 1957.

[4] For example, the United Nations Economic Commission for Latin America has published all manner of untenable propositions under this heading which purport to show that the industrial countries owe a large but unspecified debt to the underdeveloped nations. For an exposure of some of the shoddy statistics that have been used by the proponents of the view under discussion, see P. T. Ellsworth, The Terms of Trade Between Primary Producing and Industrial Countries, Inter-American Economic Affairs, summer 1956.

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save in export sectors. Much more important, however, is the feature which usually gets little attention, perhaps because most of the writers know little about underdeveloped agriculture and particularly the fact that most rural areas have only recently emerged from subsistence production: such output is capable of substantial expansion at relatively small cost in terms of scarce resources, especially foreign capital. Everywhere, moreover, agricultural employment can be markedly upgraded, and sometimes it may even be expanded quantitatively, with individual and national gain. The potential for improvement in agriculture is perhaps the most important single generalization that may be made about the problem of underdeveloped economies.

The second generalization closely parallels the first. It is that in most underdeveloped areas typical rural producers labor under at least several serious handicaps, each removable: a deep distrust of local (county) officialdom owing to longstanding abuses of the peasants—for example, the stealing of chickens and pigs; a neglect of long-range livestock improvement at the farm, community and national level, with the result that output is small in relation to scarce feed inputs; a common neglect of the simple techniques of cereal production, especially soil-crop correlations, seed selection, soil drainage, and fertilizer-output relations; poor or nonexistent facilities for procuring production credit; insufficient low-cost storage capacity; the absence of trusted market news services, which handicaps small producers particularly in the marketing season; a host of land-tenure difficulties, chief of which perhaps is the frequent absence of any incentive for the operator to effect improvements on another man's land, so that the economy suffers a significant loss of capital formation.

Third, import requirements for food and fiber frequently are higher than necessary [5] and indigenous capital formation in most sectors of the economy is much smaller than the underlying situation would make possible. Though something like a hen-and-egg sequence is involved, a good case can be made for placing primary responsibility with the rural sector (itself a reflection basically of defective government-producer relations); that is, for the view that rural capital formation lags behind its potential more than is the case in any other sector. The behavior of the rural economy thus leads to the loss of substantial capital to the economy as a whole; in consequence, otherwise attainable economywide cumulative growth goes unrealized. In contrast, other basically agricultural economies which enjoy better intergroup rural economic relations and operate within a close distance of optimum technical levels of production deploy their rural resources with much better effectiveness. Not unexpectedly, they show results that count in terms of impressive rural economic growth and an expanding national market for nascent industry which badly needs local outlets for output derived from plants of economic, rather than subeconomic, size. In this connection, let me emphasize that for the majority of underdeveloped countries the most effective route to industrialization is by way of a vastly strengthened agriculture. In contrast, the direct route, because of the want of econ-

[5] This results in a net loss of resources to the underdeveloped areas in view of the fact that the indicated imports often originate outside such areas.

omywide underpinning and the existence of inappropriate or immature institutions, is almost certain to be characterized by haste and waste. This route will generally involve haste and waste, let me add, no matter how much sophisticated sloganizing is used; for example, in the form of the plea that the United States underwrite what is vaguely referred to as the underdeveloped countries takeoff to self-sustained growth.

There is a fourth important, but I believe overplayed, consideration. It is that basic public-service facilities—such as roads, irrigation projects, vocational education facilities, and agricultural experiment stations—are insufficient and/or poorly distributed in relation to areas of comparatively high potential output. Outside resources should be able to make a sizable contribution in this sector of development, at least in the earlier stages of growth. I return to this matter later on.

Fifth, government-private sector relations usually leave very much to be desired from the critically important standpoint of realizing a maximum activation of latent human and material resources. It is here that we find case after case of ideological considerations overpowering both commonsense and relevant records of achievement among the western countries now classified as "developed." [6] Bad or inadequate government-private sector relations seldom take the same shape in any two underdeveloped countries. But the following may be said to point up the issue: Many governments have seriously encroached upon the private sector, not uncommonly at the expense of neglecting investment and/or maintenance in the area of public-service facilities proper; [7] corruption often takes a high toll, in the economic sense of diverting funds (resources) having high investment potential to extra-legal consumption by the bureaucratic "elite"; industry is overregulated, not infrequently to serve narrow political ends; government-run enterprises often use labor in extremely wasteful ways, thus saddling the economy with such things as burdensome costs and discouraging minimum essential capital maintenance or greatly reducing feasible capital formation in such enterprises; tax policy frequently seeks to absorb such a high proportion of increments to income, especially business income, as to deter or prohibit private investment which (1) gives a higher yield per unit of capital than typical government investment, and (2) is more flexibly attuned than government-run operations to changing market demands and problems of efficiency in resource use; [8] and the protection of property is often so deficient as to require innumerable instances of import-originating, small-scale private capital formation that is without social net advantage, merely to provide minimum physical protection of the sort that is achieved at low resource cost in developed countries through public action; moreover, because of the absence in many underdeveloped nations of

[6] To illustrate just one facet of this matter, a recently deceased United Nations economist—a specialist on the Middle East and adviser to governments—has emphasized in a professional journal that because the Middle East countries have to use organized measures to conserve water resources individual farmers should operate only as employees of the state.

[7] Mr. Black, president of the World Bank, summarized this view at the recent annual meeting of the World Bank and Monetary Fund: "I deplore the decisions of governments which tend to reduce investment in their own legitimate spheres of activity to branch out into fields where private enterprise, domestic or foreign, is willing to do the job."

[8] In a number of instances, however, the tax system is quite regressive. Looked at in isolation, this is a factor favorable to capital formation. Incidentally, our own tax system was regressive during all of the stages of economic growth now included within the vague concept of an underdeveloped economy.

an environment favorable to private property and free enterprise, we find that a sizable amount of capital belonging to the citizens of such countries is invested abroad.

Sixth, tariff and other forms of protection against imports often channel scarce resources either into fields which are inappropriate to the country's basic endowment or prematurely into certain industries which could be developed at a later date either without protection or with small amounts thereof. The result is that the yield of scarce capital is reduced, generally with cumulative adverse consequences for local capital formation.

Foreign Capital: Its Role and the Form in Which It Should Be Provided

Clearly, the contribution required of outside resources is small in relation to the total job. Yet there is an important role to be played by foreign capital. This may be indicated under two headings. First, there are the capital-intensive areas of early-stage development in which foreign capital traditionally has made significant contributions. These are largely confined to the field of public service facilities. Most of the necessary capital has to originate locally, but some well-chosen projects will justify recourse to outside capital. Second, private foreign capital, which has long contributed significantly to the development of many underdeveloped economies, awaits only an appropriate investment climate before it surges ahead increasingly with innumerable, highly catalytic direct investment activities (extractive and industrial) in every corner of the free world.

In fact, there is no reason why existing private and public sources of direct-investment and bona fide loan capital in countries such as the United States cannot supply all the truly necessary outside resources. This is not to say that the maintenance of recent levels of such foreign investment will necessarily suffice, impressive [9] as such investment has been. We should expect a substantial increase in exports of American long-term capital to the underdeveloped countries when and if many of them effect marked improvements in the general areas outlined above. In this connection, too. "nothing succeeds like success."

Why should American policy seek to have outside resources originate exclusively [10] with direct-investment and bona fide loan capital? There are a number of reasons. No other system remotely approaches it in apportioning scarce resources consistently with established principles of resource allocation. It operates in terms of economic tests,[11] not unworkable political ones. It puts a premium on good economic performance in both the private and public sectors of underdeveloped

[9] See, for example, American Private Enterprise, Foreign Economic Development, and the Aid Programs, American Enterprise Association, pp. 1–6, a study prepared for the Special Committee To Study the Foreign Aid Program, U. S. Senate, 1957; and Collado, E. G., and Bennett, J. F., Private Investment and Economic Development, Foreign Affairs, July 1957.

[10] Largely because of its importance in the area of technical education, we probably should continue our bilateral technical assistance program at about existing levels while continually striving to upgrade the quality of the personnel representing the country abroad.

[11] Contrast this with, for example, the M. I. T. group's noneconomic criterion of "absorptive capacity," a wholly unworkable engineering concept. For a critique of this concept, and the alleged "limited capacity" of the underdeveloped countries to absorb foreign capital even on a gift basis, see my "MITAID—Waste, International Bickering and Some Development," Inter-American Economic Affairs, autumn, 1957.

countries as a precondition for winning the use of foreign resources. It minimizes the role of diplomacy in deciding how American resources are to be used abroad, an important consideration when it is remembered that diplomats usually prefer the easy way out that is available to them when they have the power to make or recommend gifts. In favors those forces in the underdeveloped lands who genuinely believe in the efficacy and flexibility of a strong private enterprise approach to economic growth.

Contrast this position with the views of people who favor very large grant-aid and grant-like "soft" loans for development, with emphasis on government-to-government relations and an indifference to socialistic development policy in underdeveloped lands. Perhaps the best illustration of the opposing view is that of the Center for International Studies of M. I. T. In a report submitted to the Special Senate Committee To Study the Foreign Aid Program, the M. I. T. writers urged that very large grant and other aid be given a country without strings attached whenever it was found to be making what is vaguely referred to as an "additional national effort" toward economic development. The looseness of, and dangers inherent in, such an arrangement are well revealed by the M. I. T. procedures for determining whether an additional national effort is being made. Only two rules of thumb are prescribed. First, the Government must "launch measures to capture a good fraction of increases in income for the purposes of further investment"; and second, the "country's leaders [must] have worked out an overall development program."[12]

It is a revealing commentary on this type of thinking to note that the United States could never have qualified as a country making an "additional national effort" according to these criteria. Significantly, the only nations that satisfy the M. I. T. tests in full are the Communist countries, all of which, as their long-suffering consumers will attest, employ stern measures "to capture a good fraction of increases in income for the purpose of further investment" and ruthlessly pursue "overall development programs."

Clearly, there are right and wrong ways of assisting other countries in their economic development. The last thing we should do is to encourage them—by providing easy access to our Treasury—to accept some of the central features of the Communist ideology in the guise of "development imperatives." Yet we should be doing pretty close to that if we liberally assisted nations which take the ideological position that they must exercise comprehensive control and direction of the economic life of their citizens.

The upshot of this discussion is that foreign economic aid should not be regarded as a policy variable with respect to governmental actions having to do with the growth and stability of the American economy. Rather, such aid should be terminated as soon as feasible. We have better tools with which to work, even if foreign government officials long accustomed to receiving economic aid publicly deny this in the hope of keeping "costless" resources within their grasp. The United States has the capital and, more importantly, thoroughly tested institutions and mechanisms capable of being adapted to foreign re-

[12] The Objectives of United States Economic Assistance Programs, committee print, 1957, pp. 57, 58. I have dealt critically with the MIT study in my "MITAID * * *," op. cit.

quirements with which to assist the economic growth of friendly countries on mutually satisfactory bases. We should proudly put our case in such terms. In doing so, we should be ever mindful of the truly great fact that it is our type of system rather than the collectivist brand which, as the long record of human experience shows, yields both efficient growth and economic and political freedom.