COMMITTEE PRINT

[...]E ROLE OF FOREIGN AID IN THE DEVELOPMENT OF OTHER COUNTRIES

A STUDY

PREPARED AT THE REQUEST OF THE

SPECIAL COMMITTEE
TO STUDY THE FOREIGN AID PROGRAM
UNITED STATES SENATE

BY

THE RESEARCH CENTER IN ECONOMIC DEVELOPMENT
AND CULTURAL CHANGE
OF THE
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PREFACE

By Senator Theodore Francis Green, Chairman, Special Committee to Study the Foreign Aid Program

Since 1948 the United States has appropriated in excess of $50 billion for foreign aid. During the 10-year period since the inception of the Marshall plan, however, the relationships among the nations of the world have undergone substantial change and the scope and nature of United States aid programs have frequently been altered.

Although there has been a gradual decrease in the sums appropriated over these years, there has been a gradual increase in the opposition to these programs. This increased opposition is evident in the votes in the Senate.

In 1948 there were seven votes against final passage of the Marshall plan. In 1956 there were 30 votes against final passage of the mutual security appropriation bill, equally divided between the 2 parties.

There is serious cause for concern when foreign policy programs of the size and impact of the annual mutual security acts do not command the support of more than two-thirds of the Senate. It would seem that such programs if they are to be successful in promoting the national interest should be of a kind to enlist wider congressional and public support. One of the reasons for the constitutional requirement of a two-thirds majority for consent to ratification of treaties is that the Nation when it speaks in foreign policy should speak with a strong, united voice. Foreign aid programs cannot achieve their full potential unless they draw support from the American people.

The trend of increasing opposition to these programs would seem to indicate either that their purposes have not been clearly understood or that there is a growing belief that they have in some way failed to serve the national interest. In either event, the trend must be reversed either by clarifying the relationship between the programs and the national interest or by changing the programs so that they may more clearly serve the national interest.

It was as a result of considerations of this kind that the Senate on July 11, 1956, passed Senate Resolution 285, creating the Special Committee to Study the Foreign Aid Program. The Senate instructed this special committee to make—

> exhaustive studies of the extent to which foreign assistance by the United States Government serves, can be made to serve, or does not serve, the national interest, to the end that such studies and recommendations based thereon may be available to the Senate in considering foreign aid policies for the future.

The special committee is composed of all member of the Committee on Foreign Relations and the chairman and ranking minority member of the Senate Committee on Appropriations and the Senate Committee on Armed Services.

Without limiting the scope of its inquiry, the special committee was instructed to direct its attention to the following matters:

> SEC. 3. The committee shall, without limiting the scope of the study hereby authorized, direct its attention to the following matters:
>
> (a) The proper objectives of foreign aid programs and the criteria which can be used to measure accomplishment.
>
> (b) The capability of the United States to extend aid, in terms of the Nation's economic, technical, personnel, and other resources.
>
> (c) The need and willingness of foreign countries to receive aid, and their capacity to make effective use thereof.
>
> (d) The various kinds of foreign aid and alternatives thereto as well as the methods by which and conditions on which aid might be furnished.
>
> (e) The related actions which should be taken to make foreign aid effective in achieving national objectives.

In the conduct of its study the committee was instructed to make—

> full use * * * of the experience, knowledge, and advice of private organizations, schools, institutions, and individuals.

It was authorized to enter contracts for this purpose and not to exceed $300,000 was made available to meet the expenses of the committee.

Since the special committee was instructed to transmit the results of its study to the Senate not later than January 31, 1957, and in view of the shortness of time available for its work, a small executive committee was constituted to supervise the detailed research work for the full committee. The executive committee upon instructions from the full committee outlined a series of research and analysis projects to be undertaken by private institutions in the United States.

The executive committee has concluded the following contracts covering 11 major research projects:

Project No. 1—Military assistance:

- Part A: The Policy: *Contractor*—The Institute for War and Peace Studies of Columbia University, New York City.
- Part B: The Program: *Contractor*—Systems Analysis Corporation, Washington, D. C.
- Part C: Military Review and Evaluation.

Project No. 2—The Objectives of United States Economic Assistance Programs: *Contractor*—The Center for International Studies of the Massachusetts Institute of Technology, Cambridge, Massachusetts.

Project No. 3—Foreign Assistance Activities of the Communist Bloc and Their Implications for the United States: *Contractor*—Council for Economic and Industry Research, Washington, D. C.

Project No. 4—American Private Enterprise, Foreign Economic Development, and the Aid Programs: *Contractor*—The American Enterprise Association, Inc., Washington, D. C.

Project No. 5—The Use of Private Contractors in Foreign Aid Programs: *Contractor*—Jerome Jacobson Associates, Washington, D. C.

Project No. 6—The Role of Foreign Aid in the Development of Other Countries: *Contractor*—The Research Center in Economic Development and Cultural Chance of the University of Chicago.

Project No. 7—The Foreign Aid Programs and the United States Economy: *Contractor*—The National Planning Association, Washington, D. C.

Project No. 8—Agricultural Surplus Disposal and Foreign Aid: *Contractor*—The National Planning Association, Washington, D. C.

Project No. 9—Foreign Aid Activities of Other Free Nations: *Contractor*—Stuart Rice Associates, Washington, D. C.

Project No. 10—Personnel For Foreign Assistance Programs: *Contractor*—Louis J. Kroeger & Associates, San Francisco.

Project No. 11—The Administrative Aspects of United States Foreign Assistance Programs: *Contractor*—The Brookings Institution, Washington, D. C.

The committee has also made arrangements with the following ten individuals to conduct "on the spot" surveys of foreign aid programs in different geographic regions of the world as follows:

1. Former Ambassador Norman Armour: *Countries*—Greece, Turkey, and Iran.
2. Mr. Hamilton Fish Armstrong, editor of Foreign Affairs: *Countries*—Lebanon, Iraq, and Jordan.
3. Former Ambassador David K. E. Bruce: *Countries*—Peru, Chile, Argentina, Uruguay, and Brazil.
4. Former Ambassador Jefferson Caffery: *Countries*—Portugal, Spain, France, and England.
5. Dr. John A. Hannah, president, Michigan State University: *Countries*—Korea, Japan, Okinawa, Formosa, and the Philippines.
6. Mr. William Randolph Hearst, Jr., president, Hearst Consolidated Publications, Inc., and editor in chief of Hearst Newspapers: *Countries*—Norway, Denmark, and Western Germany.
7. Mr. Clement Johnston, chairman of the board of the United States Chamber of Commerce: *Countries*—Burma, Thailand, Cambodia, Indonesia, Laos, and Vietnam.
8. Dr. Lewis Webster Jones, president, Rutgers University: *Countries*—Pakistan, India, Afghanistan, and Ceylon.
9. Mr. James Minotto, former MSA Chief in Portugal: *Countries*—Cuba, Haiti, Dominican Republic, Venezuela, Panama, Costa Rica, Nicaragua, Honduras, El Salvador, Guatemala, and Mexico.
10. Mr. Allan B. Kline, former president, American Farm Bureau Federation: *Country*—Yugoslavia.

Each of these contractors and individuals will submit a report to the committee.

This study of The Role of Foreign Aid in the Development of Other Countries was the third to be submitted to the special committee. It was designed to help the committee find answers to subjects covered in an outline prepared by the committee staff. A copy of the outline appears in the appendix. (See p. 87.)

The study was prepared for the committee by the Research Center in Economic Development and Cultural Change of the University of Chicago under the direction of Dr. Bert F. Hoselitz.

I anticipate that the special committee may wish to make this study the subject of a public hearing. In that way it would be possible for committee members to test the soundness of the suggestions and recommendations included in the study, prior to the committee reaching its own conclusions, and submitting its recommendations to the Senate.

This report has been printed for the use of the Special Committee to Study the Foreign Aid Program, and does not necessarily reflect the views of the committee or of any of its members.

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LETTER OF TRANSMITTAL

The University of Chicago, Research Center in
Economic Development and Cultural Change,
Chicago, Illinois, December 14, 1956

THE CHAIRMAN,
Special Committee To Study the Foreign Aid Program,
United States Senate, Washington, D. C.

DEAR MR. CHAIRMAN: With reference to the contract between the Special Committee to Study the Foreign Aid Program of the United States Senate and the Research Center in Economic Development and Cultural Change at the University of Chicago, I have the pleasure of submitting to you the report this research center produced.

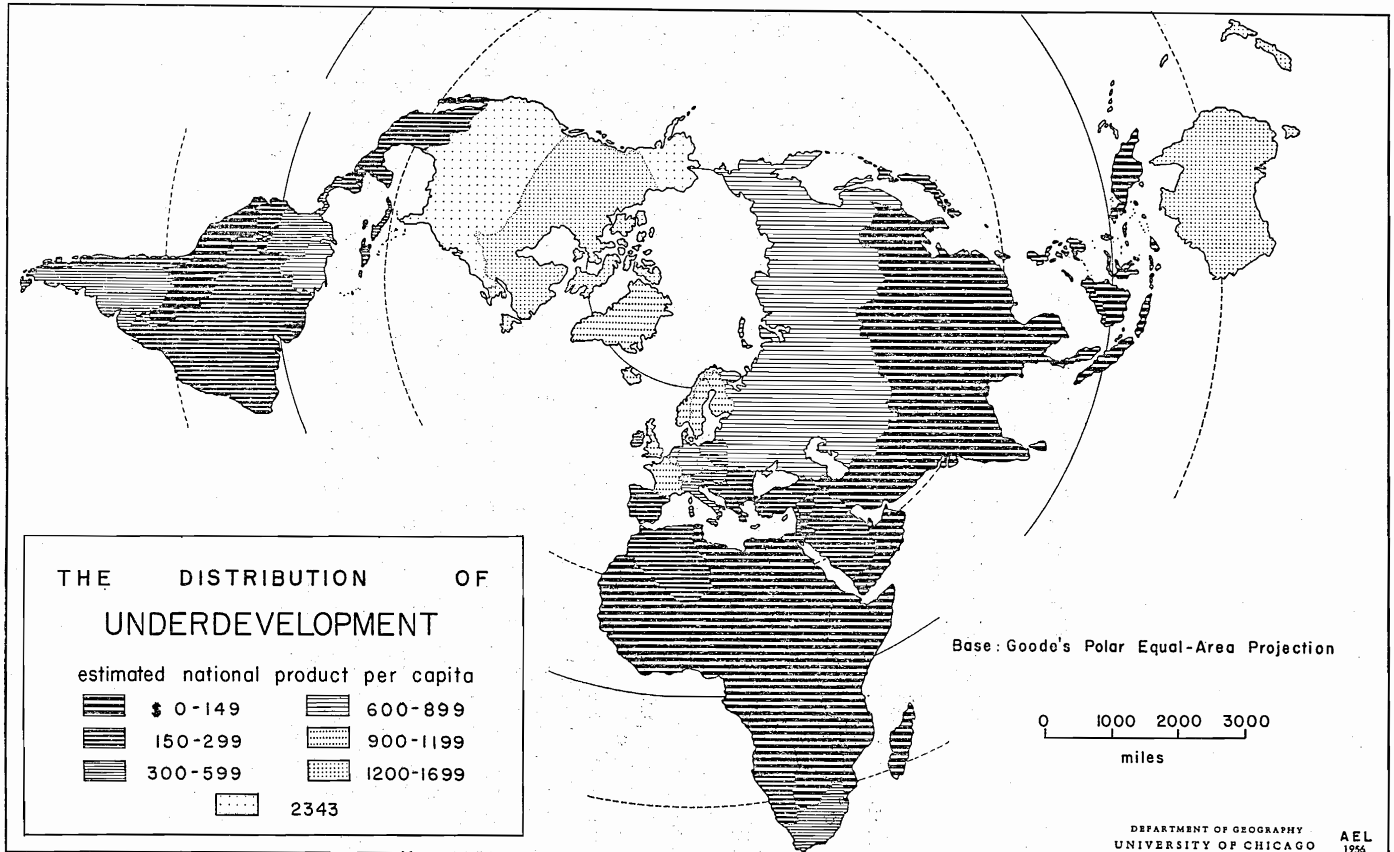
In the preparation of the study the following personnel of the research center have collaborated: Dr. Bert F. Hoselitz, professor of social sciences in the division of social sciences, director of the research center; Dr. Lionel J. Lerner, research associate of the research center; and Mr. Robert S. Merrill, research associate of the research center.

In preparing this report, the authors have drawn exclusively upon published sources, and there is no portion of this study in which restricted information of any kind has been used.

I should like to repeat that we considered it a special privilege to be selected to do this report for the special committee, and we hope that it will meet with your approval. I shall be ready to come to Washington at any time desired by you in order to testify before the special committee in connection with the enclosed report.

Very truly yours,

BERT F. HOSELITZ, *Director.*


THE DISTRIBUTION OF
UNDERDEVELOPMENT
estimated national product per capita
$ 0-149
150-299
300-599
600-899
900-1199
1200-1699
2343
Base: Goode's Polar Equal-Area Projection
0 1000 2000 3000
miles
DEPARTMENT OF GEOGRAPHY
UNIVERSITY OF CHICAGO
AEL
1956

THE ROLE OF FOREIGN AID IN THE DEVELOPMENT OF OTHER COUNTRIES

SUMMARY

1. The degree of economic development of the countries of the world is measured customarily by means of their per capita annual gross national product. Countries with a per capita gross national product above $750 may be regarded as fairly advanced; countries with a per capita gross national product below $300 are those most in need of economic development. Those with a per capita gross national product between $750 and $300 are in an intermediate stage. The countries of North America, Oceania, and Western Europe fall in the first category; most of the countries in Asia, Africa, and Latin America in the second. The Soviet Union and a few scattered countries in Central and Eastern Europe and elsewhere fall in the third category.

2. Among the characteristics of underdeveloped countries is not only a comparatively low level of economic welfare, but also a preponderance of the labor force in agriculture and a low level of capital formation. These countries have fallen behind in their economic performance because the quality of the human resources employed in production and the quantity and kind of capital they use are far below those employed in the advanced countries.

3. The major problem of economic growth for the underdeveloped countries consists, therefore, in their being placed in a position of improving the quality of their human resources and the quantity of capital, especially "social overhead" capital.

4. Most underdeveloped countries are unable to mobilize a sufficient amount of funds of their own to carry through a successful process of rapid economic development. Although they are able to prevent an actual decline in living levels, their aspirations have been aroused to the extent that a significant improvement of living standards has become an important objective of their policy.

5. In attempting to meet this objective, many countries in Asia and Africa rely upon governmental action and guidance. These governments are aware of the economic progress which has been made in the Soviet Union during the last 25 years, and are impressed by the Soviet record. Although they are not committed to join the Soviet camp, they would be ready to adopt coercive totalitarian policies for economic development as a last way out.

6. These tendencies are enhanced in some underdeveloped countries because of the social dislocations that have been initiated by the beginning modernization and westernization of their societies. Many of the Western-educated intellectuals form a newly rising group which finds in the anticolonial, nationalist sentiments and in the aspirations for economic advancement of these countries a sphere of action in which they may attain or preserve positions of power. These middle-class intellectuals provide the leadership in many political and social

movements, and their attitude with respect to totalitarian methods, though as yet by no means firm, is not unfriendly to the use of violence if it seems to be the most effective means of social action.

7. In this situation of instability and lack of commitment, it is possible to satisfy the aspirations of many elements in underdeveloped countries by providing them with assistance from abroad by aiding in the process of capital formation and the improvement of the quality of their human resources. The major aspects of such an aid program would consist in the continuation of the present programs of technical cooperation and developmental assistance on a considerably larger scale.

8. The general support for an American policy of extended foreign economic aid for development is based on the following propositions:

That the United States is a country of vast and increasing wealth, and is able to transfer substantial amounts of resources to foreign countries not only without sacrifice to domestic living standards, but even with continuously rising living standards at home;

That American economic assistance to other countries, if it is sustained and on a sizable scale, can lead to economic growth of substantial proportions in all or most underdeveloped countries;

That the extension of American economic assistance and the resulting economic growth will lead to politically more stable and mature societies in the underdeveloped countries;

That successful economic development, contingent upon American aid, of a substantial number of underdeveloped countries, chiefly in Asia, is likely to lead to a decrease in political tension in the world at large by substantially reducing the chance of Soviet political successes in that area;

That American economic aid, supporting the self-devised development plans of underdeveloped countries, is capable of demonstrating that over a period of 15 to 20 years the underdeveloped countries are able to meet and progressively resolve their internal problems without resort to totalitarian measures; and

That the ultimate result of this process is a likely strengthening of democratic forces in the underdeveloped countries and that the establishment of more stable political relations in them, coupled with their nationalistic aims, directed toward the strictest maintenance of political independence, will leave open to the countries in the Soviet orbit only one rational choice: a negotiated settlement with strong built-in safeguards against international violence.

9. In supplementation of this objective, it is necessary that the United States engage in a sustained and extended program of economic aid to underdeveloped countries. All countries outside the Soviet orbit should be included in this aid program, even those that are not military allies of the United States; and American aid should under no circumstances be used as a reward for military alliances with the United States. Moreover, since economic aid is of maximum benefit if it is sustained over a period of time, some suitable measures should be taken to insure that it can be extended on a sustained, long-run basis.

10. It is estimated that economic aid to the strategically located countries in Asia, the Middle East, and Africa, if provided on a basis large enough to achieve the objectives envisaged in this report, and yet to be absorbed suitably by the economies of the aid-receiving countries, would run at a minimum of \$2 billion per year in the early years, but that this amount may have to be raised to approximately \$3 billion annually, that it might rise to a minimum of \$5 billion annually at a later stage, and that it would decline after that, as the aid-receiving countries become progressively more able to sustain their own economic development out of their own resources and savings.

CHAPTER I

THE STATE OF ECONOMIC DEVELOPMENT IN THE WORLD

A. MEASURES OF ECONOMIC DEVELOPMENT

An analysis of the impact and potentialities of foreign aid in the underdeveloped countries requires some insight into the present state of economic development in the various regions of the world. Considerable effort has been devoted to finding some adequate simple measure which would indicate the overall level of economic development of a country or region, but social scientists are by no means unanimous on what this measure should be, nor whether any adequate measure of this kind is available now or could ever be made available. Nevertheless, it has become customary to regard per capita (or average) national income or gross national product as a measure.

Per capita gross national product has several advantages as a measure. It embraces all kinds of economic activity and hence is a comprehensive index. In addition it is a rough measure of material welfare, unless the distribution of income and wealth in different countries is very different. Finally, it seems to be rather well correlated with a series of other nonmonetary indicators of material welfare. For example, if we rank countries in terms of their average gross national product and compare that with a list of countries ranked by some index composed of such items as food consumption; consumption of textiles; availability of doctors, hospitals, and other facilities for health; the proportion of literate persons; and other nonmonetary indicators of material welfare, we obtain a closely parallel ranking of countries.

The greatest danger in using per capita gross national product as a measure of the level of economic development of a country is to take its absolute value as fully indicative of the spread in actual economic performance between the countries which are compared. In general, the data for gross national product in poorer countries are undervaluations. Since national income or gross national product is usually expressed in terms of money, many goods and services produced in underdeveloped countries which are not sold for money but directly consumed by the family unit that produced them fail to be counted altogether, or are counted only at less than full valuation. Moreover, in reckoning the money equivalent of commodities which are consumed by the same unit which produces them, much processing activity that would be included in estimates of the gross national product of richer countries is necessarily omitted because of the lack of adequate data, or simply because it is impossible to estimate the value of these processing activities. There are numerous other reasons why the actual differences in per capita gross national product give less than a fully accurate picture. A further source of inaccuracy is the need to convert all national prices into a common currency, when the actual purchasing power of a national currency in domestic markets may not fully correspond to its foreign exchange rate. Finally, it is difficult to estimate the value of many commodities which are sold daily in different markets at different prices, depending upon the general state of supply and demand, the shrewdness of the bargainers, or the particular local conditions under which a commodity is traded.

Table I of the appendix contains a list of per capita gross national product for 1954 and 1955 in a number of countries. As can be seen from that list, the spread is enormous. In the United States, per capita gross national product in 1955 was $2,343, in Japan it was only $240, and in India only $72. This does not mean that the average person in the United States is roughly 10 times better off than the average Japanese and roughly 30 times better off than the average Indian. Nor does it mean that the average Japanese fared as badly as would an American with an annual income of $240, or the average Indian as an American with an income of $72. If we compare food intake, for example, we find that whereas the American, on the average, consumed 3,090 calories per day in 1955, the average Japanese consumed 2,180 calories, and the average Indian 2,004 calories. But the differences are greater if we compare the kinds of food the American, the Japanese, and the Indian consumed, and if we compare the many other items which are common household objects in the United States but quite beyond the reach of all but the wealthiest Japanese or Indians. Some comparisons between countries in terms of nonmonetary measures are contained in table 3 of appendix II.

Thus the value of the per capita gross national product figures does not lie in the absolute magnitudes they display, but rather in the rough general ranking of countries they indicate. Thus we find that in the United States average gross national product was $2,343 in 1955; in many Western European countries, it was around $1,000; and in some of the more prosperous Latin American countries it stood around $300 to $500 per year. In most Asian and African countries annual average gross national product was, however, less than $250 in 1955. In general, we may say that a country with an economic performance so low as to yield less than $250 per person on the average makes much less than optimal use of its human and nonhuman resources and is probably capable of improving its economic performance if the proper steps are taken. A country with so low an average gross national product must be regarded as poor, even if a fortunate minority of its citizens may be owners of great wealth. Such poor countries are almost invariably economically underdeveloped countries. The only poor countries which cannot properly be regarded as underdeveloped are those which lie in such inhospitable climatic regions that, with our present technical knowledge, it is impossible to make them productive. Only icebound regions beyond the Arctic Circle, countries in the northern tundra, and in desert regions fall into this group. In contrast to these scarcely habitable countries, the underdeveloped countries are usually quite densely populated and the impact of poverty is experienced by a large number of persons.

If we combine the per capita gross national product, data of table I of the appendix into regional averages, we obtain the following rough data for average gross national product for 1955 (more detailed data may be found in table 2 of Appendix I):

United States and Canada	$2,300
Oceania	1,050
Western Europe (OEEC countries)	750
Latin America	275
Near East	200
Africa	110
Far East and south Asia (except China)	100
U. S. S. R. and European satellites	600
Mainland China	55

From this rough regional calculation we may draw the conclusion that the United States, Canada, Australia, and the more highly industrialized countries of Western Europe are in the class of economically developed countries; that the Soviet Union and its European satellites, as well as some of the less highly industrialized countries of Western Europe and 2 or 3 economically leading countries of Latin America and the Middle East (Venezuela, Uruguay, Israel, and 1 or 2 others) are in an intermediate position; and that the remaining countries, i. e., all of Asia, Africa, the Near East, and the bulk of Latin America, fall into the class of economically underdeveloped countries. In terms of population figures, this means that only some 800 million, or somewhat less than 30 percent, of the almost 2,700 million persons who make up the population of the world live in countries which have overcome economic backwardness.

B. CAPITAL FORMATION AND THE LEVEL OF ECONOMIC DEVELOPMENT

Differences in the level of average gross national product provide only a rough measure of the overall degree of economic advancement of a population. Fuller examination requires answers to several further questions. Among the problems that appear to be most important is the question of whether differences in already achieved levels of economic development determine in some way the capacity of an economy to grow further. A simple and unambiguous answer to this question is not possible. On the one hand, it appears to be true that the economically most advanced countries have shown in the past the greatest capacity to grow, and that, in this way, the gap between rich and poor countries, on the whole, has widened. At the same time there are on record several cases of countries which, coming from behind, have outdistanced those that have been economically more advanced.

In general, we may say that a country can experience genuine economic growth only if it can add a certain amount annually to its productive capacity, i. e., only if it can save and invest a portion of its gross national product which is larger than the depreciation, depletion, and obsolescence of its existing capital, and which furthermore equips each worker with a larger quantity of capital than in the preceding period. If we assume a society in which population is steadily growing, some addition to the capital stock of the society must be made to provide tools and equipment for the growing labor force. If this provision is not made, the new entrants in the labor force will become openly or disguisedly unemployed, a phenomenon about which we will have more to say later. For the total output of an economy to grow by

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1 percent per year, capital investment of approximately 3 or 4 times this amount must be made. Thus, if we assume that the annual rate of depreciation and depletion is about 3 percent of the gross national product, and that a population growth rate of roughly 1 percent necessitates "demographic" investment of another 3 to 4 percent of the gross national product, then average gross national product is not going to increase unless a society can invest at least 6 percent of its gross national product annually. And if population grows at a faster rate than 1 percent per year, the share of the gross national product which must be invested to maintain existing standards of living must increase correspondingly. In fact an economy can break out of the vicious circle of poverty and underdevelopment only if it succeeds in allocating a minimum of 15 percent of its gross national product for capital investment. This requires a tremendous effort, and very few underdeveloped countries actually have achieved such a high rate of investment for any but very brief periods.

However, we can see what an important role foreign aid may play in helping a country's economic growth, even if it is not granted in very large amounts. This can be exhibited by an example. The current gross national product of Pakistan is approximately $4,500 million. Its annual rate of population growth is slightly over 1 percent. Hence, if Pakistan can save out of its own resources approximately $300 million annually, it can maintain the current level of living of its population, which is admittedly very low. Capital funds which it received in addition to this could then be applied to increasing available capital, and any such funds—whether private investments by foreigners or aid granted by foreign governments or international agencies—would form a basis for raising living standards in Pakistan. It goes without saying that the larger the amount of capital imported, the faster will be the rate of capital accumulation, and hence the rate of economic growth. Thus foreign aid (of certain kinds, which will be discussed below) may exert, in some instances, a strategic effect upon a country's potentiality for growth. Of course, if, and to the extent to which, the people of Pakistan are unable to save 6 to 7 percent of the gross national product of $4,500 million, foreign aid will help not in increasing the level of material wefare in the country, but in maintaining it at the present level.

In table 4 of appendix III are contained the ratios of capital formation to the gross national product in selected couutries. It will be observed from this list that the underdeveloped countries show, on the whole, lower rates of capital formation than the economically more advanced ones, although there are some exceptions. We can confidently say that countries in which gross capital formation is less than 5 or 6 percent of gross national product are definitely stagnating, that countries where this ratio amounts to around 10 to 12 percent of the gross national product are maintaining their present levels of living, and only in countries in which the ratio exceeds 10 or 12 percent of the gross national product is there a real expectation of economic development and rising levels of material welfare.

C. LEVELS OF ECONOMIC DEVELOPMENT AND OCCUPATIONAL DISTRIBUTION

There are, of course, good reasons why countries with a low level of economic development show, on the whole, lower rates of capital formation than advanced countries. Not only do these countries produce with a less efficient technology, but also they are primarily agricultural and often largely dependent upon subsistence agriculture. There is no inherent reason why agriculture should be less productive than industry, and indeed, in an advanced country like the United States, farming is as efficient and economical an occupation as industry, commerce, or other service trades. But subsistence agriculture, characterized by very low capital intensity and very high labor intensity, often yields only little more to a farm family than the absolute necessities of life. Hence there is very little that can be saved. Nevertheless, one should not underestimate the amount of savings that can be extracted even from the poor subsistence farmers of underdeveloped countries. It has been the function of the governmental tax collector, and in his absence of the rural moneylender or the landlord, to collect in the form of rent or interest those amounts that a farm family managed to spare from consumption. But the landlord or the rural moneylender has usually been content to spend what he collected on consumption and has not reinvested it in improvements of the land or in other forms of productive activity. As long as these patterns of forced saving and conspicuous consumption continue, the poverty of the subsistence farmer is merely a prop for the more comfortable life of the landlord or moneylender and does not have its counterpart in the accumulation of productive capital. This is one of the reasons why land reform programs are so popular and find such wide support. But it should be noted that an indiscriminate program of land distribution may not lead to higher capital investment either, although it may lead to a changed and more equitable distribution of income.

In general, the growth of industry is an important factor in improving the rate of savings of an economy. It would lead too far to discuss in detail the social and ideological conditions which tend to produce a higher rate of savings in an industrialized society than in an agricultural society. But it was the common experience of European countries which already had rapid economic development that businessmen and industrialists tended to build up capital, whereas landlords—except for the relatively few "improving landlords"—tended to engage in conspicuous consumption. Once industrialization and urbanization takes hold of a country, the rural population—peasants as well as landlords—tends to adopt some of the values and behavior patterns, together with some of the technology and forms of economic organization, of industry and to begin to accumulate capital on a relatively sizable scale.

There is yet another reason why the rate of savings is higher in industry than in agriculture, especially in underdeveloped countries. In view of the predominance of subsistence agriculture and the small scale of individual peasant holdings, agriculture has a low productivity. Industry, on the other hand, usually employs modern imported machinery and uses some of the most advanced methods of production. Hence the yield per person employed in industry is considerably higher than the yield per person in agriculture. This means that industrial wages may be higher and may enable a working class family to save with somewhat less of a sacrifice of the necessities of life than a peasant family. At the same time, since capital is applied in more concentrated lumps in industry than in agriculture, the accrual of interest to the owners of the capital and of profit to the entrepreneurs constitute rather large funds out of which further capital investment can be made.

For these reasons we usually find that countries with a relatively larger proportion of the labor force in industry also can save a higher proportion of their gross national product, and that countries which are the wealthiest and economically most advanced usually have only a small proportion of the population in agriculture. This has led to the theory that economic development invariably is associated with industrialization. Without entering into the merits of this theory—which appears to be supported fairly well by historical facts—we may say that, in general, an underdeveloped country has a very large proportion of its labor force in agriculture or associated occupations. In Asia, Africa, and the Near East, the 3 poorest areas of the free world, between 70 and 80 percent of the labor force are in agriculture. In Latin America, which is somewhat better off materially, only about 60 percent of the labor force is in agriculture. In Western Europe this proportion drops to 30 percent, and in the United States and Canada, which enjoy the highest average gross national product, the proportion of the labor force in agriculture is only about 15 percent. These relations emerge fairly clearly if one compares the first and last columns of table 4 in appendix III.

In summary, we may characterize an underdeveloped country in the following terms: it is a country with a low level of per capita gross national product, in monetary value usually below $250 in 1955. Furthermore, it uses a relatively antiquated and inefficient technology, and lacks extensive educational, health, and sanitation facilities. Moreover, it has shown little capacity to grow during the last three decades. The economy is stagnating, due partly to the fact that the rate of gross capital formation barely keeps up with the growth of population. Finally, the population of an underdeveloped country is primarily rural, and most of the rural people are engaged in subsistence agriculture.

In contrast, an economically advanced country not only has a high average gross national product, in general in excess of $1,000 in 1955, but it also has shown the capacity to grow in the past decades and has added, during at least a portion of its period of growth, steadily around 20 percent of its gross national product per year to its capital. It is predominantly industrialized, and a rather large proportion of the population is urban. Education, sanitation, and health services are relatively well-developed; the technology used is modern, up to date, and rational.

Finally, there is a small group of countries which fall in between these two extremes. They form an intermediate group and show some characteristics of both underdeveloped and developed countries. Usually they still have a large proportion of their population in agriculture, but at the same time they have a large, modern, technologically efficient industry. Levels of gross capital formation vary somewhat but are, on the whole, rather high. Per capita gross national product in 1955 amounted roughly to somewhere between $300 and $750.

CHAPTER II

DETERMINANTS OF ECONOMIC DEVELOPMENT OF NATIONS

We have argued in the previous section that a ranking of the countries of the world in accordance with their per capita real incomes yields several classes, among which the most significant are those with very high and those with very low per capita incomes. We have seen, moreover, that the level of per capita incomes roughly measures the degree of average material welfare, and that living levels are fairly closely correlated, on the whole, with average real incomes. Finally, we have seen that the important differences between the countries at the two extremes of the scale include not only differences in the real income and material welfare of the average citizen and the difference in the capacity to save and invest, but also different recent experience with rapid economic growth. The advanced countries have shown a capacity for maintaining a process of self-sustained growth, sometimes at high rates, whereas the underdeveloped countries have shown little, if any, growth in the past, and then only in brief spurts. The result of this has been an ever-widening gap between levels of material welfare in advanced and underdeveloped countries, and a growing recognition that more effort must be devoted to the study of the determinants of economic growth than has been done in the past. In this study some results have been achieved, though our knowledge of the process of economic development is as yet far from sufficient. In part, this knowledge was derived from a study of the past history of presently advanced countries, and, in part, from an analysis of the economic and social impact of various strategic factors on the development process. Although in various previous studies different factors have been stressed prominently, it may be convenient to group them under three general heads: (1) human resources; (2) nonhuman resources; and (3) social and cultural factors. It should be pointed out that, in practice, such a neat distinction is not always possible, and that especially the supply of human and also of nonhuman resources for economic development depends to a considerable extent upon social and cultural conditions.

A. THE ROLE OF HUMAN RESOURCES AS DETERMINANTS IN THE ECONOMIC DEVELOPMENT OF NATIONS

In evaluating the impact of human resources on the economic development of nations we must distinguish between their quantity and quality. A serious deficiency of population may be an important factor of the lack of economic growth, and, conversely, too dense a population may also affect importantly the capacity of a country to grow. For example, the sparsity of population on the North American Continent before its settlement by populations with European background was doubtless an important factor in its state of primitiveness, and, on the other hand, "excess" population in countries like India and Egypt is a serious bottleneck to economic development of these countries. Moreover, under conditions of high population density, an important consideration is not only the existing number of people in proportion to developed and developable natural resources, but also the rate of population increase.

With reference to the quality of the population, it is not difficult to see that the degree of health, technical training, and average educational attainment of a population are important factors in the productivity and adaptability, and, hence, in the level of economic development of that population. But the quality of population at the same time affects the density of population which a given area can support. A more highly skilled labor force can get the same out of poorer resources or more out of the same resources than a less skilled one. Hence, from the viewpoint of development, there is some interrelation between the quantity and quality of a population which must be borne in mind, even if—for reasons of simplicity—we discuss quantity and quality of population separately. Thus, in discussing the impact of population size, we will assume that skills and technology do not change, and will examine the influence of changing skills, technological know-how, and educational attainment later.

1. The quantity of population and its impact on economic development

If it is granted that neither too sparse nor too dense a population may produce optimum results, it follows that there is some number or range of population in between the two extremes which constitutes an "optimum" in terms of output of goods and services of a given country. As population increases to this level, real incomes can increase faster than the rate of population growth, since large-scale and cost-saving methods of production become possible and overhead costs are spread over a larger number of persons. But once population increases beyond the optimum point or range, further gains along this line are outweighed by the appearance of "decreasing returns" in many types of production. Limitations of agricultural land resources or mineral resources will form important obstacles to further expansion of production, so that additional workers—assuming technology and skills to remain unchanged—will produce smaller and smaller additions to the society's total output.

This situation is manifest today in several underdeveloped countries, especially in South Asia and in Egypt, and contributes to the low output per head of farmers and agricultural workers in these countries and to the appearance of what has sometimes been called disguised unemployment in agriculture. Any further expansion of the rural population in these regions without concomitant technical change would lead to a worsening of conditions, especially since in some villages of India and elsewhere the minimum levels of subsistence have apparently already been reached. It is not difficult to see that in such a country, the crucial problem for economic development is either the drawing away of population from agriculture, i. e., industrialization, or the development of new and more productive techniques in agriculture, or indeed, a combination of both approaches. A simultaneous need is limitation of population growth, but this is a factor about which more will be said later.

It appears that one of the most critical problems in economic development is posed by those countries in which the pressure of population is serious. There the methods and potentialities of foreign aid will have to be attuned to the very difficult problems posed by the likelihood of further rapid growth of population, and the serious strains which this is likely to exert on the potentiality for economic development.

(*a*) *Nations with high population density and the problem of industrialization.*—In a country in which relatively large amounts of unoccupied natural resources are available, the major problem of economic development is making available the capital which will permit the geographical extension of settlement and productive activity. This was the task faced by the United States and countries with similar overall topographical and resource features during the 19th century. Economic development in the United States, Canada, Australia, and other areas with relative abundance of agricultural land, consisted in considerable part in finding ways and means of pushing the frontier further and further into the wilderness. The overall problem of development in countries like India, Indonesia, parts of Pakistan, Egypt, and elsewhere is precisely the opposite. Those patterns of economic growth which were most promising in this country have little applicability there, and the overall relationship of human and nonhuman resources requires the application of plans and policies which differ considerably from those that were traditionally used in the United States and countries with similar developmental tasks.

An underdeveloped country with a relative scarcity of fertile land and other raw material resources must, in order to improve its level of material welfare, develop industries which make relatively small demands on scarce resources and which may rely to a greater degree on labor-intensive methods of production. Thus, manufacturing industries and service trades must be expanded, which will check an increase in the supply of labor in the relatively overpopulated rural sectors of the economy and at a later stage offer opportunities of nonagricultural employment which will tend to reduce, in the long run, the proportion of the labor force in agriculture. The most conspicuous example of a country in which a fair measure of economic development has taken place, even though it was faced with a dense and rapidly growing population, has been Japan. For this reason, the most important lessons to be learned for the densely populated countries of Asia and Africa come from the history of Japanese economic development, rather than from Europe, North America, or Australia.

(*b*) *Effects of the rate of population growth.*—The problem of development in countries with dense agricultural populations will be easier if they can prevent population from continuing to grow rapidly. Unfortunately, there is every likelihood that industrialization and economic development, in general, is likely to give an impetus to, rather than retard, the rate of population growth. Most underdeveloped countries with proportionately large rural populations have high birth rates, which in the past were counterbalanced in most of them by high death rates, resulting from endemic diseases, low nutritional levels, and high rates of infant mortality. One of the first steps in economic development is an improvement of health conditions, with the result that death rates are reduced, whereas birth rates remain at their customary high level for some time. An additional agent counteracting the maintenance of high death rates in developing countries is the improvement in transportation, since a major reason for past famines has been the local unavailability of foodstuffs, rather than their general scarcity.

The factors determining birthrates lie in large part outside the field of economic relations, and include various cultural and religious views and beliefs. Such practices as birth control or other means of reducing the incidence of conception or birth, and rules concerning the customary age of marriage, as well as customs relating to extramarital sexual abstinence, are normally regulated by the legal and cultural systems of a society and, for this reason, are only to a small extent influenced by economic or social policy. In some underdeveloped countries, however, as infant mortality has been reduced, signs of a desire for smaller families, or at least fewer births, have been noted. In such countries, the teaching of birth-control methods or the establishment of birth-control clinics may serve an important function. If the experience of the more advanced countries can serve as a guide, the rising trend of births associated with the early stage of economic development and industrialization tends to subside after a time, and both birth and death rates tend to level out at a lower level than before. Clearly, in countries in which population pressure is already high, it would ease the problem of economic development if the period during which high population growth rates prevail could be shortened. But attempts to attack this problem directly, i. e., through an effort to influence the number of births, encounter strong objection and even if made, would probably not be successful. The attainment of rapid economic growth and rapid urbanization may bring in their wake a decline of the birthrate. Thus the application of foreign aid to the development of industry, and especially urban industry, may be the most effective method by which foreign aid can become a factor in this aspect of economic growth.

2. The quality of population

(*a*) *Problems of the quality of the human factor.*—Next to the sheer numbers of people, the skills and technical competence of the labor force is an important determinant of the potentialities of economic growth. In part this depends upon the regularity with which employment opportunities and a labor market for personnel with certain skills are provided, and in part upon the system of education and vocational training, as well as professional training available to the population of a country. It is usually said that the labor problem is the least serious problem in underdeveloped countries and that there is an abundance of labor available. This is true in many underdeveloped countries, and especially so if we speak of unskilled labor. But it should be noted that the efficiency, and hence the quality, of unskilled labor in many underdeveloped countries is often adversely affected by low nutritional standards and the prevalence of disease. The early introduction of programs designated to eradicate endemic diseases and to improve public health in general is a common feature in most governmentally sponsored development plans. However, unless measures designed to improve conditions of health are accompanied by complementary measures designed to increase the food supply and productive output in general, many of the old diseases may be replaced by new ones or, in some extreme cases, the old diseases may return again. This dilemma does not apply to such measures as malaria control, which result in higher output even without taking other measures, since it permits the cultivation of land which previously was unused because of disease hazard.

There has been a considerable amount of foreign aid in the fields of control of disease and general public health. On the whole, these programs are cheap, and the results are striking. The World Health Organization has developed a series of quite efficient techniques in the control and eradication of endemic disease and in technical aid with public health programs. The United States has had some excellent success with health and sanitation programs in Latin America, where these programs were administered chiefly by servicios staffed largely by personnel native to the aid-receiving country. An account and evaluation of these programs appears in Ten Years of Cooperative Health Programs in Latin America (U. S. Public Health Service, Washington, 1953). Health programs on a similar scale have also been undertaken in other parts of the world on the basis of bilateral agreements, by the World Health Organization, and by private philanthropic and religious organizations. They have become an important ingredient of foreign aid programs.

(*b*) *Skilled labor and professional services.*—The overall effect of health and sanitation programs has been the improvement of the quality of labor in underdeveloped countries. They have also contributed to the quantity of labor (and population in general) by saving lives, especially by reducing infant mortality, and by extending the life span of individuals. Thus the advantages of health programs have been counteracted in a strictly accounting sense, in that on the one hand they improved the productivity of the human factor, but on the other they caused an increase in the number of people in unproductive ages (children and old people) whose consumption needs must be provided for by the labor of the actively employed working population.

Equally important with the improvement of health has been the improvement of the quality of labor by means of education and specialized training. In order to discuss the role played by labor of various skills and kinds in the process of economic development, it is useful to distinguish between the following types of labor services: (1) skilled manual labor; (2) white-collar workers and labor in administrative services; and (3) professional services, including the services of persons employed in educational institutions.

We are omitting here mention of the problem of eradicating illiteracy. The main burden of technical aid in literacy programs in underdeveloped countries is carried by the United Nations Educational, Scientific, and Cultural Organization, which has developed a worldwide series of training programs for elementary education and the abolition of illiteracy. There is no question that literacy is an important factor in an improved labor force, but fundamental education is so basic that apart from UNESCO programs, this is a matter normally left to national governments and their agencies.

The United States maintains, however, some fundamental education programs in several Far Eastern countries. Of equal importance is the widespread activity sponsored by the United States in the field of agricultural extension services.

With reference to the three categories of skilled labor services which were listed earlier, experience has been that it is, on the whole, easiest to train skilled manual workers. In many instances this training has been left to the industry or firm itself, and on-the-job training programs have produced, on the whole, very good results. In general the supply of skilled manual labor has not been a serious bottleneck to economic development. In some instances schools concentrating on vocational training have been established, and in other cases schools for mechanics have been provided by some form of foreign aid. Many of these special schools teaching manual skills concentrate, however, on the training of very highly skilled operators, and in some instances on training in artistic or semiartistic handicrafts.

A more serious problem for economic development is the supply of white-collar workers, administrators, and especially, certain classes of managerial and administrative personnel and technically trained professionals. There is no question that the need for people with these skills grows commensurately with capital investment. Moreover, the increasing scope of governmental services in developing countries requires a supply of Government workers and administrators; the growth of urban centers requires the services of municipal workers; and the development of industrial and large-scale enterprises in general makes imperative the employment of managerial personnel from top management down to foremen and shop supervisors. It is labor of these grades which is usually in short supply in underdeveloped countries. Moreover, even in those countries in which there is no dearth of persons with a modicum of advanced education, these people often specialize in law or certain liberal arts and shy away from professional or semiprofessional jobs in public administration, business, or industry.

Technical assistance has played an important role in the field of qualitative improvement of this type of labor in underdeveloped countries. In the field of public administration, technical aid has contributed by means of projects which included the setting up of training institutes for public administrators. Foreign experts from advanced countries have accepted positions as advisers to governments and municipalities, as well as to private organizations in business and other fields, and have helped develop rational programs of administration as well as train native administrators for new tasks. Exchange of persons programs and the availability of training opportunities in the United States for public officials and others from underdeveloped countries have also been projects with similar objectives. A recently established Economic Development Institute at Vanderbilt University, attended by selected administrators and officials from underdeveloped countries, is one instance of the provision of such a program for better qualified public servants supported by the International Cooperation Administration.

Technical assistance has also been successfully applied to the improvement of labor services in special fields of professional competence. The availability of fellowships for foreign students in the

United States in various fields, but more especially in different branches of technology, medicine, science, and many other branches of knowledge, has been an important factor toward this end. Some of these fellowships were made available by private institutions, foundations, and schools, but a large number were also provided by international organizations and various agencies of the United States Government. We shall return to the overall evaluation of this aspect of foreign aid in a later section of this report.

One of the crucial shortages in underdeveloped countries of a quasi-professional nature is the general lack of entrepreneurial and managerial personnel. Modern production, and especially large-scale production, requires a proportionally larger number of managerial personnel than small-scale manufacturing. The sheer number of employees, as well as the high value of the machinery and other equipment installed in a modern industrial process, require a greater degree of coordination, checking, and supervision than the employment of similar numbers of workers on a small scale. Moreover, large-scale production also demands a greater degree of specific training on the part of its managerial personnel than is true of the entrepreneur who operates a small shop. Some comparative studies of the steel industry in the United States and selected European countries have shown that the relatively greater number and more extensive specialized training of American managerial personnel may be responsible in considerable part for the considerably greater output of American, as compared with European, steel plants of similar size. Similarly, some tentative conclusions reached in a comparative study of American and Egyptian cotton manufacturing plants seem to show that the superiority of the American plants is not due to better capital equipment, but rather to a more productive labor force and, equally important, to more numerous and more highly skilled managerial personnel.

This indicates that the shortage of adequately trained managerial personnel is an important bottleneck in economic growth and that educational and training facilities must be made available in order to achieve effective economic development, not only to increase the availability of public officials and administrators, but also of industrial, commercial, and other business managers. To be sure, some business and commercial managers are trained like skilled workers, on the job. But these men usually have few of the technical competences which make for good management. These deficiencies can be made up only to a small extent by providing training in universities, colleges, and other institutions of higher learning in the advanced countries. They call ultimately for a complete remodeling of the systems of higher education in the underdeveloped countries themselves. It would lead us too far to go into a detailed examination of the changes in educational policies which are necessary, but one may say in brief that one of the most indispensable tasks appears to be strengthening higher education in medicine, science, and technology, and administration, economics, and business management. Only an increased supply of persons well trained in these fields can make an underdeveloped country independent of recurring needs for experts in these fields from abroad.

In several underdeveloped countries, particularly in those where, owing to the fear of Communist aggression, large armies are maintained, a substantial number of skilled workers and administrators are drained into the army, thus adding to the shortage of these persons in the civilian economy.

B. NONHUMAN RESOURCES AS DETERMINANTS OF ECONOMIC DEVELOPMENT

We now turn to a brief discussion of nonhuman resources and the role they play in the process of economic development. Here several distinctions must be made in order to arrive at a better understanding of the factors affecting economic growth. First we must distinguish between natural resources and manmade nonhuman resources, or capital. Secondly, we must distinguish between capital installations which form social or general economic overhead, and those which are directly applied to the production of a specific commodity or service. And thirdly, we must distinguish between resources employed in different branches of production, notably between primary production, i. e., the production of raw materials in agriculture, fishing, forestry, and mining, and secondary production, i. e., manufacturing, industry, and the output of various services.

1. Natural resources

Among natural resources must be counted all those free gifts of nature which exist independently of the exertion of man. To be sure, what is a natural resource will depend upon available technological and scientific knowledge. For example, before the discovery of the process of nuclear fission, uranium ores were a much less valuable natural resource than at present, and for this reason many uranium-bearing deposits remained unexploited. Similarly, at a certain level of technological knowledge, some of the low-content mineral ores are just so much rock, whereas with greater technological knowledge these same "rocks" may become valuable natural resources.

A further point which must be understood about natural resources is that the mere presence of a natural resource is irrelevant for economic development so long as it is beyond reach, i. e., until access to it has been established. For example, the iron-ore deposits in Labrador did not contribute to the economic development of Canada until they had been made accessible by the establishment of transport and communications facilities to the region where these deposits were found.

Finally, we may say that only those objects are resources which are known. As long as some of the most precious ores are undiscovered, they are not resources, and a man owning a piece of land in which they are discovered later, may give it away for a pittance. The object of geological and general land surveys—an important aspect of technical assistance—is then to determine the full endowment of natural resources of an underdeveloped country.

This means that the amount and the kind of natural resources at the command of a given society are to some extent under the control of that society. The building of an irrigation system or the drainage of a swamp which result in the increase of agriculturally usable land are controlled operations adding to the amount of natural resources available. Since this land has been gained by manmade works, it would be difficult to maintain that it is an entirely free gift of nature. Hence, a considerable number of resources, which are commonly regarded as free gifts of nature, are on the borderline of manmade resources, and it is chiefly due to their similarity to other resources which are freely available that they are classified together with them.

It need not be pointed out that the quantity and kind of natural resources available to a country are important determinants of the kinds of industries that can be established there. In discussing this problem somewhat more in detail, it is useful to distinguish between two kinds of primary (or extractive) activity. First there is agriculture, and some associated occupations such as fishing or forestry if carried on on a small scale. Secondly, there is mining and forestry if carried on in the form of large-scale exploitations. This distinction is of special importance for underdeveloped countries, since the typical unit of agricultural output there is small and uses a rather primitive technology. At the same time most mining operations in underdeveloped countries, as well as the exploitation of some of their forest resources, are carried on by means of modern technology, employing often large-scale machinery and resembling on the whole, in the technology employed and the organization preferred, modern industry. For this reason we shall discuss first agriculture by itself, and will include our discussion of mining and other modern rationalized extractive productions as a branch of industry.

2. Agriculture and land resources

Since most underdeveloped countries are predominantly agrarian, the availability of usable land resources is an important determinant of the level of economic performance in these countries. Whether or not land is usable for agriculture depends not merely on its fertility and its accessibility, but also on the climate and especially the amount of rainfall in a given territory. Since man is as yet unable to control climate in any significant manner, land which would otherwise be productive but is poor in moisture is unusable agriculturally unless irrigation installations, often large-scale, are made. The immense importance to a country like Egypt of an installation like the High Dam at Aswan lies largely in the increased supply of agriculturally usable land that this dam would provide, although, like most irrigation works, it would also have additional benefits, such as flood control, improvement of navigation, and so forth.

We see from this that the amount of natural resources which are available to a society depend only in part on the free gifts of nature, and that in those cases where, owing to natural conditions, there is a scarcity of certain resources, including agricultural land, the amount of the resource available to this society can be increased by suitable capital installations. Thus, if nature has treated a country relatively niggardly with respect to land, the amount and quality of land can be increased by drainage, irrigation, terracing, and the application of fertilizer. If the ore resources of a country consist of low-grade ores only, technological processes which enable us to extract metals from low-grade ores may be applied. If certain raw materials important for the supply of power—as for example, coal—are scarce, alternative power resources such as waterpower can be exploited. In all these cases the resource deficiency can be made up to some extent by capital installations of various forms. It is, of course, granted that these applications of capital, i. e., manmade installations, can replace deficient resources only within limits, and that absent resources—

especially certain minerals and agricultural raw materials whose production depends upon special climatic conditions—must be imported. It should also be pointed out that an important and, in fact, often decisive factor in the substitution of capital installations for a qualitative or quantitative deficiency of natural resources is the cost of creating the capital. Often poor and deficient resources continue to be used because the funds for capital formation are not available and the country which has poor resources is, for this very reason, unable to form capital rapidly on its own. The role which foreign aid can play in this process is obvious. In fact, foreign aid applied to the creation of basic capital resources is one of the oldest and traditionally most widely approved functions of foreign aid.

But the important fact to bear in mind is that under conditions of modern technology, the dependence of a given economy upon naturally given resources is much less than would be the case under more primitive technological conditions. Since many underdeveloped countries still employ rather primitive technologies, their agriculture and other extractive industries depend heavily upon natural conditions. But the application of modern technological and scientific knowledge allows them to depart from time-honored but old-fashioned and ineffective methods of production and to use their natural resources in the production of new products. It is in this field of applying modern technology to an improved use of natural resources that foreign aid programs can contribute and have actually contributed. Among the specific types of projects which may be and have been undertaken by the United States, the United Nations, and some of its specialized agencies (notably the Food and Agriculture Organization) are the following: resource surveys (both of land and agricultural resources and of minerals), land clearance, irrigation projects, drainage and other forms of land reclamation projects, surveys of fishery resources, and surveys of forest resources. These programs, especially the agricultural programs, are supplemented by programs designed to affect the quality of the human factor engaged in agriculture, and also to supply manmade capital to agriculture. The first objective is served by projects designed to help establish agricultural extension services and by agricultural research projects; the second by foreign aid programs supplying agricultural machinery, fertilizer, improved seeds and/or animals, and new crops.

3. The supply of capital

It has been argued that with increasing technical knowledge the dependence of an economy on naturally available resources becomes less, and that scarcities in these naturally available resources can, to a certain degree, be counteracted by the application of capital. It is often said that the lack of adequate amounts of capital is the chief bottleneck to economic advancement, and a good deal of foreign economic aid has been looked upon chiefly as supplying capital to underdeveloped countries, either in the form of private investments or in the form of loans or grants from private, governmental, or international institutions located outside the underdeveloped countries receiving the loan or grant. One may also regard the disposal of surpluses or the making of grants in the form of commodities—practices which the United States has used widely in its foreign aid program—as measures contributing to the formation of capital in underdeveloped countries. This is because to the extent to which these countries receive the surplus commodities, they can divert resources to the formation of capital which they otherwise would have had to employ in the production of substitutes for the surplus commodities or commodity grants.

Nevertheless, although capital imports in various forms from abroad make up an important factor in foreign aid, few if any underdeveloped countries experience any genuine economic growth unless they themselves participate substantially in the formation of their own capital. Successful economic development, as we have argued before, means the attainment of a level of economic performance which makes self-sustained growth possible and practicable. But self-sustained growth requires the constant accumulation of capital, and for this reason the stage of underdevelopment is not successfully overcome until a country has been put in a position of providing the bulk of its own capital needs from its own savings.

The major way in which capital can be formed domestically in underdeveloped countries (as in any other economy) is by saving. When we talk about saving, we do not mean the mere putting aside of a certain amount of income each payday—although this is an important personal habit to be formed on the part of many income recipients in underdeveloped countries—rather we mean the appearance of real savings, i. e., of a situation in which consumption remains behind production, so that the difference can be applied to capital formation.

(*a*) *Capital formation and inflation in underdeveloped countries.*—Real saving may either be voluntary or forced, and forced saving may be achieved either by fiscal measures or inflation. We do not propose to discuss these differences in detail, for they lie somewhat off our main trend of argument, but it should be pointed out that the attempt to obtain real savings by means of inflation in an underdeveloped country often has very undesirable consequences. Its main danger is that it will discourage the kind of investment most needed for economic development. By creating a lack of confidence in the currency, inflation causes savings to be diverted into land, hoards of gold and jewels, and speculative holdings of commodities, foreign exchange, and even luxury apartments as a hedge against inflation. In this way, productive investments which would yield much needed real returns are starved for funds. Moreover, inflation tends to bring about a redistribution of income in which unskilled labor and the recipients of pensions and other fixed incomes suffer, whereas skilled labor and businessmen in general gain. Since income distribution is already quite unequal in underdeveloped countries, the enhancement of inequalities through inflationary trends is likely to lead to discontent and its possible expression through political propaganda of a radical kind.

This redistributive aspect of inflation is its chief attraction as a means of capital formation. If prices rise more than wages and other incomes, consumption will be curtailed and more resources will be available for capital formation. But this theory is of questionable validity. In an underdeveloped country with a substantial proportion of the population in subsistence agriculture, inflation will have little effect upon this part of the population. Moreover, though it may lead to some additional investment which without inflation would not be forthcoming, its disadvantages, notably its impact on misallocation of resources, may outweigh its advantages to such a degree that less rather than more capital will be formed.

Thus from the viewpoint of aid-providing countries, inflationary developmental financing is an undesirable policy, and it is understandable and proper that an aid-giving government or international agency will attempt to obtain guaranties from the aid-receiving government that proper safeguards for the prevention of inflation will be set up. Unfortunately, such promises have not always been adhered to in the past, and the history of economic development everywhere in the world exhibits many inflationary episodes. Inflation as a means of trying to finance capital formation is not a new invention. It was in vogue as long ago as the time of the Roman Empire, and has been employed during more or less prolonged periods by almost all the economically most highly advanced countries of the present.

(*b*) *Capital formation through community projects.*—In contrast to the method of financing capital formation by inflation are the methods of financing it out of voluntary savings or out of taxation. The former method, which was the common rule in the Western World during its early phase of economic growth, depends upon the institution of private ownership of capital, and thus plays a very subordinate role in a socialist or fully planned economy. More recently in the economic development of the post-World War period, less reliance has been placed upon voluntary savings and more use has been made of fiscal measures to force the population of underdeveloped countries to curtail consumption in order to provide the resources to be applied to capital formation. This is the general rule in Communist countries, but fiscal measures for capital formation have also been widely employed in many non-Communist countries.

There is still another way in which capital may be formed which has attracted a good deal of attention in foreign aid programs, and that is the formation of capital through community projects. Countries with high population densities in rural areas often exhibit a good deal of actual or disguised unemployment among agriculturalists. Disguised unemployment means that farm output would not be reduced, even with current methods of farming, if a certain proportion of the agricultural labor force were withdrawn. We may speak of disguised unemployment, because the persons who live in the villages are not actually idle, and in fact often work very hard. But their activity represents an excess application of labor with insufficient capital and on an insufficient piece of land. Thus their removal from agricultural pursuits would not curtail total production of agricultural commodities, and the economy would profit considerably if they could be employed gainfully in industry or services.

Another aspect of disguised unemployment is the seasonal fluctuation in demand for farm labor. In periods of sowing or harvesting, all hands available are fully occupied in the fields. In periods of slackness, there is little pressure on the farmer's time and he may engage in some accessory occupations. Some aspects of disguised unemployment also appear in the petty commercial activities in which some rural people engage, and in some of the handicrafts and so-called cottage industries with which they occupy themselves.

In countries with a good deal of disguised unemployment, some of these underemployed persons can be employed in building certain forms of capital, such as roads, irrigation works, terraces, and other earthworks. Such construction may be done without a large amount of machinery and often with only simple tools such as are available on farms or can be supplied from government inventories. Capital created in this manner does not lead to a reduction in the production of consumer goods. If these investments were financed by taxation, the net result would not be a curtailment of total consumption, but a redistribution of income (and consumption) from those who bear the taxes to those who receive the wages for construction of the new capital installations. One possible way of using the underemployed in capital construction without either taxation or inflation is through community projects in which farmers volunteer to work without pay on projects such as local roads, the digging of tube wells, and other jobs which are of direct benefit to their local communities. Foreign aid projects, especially of some philanthropic organizations and foundations, have included community projects of this kind. Often aid was rendered by supplying organizational and planning services, as well as by providing certain types of machinery. The labor services necessary were supplied by the local population. Since in these cases foreign aid penetrates directly and immediately to the local level, and since it centers around the production of capital which is of obvious usefulness and benefit to the mass of the common people, it appears to be a most efficient method of rendering foreign aid. It is a project which people can understand, and the effects of which they can sense.

It may enhance the solidarity of the villagers among one another and with the staff of the foreign aid-rendering agency, and thus may create sympathy and good will for the country which is aiding in the building of such capital installations. At the same time, it may cause friction and conflict, and for this reason an important aspect of technical assistance through community development programs centers around the proper selection and training of the personnel engaged in such projects.

4. "Social overhead" capital

Apart from capital formation in the form of community projects, in which the effective agent determining the allocation of resources for new capital installations is a local community, the chief agents determining capital formation in underdeveloped countries may be either private enterprisers or the government. In totalitarian Communist countries, this function is entirely in the hands of the government, and even projects similar to community projects discussed in the preceding paragraphs are carried out in these countries by the government, usually with the help of forced labor. It goes without saying that these projects are less successful than those undertaken with the free cooperation of villagers or members of a small urban community, and that they suffer the usual defects of projects undertaken with the use of slave or forced labor.

Though a certain amount of capital constituting social overhead is constructed in this way, most is built by government in the normal process of providing public works. Although a good deal of discussion has been devoted in the recent literature on economic development to the problem of social overhead, the issue of what constitutes social overhead is not quite clear. No one doubts its importance, and it is generally said that its provision is one of the first tasks of economic development. But in view of the increased functions taken on by governments in many underdeveloped countries, there has been some doubt as to what kinds of capital installations fall under the heading of social overhead and which ones do not. We will limit this concept for purposes of this paper to include two kinds of installalations: (1) Buildings and other capital installations which serve directly the orderly performance of govenmental tasks, including public buildings, schools, museums, public recreational facilities, hospitals, and a number of municipal institutions, such as fire stations and sewage-disposal plants. These installations will be designated as social overhead in the narrow sense. (2) In addition, there is social overhead in the wider sense, or economic overhead, as it has sometimes been called, which consists of capital installations in such fields as the provision of power (electric power stations), transportation (roads, railroads, airlines, harbors, and shipping lines), and communications (telephone, telegraph, and radio), which are under the management and general care of the government in most underdeveloped countries. Social overhead installations include, therefore, all those forms of productive capital which may be included under the concept of public utilities in the widest sense of this term.

The shortage and inadequacy of social overhead capital usually is an important bottleneck to economic development. Although during the 19th century a not inconsiderable amount of private foreign investment went into the provision of social overhead capital items, especially railroads, private investors at present are reluctant to finance the construction of this capital. It has also become increasingly difficult for governments of most underdeveloped countries to raise loans on the international capital markets which will enable them to provide these capital items. To some extent the International Bank for Reconstruction and Development has made loans for the purposes of overhead capital construction in underdeveloped countries, and so has the Export-Import Bank. But the need for funds for this type of capital outlay is greater than can be raised through the customary channels, and thus the governments of underdeveloped countries have spent a sizable amount of their revenue on overhead capital construction.

The fundamental role played by social overhead capital is due to the so-called external economies which accrue to a society through its existence. A country which is without adequate communications and transportation facilities suffers from inadequacies in resource allocation. Important raw materials in one part of a country cannot be made available to another where they could be used. Shortages of food or other necessities in one part of a country cannot be remedied by shipments from other parts, for the intervening transport facilities are not available.

Similarly, the availability of power is an indispensable prerequisite of industrialization, and also of urbanization. But in spite of their basic importance for economic development, the rate of return on most overhead capital items is very low. To be sure, overhead capital is normally very durable, but it becomes amortized only over a long period of time. It represents, therefore, a considerable amount of resources immobilized for a long time which only pay off at a very slow rate. Whereas an industrial plant in an underdeveloped country may pay off its cost of original construction and equipment in a few years, a road or a railroad may not pay off for 15 years or more. And if the cost of construction of such an installation is high (because of the difficulty of the terrain over which it goes), it may not be paid off in even a longer time.

The great initial capital outlay required for most installations of social overhead and the slow rate of return make it virtually imperative that such capital items be provided for and owned and operated by the Government. This puts a serious strain on Government budgets and also increases the administrative load on the Government. In another direction, it permits the Government to exercise more economic power and, in fact, forms the basis of governmentally designed development plans. Since the objectives of governments in underdeveloped countries are not merely the furtherance of economic welfare, but also include political and military ends, a certain amount of social overhead capital is employed not for purposes of economic growth but for strategic or political purposes. Much has been said and written about the "modern equivalent of pyramids" in underdeveloped countries, and it is admitted that such installations often represent a misallocation of resources from the viewpoint of optimum economic growth. The construction of capital installations which have little or no economic significance—at least in the short run—is one of the unfortunately indispensable forms of waste which any country, whether rich or poor, engages in for social or political purposes. The role of foreign aid in this field can at best be to attempt to restrain excessive expenditure for "pyramids" and to try to channel funds provided by foreign aid into productive equipment. But it would be vain to expect that waste can be entirely eliminated in development programs. The worthiness or unworthiness of a country to receive foreign aid should not be judged upon whether or not it manages to avoid all waste in its capital construction programs.

5. *Capital for the production of goods and services*

If, as we have seen, a large proportion of capital formation in underdeveloped countries is in the field of construction (of roads, dams, plants, and buildings), and if, under the circumstances of scarcity of savings and the need to use large amounts of capital in construction projects, the majority of these must be performed by governments, the overall scope for private enterprise in underdeveloped countries is limited to capital formation in manufacturing, agriculture, mining, commerce, and certain service industries.

Even in these fields, government intervention and various forms of direct or intermediate planning are frequent occurrences in many underdeveloped countries. But, with the exception of the countries under Communist domination, a large sector of these branches of production is left to private initiative. To be sure, developmental plans often concern themselves with industrial growth, and in particular with the establishment of heavy industries, both because of their relatively large capital requirements and their potential or actual military and strategic importance. But planning, even in this field, is often indirect; government construction is usually called for only in those instances where a deficiency of private capital formation is expected or foreseen.

A favorite device employed by many underdeveloped countries to integrate industrial and commercial development under private initiative with overall governmental developmental plans is the setting up of a development corporation (or similar institution, sometimes called by various euphonious names.) A development corporation is the equivalent of an investment bank, except that it is subject to varying degrees of public supervision and receives a part of its funds from the government or through the intervention of the government. Its board of directors is often composed, at least in part, of government appointees, and in some cases even of high officials from various ministries concerned with economic affairs or from a central planning committee. The function of the development corporation is to provide loan or equity capital to private firms which it is desired to set up under the development plan, but for which insufficient funds are forthcoming from private sources. Financial subsidization of a development corporation is often a convenient form of foreign aid. For example, the International Bank for Reconstruction and Development and also the Export-Import Bank have granted sizable loans to development corporations in some underdeveloped countries with the understanding that the funds so received would be used for the furtherance of certain forms of industrial investment. It appears that the presence of a development corporation in an underdeveloped country and its role as recipient of foreign loans are more suitable to foreign aid extended by banking institutions like the International Bank for Reconstruction and Development or the Export-Import Bank than to foreign aid extended by governments. It should be noted, however, that in all those cases in which loans from abroad are channeled through development corporations in an underdeveloped country, the lending agency will usually be concerned with the overall development plans and potentialities of the underdeveloped country. Thus a prerequisite of this kind of foreign aid will be a general survey of the developmental prospects of an underdeveloped country of the kind as have been undertaken by the International Bank for Reconstruction and Development. Such general surveys will contribute, at the same time, to the better planning of development sequences in the underdeveloped country itself, and hence will provide better guidelines for the optimum strategic application of foreign aid of different forms. It appears that an eminently suitable task for technical assistance teams, whether sponsored by an international agency or by the United States Government, is to carry through an overall survey of the developmental prospects of an underdeveloped country, and such surveys have actually been made by the United Nations, some of its specialized agencies (notably the International Bank for Reconstruction and Development), and also by United States technical assistance missions.

The intervention of a development corporation is usually not required in those fields of production in which private funds are applied to capital formation in sufficient quantity. However, the complete absence of regulation and a perfectly free market in capital may sometimes lead to undesirable investments. In underdeveloped countries, as well as elsewhere, the fields into which capital flows will depend upon a series of factors, among which the expectation of maximum profits is one of the most important. But what matters to the private investor—and we are here concerned with the private investor in an underdeveloped country investing his savings (or those he has collected from others) in some enterprise in his own country—is the net amount of profits, i. e., gross profits discounted by some premium for risk and other costs of holding an investment. Under these circumstances most investors in underdeveloped countries will often give high preference to those commodities and forms of capital or enterprise which are relatively liquid, or which yield a relatively high return with a minimum amount of investment in fixed capital. This attitude, as well as the circumstances they face, accounts for the relatively widespread habit in most underdeveloped countries of investing one's savings in land or urban real estate, or of holding them in cash, precious metals and jewelry, or even foreign securities. Moreover, if savings are invested in actual enterprises, some investors in underdeveloped countries prefer certain forms of traditional enterprises which are known to yield high return. Hence investments are made in small loan companies which lend at excessively high interest rates; in pawnshops, which profit from a similar mechanism; or in certain forms of commercial transactions in which the investor can exploit some local monopoly situation, or even some national monopoly situation, especially if he can command some political support.

A considerable amount of private investment in many underdeveloped countries thus would flow into productive activities which are highly profitable from the individual viewpoint of the investor, but which contribute little to fundamental economic growth. Another portion of funds potentially available for investment in productive enterprises will be hoarded or exported (in the form of purchase of foreign stocks or foreign cash balances), and in this way be lost to the improvement of the capital equipment of the underdeveloped country.

It is not our intention to suggest that all available savings are allocated or hoarded in this fashion, and investment practices by private individuals in some underdeveloped countries deviate markedly from this pattern. But in all underdeveloped countries there occur "leakages" in the process of capital formation, either in the form of hoarding, capital export, or investment in enterprises in which private benefits vastly exceed social benefits. In a country in which there is an abundance of investable funds, this leakage is not serious. Moreover, in countries with a large amount of capital, a relatively small proportion of such leakages do occur. In a country in which the scarcity of capital presents one of the most important bottlenecks to economic development, the appearance of such leakages can be crucial. Recognition of these leakages has led to private investment being somewhat discredited, as well as to an insistence on a greater degree of governmental intervention in the process of capital formation than in economically more advanced countries.

As we have seen, the reasons for these leakages are in part based upon economic considerations, i. e., the expectation of private gains and the difference between private profit and social benefits; the desire for a high degree of liquidity; and the relatively high discounting for risks and uncertainties. In the last resort, some of these factors can be reduced to the prevalent social, cultural, and political conditions prevailing in underdeveloped countries, and we shall return to this point further below in this paper.

A final point should be raised in connection with private capital formation in underdeveloped countries, and that is its relationship to income distribution. In many of the presently economically advanced countries, a large proportion of capital formation took place on the basis of private initiative. It has been said that this was possible because in the industrialization process the poor became even more impoverished and income accumulated in the hands of enterprisers who invested it in the expansion of capital plant. Although statistical studies on income distribution during the industrial revolution are far from conclusive, it appears that this interpretation is false. The poor neither became poorer absolutely, nor relatively, and in fact, to the extent to which capital was accumulated and contributed to a raising of productivity and output, the laboring classes participated proportionately in this increase of economic performance. What appears to be true, however, is that the relative share of income of laborers did not change much and that, therefore, the overall distribution of income between workers and owners of capital remained relatively unchanged.

It is likely that a similar relationship will persist in an underdeveloped country if continuous private capital formation from domestic sources is to take place. Since laborers normally save a smaller proportion of their income than the wealthier receivers of income from property or enterprise, a redistribution of income from the latter to the former would reduce the society's capacity to save, and hence to accumulate capital at a constant or increasing rate. At this point, however, an important political consideration enters. In many underdeveloped countries, there are strong political movements favoring not only social equality, but also greater equality of economic status and opportunity. Often these political movements are associated with local Communist propaganda, but in many instances they are inspired by genuine egalitarian welfare considerations and are free from Communist influence. However, their presence, whether Communist-inspired or not, imposes upon the government policies which tend to favor distribution of income from the wealthier classes to the poorer classes, especially to the more vociferous, more urban, and more compactly organized industrial workers. Thus an underdeveloped country which relies to a large extent upon private capital formation may find itself between Scylla and Charybdis. On the one hand, the requirements of speedy economic development, and implicitly with this the long-run improvement of mass living standards, appear to demand the preservation of existing inequalities in income distribution, whereas the political demands of the workers call for the mitigation and possibly the complete eradication of these inequalities in income.

In this dilemma there are three possible ways out. One is the increasing substitution of government enterprise for private enterprise, and another is the attempt to attract foreign capital as a substitute for private domestic capital formation. Yet, in underdeveloped countries with vociferous radical movements (whether Communist or not) there is an understandable reluctance of private capital to move in. Hence a difficult problem may be posed for a governmental foreign aid program in judging the extent to which commitments to extend foreign aid to such countries should be undertaken. On the whole, it would appear preferable for part of foreign aid—if it is decided to grant it in order to avoid forces of social disorganization and disturbance from becoming stronger—to be granted in the form of transfers of consumer goods rather than in the form of capital investment. These consumer goods can be applied to raising mass living standards, and to this extent a somewhat greater equality of material welfare between the richer and poorer classes in the underdeveloped country may be achieved. Many higher incomes in underdeveloped countries are derived from landholding, monopoly profits, and political favoritism, activities that do not serve as incentives for the recipients of these incomes to engage in capital formation. A third way out of the dilemma may be redistribution of income—through taxation—by reducing incomes of these kinds and supplementing those of persons actively engaged in capital formation. This would also provide an impetus for private enterprise. Thus, private initiative in capital formation is not seriously impaired, and if a more or less temporary period of protest can be weathered, the long-run economic development of the underdeveloped country stands a better chance of proceeding in an orderly fashion than if this initiative is killed off and investment is gradually taken over completely or almost completely by the government.

6. Capital formation and balanced growth

We have previously discussed the possible wastes or leakages that may occur in underdeveloped countries, either under a system of public or under one of private investment. In the area of public works these wastes consist of large capital installations which do not have any obvious and real short-run effects on productivity; in the area of private investments these leakages consist of hoards, capital exports, or investments in such fields as luxury hotels and night clubs, in which private profit exceeds social gains from the investment. But even a system which avoids or minimizes both these types of relatively unproductive investment may not lead to economic development if capital formation in the various sectors of the economy is in serious imbalance. For example, as we pointed out earlier, a program improving health and sanitary conditions in an underdeveloped country with relatively dense population should be accompanied by a program designed to raise either food production or production in other than agricultural occupations, since otherwise the additional population would face serious deficiencies in the necessities of life. Similarly, a program of industrialization must be properly balanced by measures improving agricultural output and the supply of power. Moreover, the development of new agricultural or industrial enterprises must be accompanied by the construction of the required means of transport and communications, since otherwise the various newly developed resources remain isolated from one another and an optimum division of labor between the various newly created capital installations cannot be achieved. In addition, as we have seen, the process of capital accumulation, especially the growth of large-scale enterprise, demands a simultaneous increase in the supply of trained managers; and increased governmental duties and prerogatives in the economic field as well as the process of urban concentration of a larger proportion of the population calls for an increase in administrative personnel and public servants in general.

What we have done in the preceding paragraph is nothing else but pelling out the fact that economic development is a process which, if it is to succeed in establishing permanently higher levels of welfare and an economy which proceeds by self-sustained growth, requires a certain balance between its many facets. The reason for overall country surveys is to determine the relative weights which these various factors have given the resource endowment, population densities, skills, wants, and requirements of a particular economy. It is, therefore, wrong to look merely to industrialization as a panacea for the ills of underdeveloped countries. Industrial development by itself may produce serious disproportions between the various factors making for growth in a country unless it is accompanied by a simultaneous development of human resources, agriculture, and various forms of public utilities. Economic development is a total process, in the sense that there are no aspects of the economy of a country which are not affected by it. But it is not only the economy which changes in all its parts if a process of decisive development takes place, but also the social, cultural, and often the political background upon which the country's economy rests. We shall now turn to a brief discussion of the role these factors play and of the strategic importance that must be assigned to them.

C. SOCIAL, CULTURAL, AND POLITICAL FACTORS IN ECONOMIC DEVELOPMENT

The question of the role of noneconomic factors in economic development has two main aspects. On the one hand, there is the question of what kinds of social systems are favorable to sustained economic growth and what kinds are unfavorable. On the other hand, there is the question of how and under what circumstances changes in directions favorable to economic growth take place.

At the outset, it should be said that we have few, if any, well-founded general answers to these questions. We know enough to say that noneconomic factors are exceedingly important; that the role of single features is often variable, so that whole complexes have to be considered together; and that interaction between noneconomic factors, economic factors, and the pattern of economic change itself is important. But these very complexities, together with the difficulty of discovering regularities in historical change, make it very hard to find more precise and detailed answers.

Under these circumstances, we want to discuss two main points. First, we want to indicate the variety of ways noneconomic factors penetrate into the economic processes of development and some of the implications of this fact. Second, we want to examine some of the factors involved in social, cultural, and political change.

1. Some influences of noneconomic factors on the development process

In the previous sections of this chapter, we have pointed out the problems posed by the availability of human and nonhuman resources in underdeveloped countries, the changes in these resources required for economic development, and some of the institutions and policies needed to bring about these changes. Part of the significance of social, cultural, and political factors in economic growth lies in their influence on the impact of such institutions and policies.

(*a*) *Cultural values and response to institutions and opportunities.*—One major part of the culture of a people consists of those norms, standards, values, and beliefs to which people adhere and which guide their choices among alternatives. Such values and beliefs play a major role in influencing the way people respond to the institutions, policies, and opportunities associated with economic growth.

In the field of education, for example, a people's values affect whether and how long parents send their children to school; the kind of technical or other advanced education, if any, selected; the kind of selective learning that takes place; and the use made of training after leaving school. Not infrequently, high value is placed almost solely on education in the liberal professions, the educated seek careers remote from business or any tinge of manual labor, and even the technically trained consider it demeaning to get their hands dirty while performing their duties. Thus, even when appropriate educational facilities are available, a supply of effective engineers, agriculturists, business managers, and entrepreneurs may not be forthcoming.

In the field of medicine and public health, most measures require fairly widespread public participation. Therefore, people's ideas about sanitation, diet, cleanliness, disease, and treatment may make effective action very difficult.

In the field of economic action proper, the value placed on economic security as against economic advancement; the value of economic success as compared to social, religious, intellectual, or political positions reached through noneconomic channels; the value of leisure or of the intrinsic satisfactions to be obtained from certain kinds of work, apart from their economic reward, as compared to the value of increased consumption or wealth; the values accorded various ways of utilizing wealth; and many others are relevant. These values influence work habits, occupational choices, practices related to family size, the level of savings and how they are used, the use of resources for public purposes, the kinds of opportunities and pressures to which businessmen respond, and the kind of response they make.

Thus, the effectiveness of policies designed to improve education and health, to make capital available, to provide social and economic overhead facilities, to spread technical knowledge, etc., all depend on how people respond to such opportunities. And these responses, in turn, are influenced by the prevalent value system.

(*b*) *Social relations and the implementation of economic change.*—Another effect of noneconomic factors is the role of patterns of social relations on the formation and operation of organizations designed to implement economic change. Where people feel that only relatives can be counted on not to betray their trust, the circle from which capital funds may be mobilized is narrowed, and the size and character of firms is limited. Where public office is a prestige symbol involving little responsibility or where it is viewed as an opportunity to be exploited for private gain, the effectiveness of governmental administration is diminished. Where factional loyalties to friends, relatives, or others outweigh responsibility to an organization or a community, these agencies may be rendered ineffective. And where people lack traditions, skills, and experience in establishing voluntary organizations for special purposes, their ability to handle new problems is curtailed.

In addition, the pattern of social relations between organizations or professionals and others can have marked effects. Where doctors, teachers, agriculturalists, and other technical experts have little contact with or understanding of the people they are to serve and look down upon them, they are likely to be ineffective. Where the rule of business relations between strangers is that of unrestrained caveat emptor, the growth of firms which depend upon reliable suppliers of needed goods and services is likely to be restricted, and the business community viewed with distrust by people at large. Where the experience of people with government officials has been confined in the past chiefly to tax collectors, police, and military recruiters, over whom they had little control, the most well-informed and well-intentioned efforts of the government to arouse enthusiasm for its program and to expand its services to local communities and other groups are likely to be met with suspicion and distrust.

(*c*) *Some implications.*—The preceding discussion merely touches upon a few facets of the influence of cultural, social, and political factors on the implementation of economic growth. A more extended discussion would reinforce the conclusion that sustained economic growth requires deep and comprehensive support from the total social, cultural, and political structure of a society.

However, through practically all of human history people have lived without any conception that continuous economic progress was possible; that the useful arts could be rationally and systematically improved; that the sciences, consciously cultivated, could revolutionize the techniques of medical care, transport, communications, and production, thus making possible large and continuing increases in levels of living. That insight was the recent, unique, and difficult achievement of Western Europe and the countries derived from it. Thus, even though there is great diversity among nonwestern societies, their structures all presuppose an almost totally different range of economic possibilities from those now available. Their long histories did not include many of the crucial intellectual, economic, social, and political developments which in Western Europe culminated in the industrial revolution. It is therefore not surprising that other societies do not have forms of economic, social, and political organization; systems of values, beliefs, and interests; or modes of thought oriented toward or readily adaptable to the requirements of modern forms of economic development. The fact that even among European countries which shared in these developments, marked differences in economic growth related to sociocultural differences are found, suggests that countries even more remote from this tradition face formidable problems.

This line of reasoning leads us to expect then that among nonwestern societies, some will be more adaptable to modern technology than others, but that in practically every case, self-sustaining growth would require radical alterations in the whole fabric of society. Recent history appears to be consistent with this conclusion. Therefore, the crucial question is not so much how traditional forms of society as such affect economic development, but rather what are the potentialities for change? In other words, what we primarily need to know about social, cultural, and political factors is how they influence the ease or difficulty of bringing about transformations of society capable of sustaining economic growth.

2. *Social, cultural, and political change*

In considering how societies change so as to be capable of sustained economic growth, it is noteworthy that all the changes required in the long run do not have to precede the initiation of rapid growth. Economic change, if it is on a large enough scale and meets with enough success, tends to generate the conditions, both economic and cultural, of its own continuance. There is considerable evidence that the changes associated with industrialization and urbanization are particularly effective in this respect. Though growth also gives rise to social and cultural disorganization which must be dealt with, such disorganization, by loosening traditional structures, may aid in further favorable changes, if new substitutes and new alternatives are also available. Thus, the most strategic problems appear to center around the development of conditions rendering a takeoff into rapid growth possible.

Somewhat arbitrarily, we can look at the problem of such societal change as having two major aspects: the formation of ideologies related to economic growth; and the spread and adoption of such ideologies as effective bases for action.

(*a*) *The formation of ideologies.*—If we think of the masses in underdeveloped countries as at one time unfamiliar with the kinds of results modern economic growth can achieve and with the economic and technical means by which these results are obtained, we can then envision the initial process of change as one of becoming acquainted with these phenomena and trying to decide what it all means. The outcomes of such a process can be thought of as ideologies in which particular groups of people define the significance and implications of economic growth for them.

One element in such ideologies is a desire for improved levels of living. Such aspirations are already widespread throughout most underdeveloped countries as a result of direct and indirect contact with the West, though their content varies widely between different countries and between different groups in a single country. These aspirations imply that people have seen something meaningful and desirable in the prospect of certain economic changes and hope for, or even demand, their fulfillment. This provides a basis for an interest in economic development, but it does not mean that people understand what needs to be done to fulfill their aspirations, or that, when they learn, they will be willing to play their part or even understand the connection between what is asked and their own desires. For example, most peasant people do not appear to associate economic improvement with any great change in their traditional way of life.

Thus, one major problem in the formation of effective ideologies is to give significance and meaning to changes which are apparently remote from the results people have in mind. This is even more difficult when, as in most underdeveloped countries, quick economic results cannot be realistically promised, and the changes required involve sacrifices and new kinds of insecurity. Thus, an effective ideology cannot be based solely on an appeal to the eventual economic improvements to result from the changes advocated. It must make a broader appeal which lends intrinsic significance to the intermediate steps to be taken and binds these steps into a meaningful whole. This, in turn, means that ideologies have to be closely adapted to local values, beliefs, and situations, and that economic problems become intertwined with other issues which seem irrelevant or contradictory to the outside observer.

These phenomena are found in the kind of nationalism prevalent in many underdeveloped countries. Resentment of western influence and rule, and disrespectful personal treatment, and derogation of their way of life, which they regard as an outflow of a former or still extant colonialism, has given people in Asia and Africa a strong desire to put their country into a position of prestige and influence and to show the world their ability to modernize. Thus, a deep appeal to pride and to the opportunity to revenge injured self-respect can be evoked to support many kinds of changes conducive to economic growth which would not be supported on economic grounds alone. Moreover, the broad appeal of nationalism can reduce internal cleavages and give meaning to national issues and problems to people who previously had no such involvements, thereby enhancing the ability of a country to take effective collective action.

But, at the same time, nationalism also involves the repudiation of foreign ideas and practices, a hypersensitivity to situations implying undue foreign influence or dependence on foreigners, and the reaffirmation of traditionally honored ways. Even with respect to modernization, there is a tendency to devote resources to modern facilities which are economically irrational and largely of symbolic significance. From a rigorously economic point of view, all of these seem to be hindrances to economic development and hence constitute waste in a certain sense. There is no doubt but that they are hindrances, in part, and that they reflect the ambivalence of trying to restore one's self-respect by both reasserting the validity of one's own values and at the same time insisting that one merits respect according to another's contradictory values. Nonetheless, a deeper look reveals positive potentialities, as well. For example, economically irrational modern structures (the "pyramids" of an earlier section) may be effective in providing some of the short-run symbolic satisfactions so necessary in building up and maintaining morale during the long pull before more solid results are forthcoming. Or, since fundamental values are always somewhat vague and ambiguous, their reaffirmation in new contexts may lead to a recognition of new meanings. For example, in praising one's spiritual values as superior to the (supposed) materialism of the West, one may come to stress the ascetic aspect of these values as lending significance to the sacrifices required in building a new society.

The example of nationalism may suggest how intricate and difficult it is to form an ideology capable of meeting the problems posed by economic growth in underdeveloped countries. One implication of this is that foreign aid policy should try to avoid adding additional complications to an already difficult situation. For example, a policy of "tied" aid which makes assistance conditional upon adopting a particular international policy (favorable to the aid-giver), on establishing a particular form of government (e. g., democratic), or on adopting a particular economic system (e. g., free enterprise) is likely to be self-defeating. On the one hand, it is likely to arouse great resentment and to accentuate the more negative aspects of nationalism. And on the other, the changes imposed on the aid-receiving country are likely to fail, since they do not take into account the problems of combining social transformation with the maintenance of social and political cohesion in particular countries. (The assumption that democratic government and free enterprise are preconditions for economic growth is false.)

(*b*) *Factors influencing the acceptance of new ideologies.*—The factors influencing what kind of ideology is accepted and the extent to which it is capable of sustaining effective action are exceedingly numerous, and their interrelation is very complex. Many are internal to the countries involved and both internal and external factors are seldom affected directly by measures within the scope of foreign aid. However, foreign aid policy, if it is to be as effective as circumstances permit, must be adapted to these circumstances. This requires an intimate and profound understanding of just how the various segments of each particular society see the world, how these views are changing, and why.

Since we cannot go into detail concerning particular instances here, we will try to indicate some of the factors involved in the acceptance of new ideologies by outlining one constellation of forces not infrequently found in underdeveloped countries.

In many underdeveloped countries wealth, political power, and education are concentrated in a small group of people, and not infrequently the very individuals who control political power are also the richest and best educated men in the society. If such a group is sufficiently satisfied with its position (or even if it is not, but if it fears that economic modernization will threaten its position), it is likely to resist change strongly.

Moreover, the existence of such a group strongly affects the nature and role of any incipient "middle class" which develops in the great gap between the privileged and the masses. Such a middle-class group, consisting chiefly of educators, government officials, and members of the intelligentsia, must, in order to assure its maintenance, either aline itself with the ruling group or suffer being pushed into positions of harsh antagonism to that group. Hence intellectuals often attain positions of leadership among the discontented, the unprivileged, the poor; hence the appeal of Communist ideology exerted on intellectuals in underdeveloped countries; hence also the enhanced social cleavage which becomes little, if at all, mitigated by the rise of the middle class. Moreover, the cleavage of the world into two antagonistic camps becomes reflected in the political and ideological issues in a developing country. More and more evolutionary development toward higher levels of living ceases to be a practical third alternative between the maintenance of the social status quo on the one hand, and a revolution which threatens to throw the country into the arms of communism on the other.

If the issues are seen in this light, the rigidities of the class structure in many underdeveloped countries become understandable. But the very sharpening of the issues, the fact that many enlightened people see as the only alternative to the maintenance of the existing class structure a Communist revolution, makes them reluctant to advocate rapid and decisive innovations, which, if they are to take root, inevitably affect the social status quo. Hence technical and economic innovations, if sponsored at all, are received with the greatest caution, are severely limited in application, and supporting ideologies are not formed or accepted.

CHAPTER III

DIFFERENCES IN THE PAST PATTERNS OF ECONOMIC DEVELOPMENT OF DIFFERENT ADVANCED COUNTRIES

A. INTRODUCTION

We have seen the preceding chapter how several important factors impinge upon the economic growth of nations. Among the chief variables which we have stressed are the relationship between the quantity and quality of human and nonhuman resources; the conditions under which capital formation is carried on and the rate at which it takes place; and the general social and cultural, as well as political, conditions prevailing during a nation's economic growth.

We may now test the usefulness of this discussion by first applying it to those countries which are among the more highly developed ones, or at least which are in an intermediate position between the economically most advanced and the economically most underdeveloped countries. Later, in the next chapter, we will apply our general theoretical findings, together with the lessons of the historical experience of advanced countries, to the conditions of the underdeveloped countries.

1. *Some differences in development patterns of advanced countries: timing and resource endowment*

Although only a minority of mankind lives in countries which have overcome the fetters of economic backwardness, we have the economic history of many nations to fall back upon for our material. The economically advanced countries show considerable differences. First, they differ in terms of when their period of rapid development and industrialization started. There are early birds and latecomers among them. Since the latecomers could adopt the technology which had to be slowly elaborated by the countries which industrialized earlier, they were in a position to skip over some developmental steps. In principle, those among the more highly advanced countries that started last could change from an antiquated technology to the application of automatic or near-automatic machinery and processes. At the same time, a latecomer is in the disadvantageous position of having stagnated longer and of having to catch up faster or move a greater distance in order to equal the countries which started economic development earlier.

A second difference is in the original endowment of resources with which the process of development began. We only need to compare two advanced countries, like the United States and Switzerland, to see that very different original resource endowments may lead to high levels of economic performance. The United States has ample land resources as well as extensive deposits of coal, oil, and many important minerals. Switzerland lacks deposits of most important minerals and has relatively little land which is usable for agriculture. Nevertheless, its average gross national product is one of the highest in Western Europe.

2. The role of government

A third difference lies in the role government has played in the process of economic growth. In general, it may be said that governments have played a rather prominent role in all countries, even those in which it is generally assumed that economic development occurred under a regime of laisser faire. For example, in Britain, the classical country of economic liberalism and free enterprise, the foundation of British industrial development was laid by some of the state-inspired mercantilist policies of the 16th and 17th centuries. Even as ardent a partisan of economic liberalism as Adam Smith supported the navigation laws—a clear case of indirect governmental subsidization of the British shipping industry. Similarly, in the United States the governments of the various States and later the Federal Government subsidized various forms of capital formation. The States achieved this end by sponsoring public works of various kinds, by sponsoring mixed private-State-owned corporations, by licensing certain trades and enterprises, and by a multitude of other devices. The Federal Government contributed by such measures as its homestead policy, land grants to railroads, and its tariff legislation.

Nevertheless, the role played by government in directing economic development remained, on the whole, much smaller in the 19th century than in the period after the First World War. This is true even of countries like Germany and Japan, which are commonly regarded as more highly centralized and more subject to governmental paternalism than other states in Western Europe or North America.

Yet there were noticeable differences in the role played by governments even in the 19th century. For example, the Czarist government of Russia eagerly sponsored certain forms of industrialization, mostly of strategic significance, and there was more statism visible in Germany and Japan than in Britain, the United States, or the Scandinavian countries. It is difficult to measure with any precision the degree of state interference or state promotion of economic development. Sometimes a regulation which appears rather innocuous may have far-reaching effects, and sometimes a law which appears very restrictive may produce little change.

But there is one general difference that stands out, and that is the difference between countries in which the initiative for development and its overall planning is regarded as one of the main tasks of government, and other countries where decisions favoring economic development are left to private individuals and groups and where the government only intervenes to regulate, to eliminate certain inequities, or to sponsor a few selected branches of production which are clearly in the public interest. It is in this latter sense that Adam Smith's approval of the Navigation Act must be understood, and it was motivations of a similar nature which induced the Congress and administration of the United States to sponsor the land-grant policy for railroad construction, the development of agricultural colleges, and other measures.

The intervention of governments in the development process depends in part on the prevailing social and political philosophy. But apart from this factor, it appears to be a fact that in more recent decades government sponsorship of development plans has been on the increase. This is not only true of the Communist countries, where the main reason for governmental planning of economic growth is to be found in the totalitarian character of government, and hence, in the last resort, in the social and political philosophy of the elite. Even in democratic countries in which individual freedom and freedom of personal initiative are respected, on the whole, governmental plans for development have been drawn up, and attempts are made to implement them. In many of the countries of Western Europe, the role of government is much more extensive than it used to be in the same countries before 1914. In newly developing countries, such as the countries of south and east Asia or the Near East, developmental plans are the order of the day.

In general, it can be presumed that several factors may be held accountable for this increased role of the state in economic development. Most important among them are: the relative backwardness of a country, the speed with which economic growth is thought to be necessary, the scarcity of resources in relation to population pressure, and such ideological factors as nationalism and a sentiment of discrimination which we discussed in the previous chapter. The more backward, the more unfavorable the original composition of resources, the speedier the development desired in a country and the more nationalistic it is, the greater (other things being equal) will be the role assigned to the government. There is a further factor which, however, plays only a minor role in the advanced countries, and that is the overall social and educational distance between the various classes in a country. The more egalitarian societies are also the ones in which private initiative has a greater room for free play. On the other hand, in the more hierarchically structured societies, or in those where there is a deep gap between the elite on top and the popular masses on the bottom, governmental initiative and control will stand out more prominently. We shall return to a discussion of this point in the next chapter.

B. SOME SIMILARITIES IN THE DEVELOPMENT PATTERNS OF ADVANCED COUNTRIES

Just as we were able to point to some important differences in the developmental patterns and conditions for economic growth in different advanced countries, so may we emphasize some similarities. Most outstanding among them are the association of economic growth and industrialization, the association of early economic growth and a population "explosion," and the association between economic development and a restructuring of internal social relations.

The first factor has already been commented upon briefly in the preceding chapter. Although it has been impossible to show that industrialization is necessarily associated with economic development, there is no instance of genuine long-run economic growth on record in which the very core of the development process did not consist in industrialization. One of the first statesmen and writers to argue in favor of industry as a means of economic development was Alexander Hamilton, whose Report on Manufactures of December 5, 1791, is one of the classic statements of the growth-fomenting capacity of industrialization. Hamilton's views were absorbed and given popularity by the German, Friedrich List, who propounded the idea that the superior technical equipment of manufacturing enterprises and the greater rationality of industrial production could not fail to have a beneficial effect on agriculture. He believed that technological and organizational improvements in agriculture would only be adopted in an industrialized country, and that in order to make agriculture more productive it was necessary to industrialize first.

Whatever the merits of views such as these, the various countries which have escaped the fetters of economic backwardness have done so by becoming industrialized, and one of the similarities in the past history of the currently economically more advanced countries is the fact that their real developmental spurt began when they experienced an "industrial" revolution.

This industrial revolution led to a simultaneous growth of cities and a constant migration, in the more densely settled countries, from the countryside to the cities. In some advanced countries, notably the United States, Canada, Australia, and New Zealand, this pattern of migration from country to city did not appear until very late, owing to the abundance of fertile land available in these countries and to the absence of a dense rural population. With the growth of cities, medical services as well as sanitary and health conditions improved, and the death rate and infant mortality rate declined. A rather sudden and very rapid increase in numbers of population took place, which has sometimes been called a population "explosion." All countries of the west experienced this population explosion, and so did Japan. One may assume, therefore, that economic development associated with industrialization and urbanization also tends to increase a country's population.

We shall discuss in the next chapter the effects that this has had on underdeveloped countries. But it may be well to point out that most western countries—though not Japan—experienced this fast and proportionately large population growth at a time when their population density was considerably below those prevailing in some underdeveloped countries today. Moreover, in the 19th century when first in Britain and later in the countries of continental Europe, population pressures began to mount, there were available three continents—the Americas and Australasia—to serve as safety valves for the surplus population. Most underdeveloped countries have much more limited opportunities for getting rid of excess population through emigration. This is an important factor creating a significant difference between the developmental potentialities of currently underdeveloped countries and of those countries of Europe which started their economic development at an earlier stage.

Finally, the combined impact of economic development resulting in higher standards of material welfare, of industrialization, and of urbanization, remodelled the social structures of the developing countries. In those countries in which longstanding aristocratic prerogatives had prevailed, these prerogatives tended to fall before the growing wealth and political importance of the middle class. In the course of the 19th century, the franchise was greatly extended, and it became possible in almost all developing countries for a man with intelligence and initiative to move up to a position of wealth and influence. The fact that many American presidents and legislators started life, if not in log cabins, nevertheless in poor and narrow circumstances, is one of the more patent examples of this process. And what is true of presidents and legislators is also true of a good many business leaders in industry, trade, and finance. Although this process of rising in the social scale was particularly characteristic of the United States, it was not confined to this country, and there are numerous examples in other advanced countries in which men starting from small circumstances attained success in politics, business, or the professions.

The process of economic development and associated social change has thus had the general effect of tending to introduce more democratic, egalitarian social relations. As a society becomes wealthier it can afford to distribute its wealth more equally. As persons acquire a greater share in society's output and a greater amount of wealth, they recognize more and more clearly that they have a stake in the nation and that economic progress benefits them, whatever else it may do for others. This is an important fact to bear in mind, since a policy of foreign aid pursued by a democratic country may be justified by the fact that, where it is successful in actually helping to raise living standards noticeably, it is likely to extend the attraction of responsible democratic government and to constitute a blow against Communist irresponsibility and aggression. However, as we shall try to show in the next chapter, the path to genuine economic advance on a mass basis is slow and subject to many interruptions and potential blind alleys. The next few decades are the most crucial for the process of economic advancement of some of the most strategic countries situated in Asia and the Far East and may be of decisive influence in the development of the future political alinement of that area.

C. THE IMPACT OF INTERNATIONAL ECONOMIC RELATIONS IN THE DEVELOPMENT OF ADVANCED COUNTRIES

In our discussion of differences and similarities in the past economic development of advanced countries, we have left out of consideration so far the international interaction between developing countries. In order to complete the description of the process of economic growth in the West European countries and their overseas offshoots, we must now discuss briefly the impact of three factors which played a sometimes not insignificant role in their growth process. These factors are international trade, international investment, and foreign aid.

As concerns international trade, we may distinguish again two different patterns of growth. Some countries were large enough and endowed with sufficiently varied resources so that the main impetus for their economic development came from the gradual extension of their internal markets. Other countries were and are small and depended for their development on supplying certain goods in international demand, exchanging them for raw materials and/or foodstuffs which they were unable to produce cheaply or efficiently enough. An example of a developed country which was greatly dependent upon finding markets for its products abroad is Denmark. Denmark was a predominantly agricultural country, producing most of its own food and feed for its cattle throughout most of the early 19th century. By the third quarter of the 19th century, the availability of cheap American, Canadian, and Argentinian grain cut the ground from under the traditional agricultural economy of Denmark. The country was faced with a fateful choice. It could either erect high tariff barriers and continue its old pattern of agricultural production, which had obviously become incapable of competing on the world market, or it could maintain free trade in grain and turn to the production of high-grade foodstuffs—eggs, bacon, and butter—for sale on the world market. We know what Denmark's choice was. It specialized in the production of the more expensive foods, supplemented its high-grade farm products by initiating some small but high-quality industries, and entered an important period of economic growth. But it should be noted that the success of Denmark's choice depended upon the fact that its products were freely salable on the world market, and it became a half industrial and half agricultural appendage of the economic sphere of Britain, and to a lesser extent of Germany and some other countries which consumed Danish products. Switzerland made a similar choice at about the same time, and also succeeded in adapting its products—high-grade animal products, precision machinery, high-grade textiles, and similar products requiring considerable skill—to the demand pattern which had developed in the large European consuming areas surrounding Switzerland.

Therefore, one of the needs of a small country with relatively specialized resources is to adapt its productive pattern to the demand which exists in the world at large for specialized products which the country is particularly capable of producing. It goes without saying that such a policy is successful only in a system of free multilateral nondiscriminatory trade. For if the products of a small country encounter high and sometimes insurmountable tariff barriers abroad, or if they meet with discriminatory practices, quantitative restrictions of various kinds, or exchange controls, the developmental possibilities of a small country are seriously impaired. Thus the present United States policy in the international trade field is of great importance to many small countries, regardless of their state of economic development. But it is of special importance to small countries which must rely on certain often highly specialized exports to provide them with the foreign exchange to purchase on the world markets those raw materials, foods, and other commodities they lack. In this manner, the stanch advocacy by the United States of nondiscriminatory multilateral foreign trade is of great indirect benefit to many small underdeveloped countries.

But foreign trade and relatively open world markets also were of great significance to some of the larger countries. Take, for example, the United States. For several decades during the early 19th century the vast resources of the interior were developed. The many migrants who settled first the Middle West, then the Plains States, and finally the Rocky Mountain area and the Pacific Coast States depended upon the absorptive capacity of world markets for their raw materials and foods. The development of the great West was associated with immense costs, in terms of human effort and money. If the markets of the world had been closed to the products which those regions of our country produced in abundance by the end of the 19th century, the benefits derived from pushing the frontier farther and farther west would have been much less. To be sure, there was a large market for Western and Middle Western products in the United States itself. But the fact that many American products found ready acceptance abroad was of considerable importance. We may safely say that the addition to domestic demand of a strong foreign demand for the raw materials of the United States was one of the decisive factors in aiding the economic development of the United States.

The United States benefited not only from relatively open world markets, but also from foreign investment. All through the 19th century the United States was an attractive market for foreign investors. Although no accurate figures are available, it is estimated that foreign investments in the United States amounted to $400,000 in 1860, to $1.5 billion in 1875, and to between six and seven billion dollars by 1914. Although the United States had started to export capital by 1914, the contribution of foreign capital invested in American railroad and Government bonds should not be underestimated, and it must be assumed that this investment contributed greatly to American economic development.

The United States was, of course, not the only country receiving foreign capital. It was estimated that by 1913 Britain held foreign investments of £3,763 million, of which £1,780 million were invested in the British Empire, £755 million in the United States, £757 million in Latin America, and the remainder in the rest of the world. Of the £755 million invested in the United States £617 million were invested in railway bonds. French foreign investments were somewhat below those of Britain, and were concentrated in French overseas territories and Russia. Germany also held substantial foreign investments which, unlike French foreign investments, were spread more evenly over the whole globe. These foreign investments were a powerful stimulus to the economic development of the less advanced countries. Since a large part was concentrated in transport and power supply companies, private foreign capital was an important source of aid in building up installations which come under the general heading of social or economic overhead. In addition, foreign investments could be found in mines, plantations, and factories.

In considering the impact of foreign investment, the relative magnitude of total world production before the First World War and today must be borne in mind. The total foreign investments of the 3 major European countries amounted to approximately $32.5 billion in 1914. This is an immense sum, almost equal to the net national income of the United States at this period. To reach a comparable level, the amount of private foreign investment outstanding today would have to be in the neighborhood of $300 billion.

It is obvious, therefore, that a large amount of foreign capital, which today is supplied by national governments in the form of foreign aid programs, as well as by international organizations and such official lending agencies as the International Bank for Reconstruction and Development or the Export-Import Bank, was supplied before 1914 by private investors.

Clearly private capital is less easily available today than some 50 years ago. This is due to a multitude of factors which we will discuss in greater detail in later chapters. But it exhibits one important advantage which countries whose economic development began before 1914 enjoyed. In general, capital has become less generously available, and many sources which flowed copiously before 1914 have almost completely dried up.

In view of the relatively easy availability of private capital, the problem of foreign aid was of subordinate importance in the period before 1914. But here again some of the countries whose development falls in this period enjoyed certain advantages which are not at all available today, or at least not to the same degree. Consider, for example, the degree of foreign aid a country enjoyed when it received an annual stream of immigrants. Many of these immigrants were young and vigorous adults. The costs of educating them and supporting them until they reached a productive age had been borne by the country of origin. To be sure, many of these men and women were not skilled in the kinds of jobs they had to perform in the country to which they immigrated. But even if they were only unskilled workers, the receiving country gained an adult person who could immediately contribute to the productive activity of that country without first drawing upon that country's resources for his food, clothing, education, and preservation of health while he was in infancy and childhood and unable to earn his own livelihood. Moreover, many of the immigrants were not unskilled laborers, but highly skilled persons and professional people. They brought with them skills learned in Europe and added to the stock of technical competence available in the countries in which they settled. Since the United States was one of the chief areas of European emigration, it derived a major share of the advantage of this situation. Many of the most distinguished teachers, ministers, and other professional men in the United States during the 19th century were born and brought up abroad. Many American-born scientists and scholars received all or part of their training in European schools and universities. Here again, as in the field of private investment, technical assistance (or its equivalent) was carried on not by official missions or planned programs, but on the basis of private initiative. Nonetheless, its effects were equally and perhaps even more significant, since the technical experts did not come for a short stay, then to return home again, but remained in the country to which they had emigrated.

The countries which were the chief recipients of immigrants in the 19th century stand out in this pattern of free flow of population across frontiers. But one should not forget that international migration of skilled artisans was much more common in the 19th century than it is today. Many workers born and raised in one European country served an apprenticeship in another country and there learned new methods and new skills. Many of them returned home after their period of learning, but some stayed in the country to which they had migrated. The 19th century is often described as a wonderful period for the traveler, because passports were needed only if one traveled to some far away country, and were usually superfluous. But more important than the comfort to sightseeing tourists was the fact that the absence or slight importance of restrictions on free movement across national frontiers made possible the relatively unhampered international travel of craftsmen and technical experts of all sorts. It was this exchange of persons which was the closest equivalent to modern technical assistance programs, and it was, in many ways, a truly multilateral process.

These factors—the relative freedom of international trade, the large role played by international investment, and the freedom to migrate—were important to those countries which started the decisive period of their economic advancement in the period before 1914. All the countries which today appear at the top of the list of countries ranked according to per capita gross national product had their beginnings of economic growth in that period. In many ways the world has changed, and the presently underdeveloped countries have fewer opportunities today. International trade is more restricted and, in spite of American efforts to combat discriminatory practices, less equal than before 1914. Private foreign investment still forms an important factor in the field of international capital transfers, but its relative magnitude has declined drastically. Migration has been restricted, and most of the populations of economically underdeveloped countries must look forward to the growth of their own economies rather than to sharing in the growth of countries to which they could emigrate. All this is not said in the spirit of glorifying a "golden age" of the past, but to point to some of the opportunities which favored the economic development of early comers and which militate against that of latecomers. Many of the advantages and "safety valves" which were available when the Western countries broke through the fetters of economic backwardness are not available any more. We shall have to examine whether other policies might be put in their stead which will have similar results.

CHAPTER IV

THE POTENTIAL FOR ECONOMIC DEVELOPMENT OF PRESENTLY UNDERDEVELOPED COUNTRIES

A. INTRODUCTION

From the viewpoint of purely formal analysis, the problem of economic development of currently underdeveloped countries could be treated as that of latecomers in industrialization. In such an analysis, the economic development of India, for example, would be regarded as similar to that of Japan, with the difference that Japan's first efforts to industrialize were some 75 years ago, whereas those of India are just beginning now. Or, in other words, whereas Japan was a latecomer—compared with Britain—by some 100 years, India is a latecomer by some 175 years. Unfortunately, the problem is not that simple, since, as we have seen in the previous chapter, different countries have followed widely different patterns of development, and the experiences of one latecomer may or may not have relevance for those of another. Just as in the past, the major obstacles faced by a country like the United States and one like Switzerland differed in magnitude and kind, so the obstacles facing presently developing countries differ perhaps even more in kind and certainly in magnitude. In saying this, one states merely that an evaluation of the potential for economic development of each presently developing country must be undertaken separately, and that any attempt to generalize does a certain amount of violence to the very special conditions of economic growth in the various nations.

However, in order to remain within tolerable limits, we must confine ourselves to discussing types of potential development, rather than actual cases of potential development. In order to simplify our discussion somewhat, we will attempt to state some differences and similarities in economic development problems, as was done in the preceding chapter, and will then point to some of the most crucial and strategic factors in the prospective development of the major underdeveloped countries and regions.

1. Differences and similarities in resource endowment

Perhaps one of the major points of difference in currently underdeveloped countries is the difference in natural resources and the overall ratio between nonhuman and human resources. This latter may also be designated as the resource density of the population. Since economic development requires the importation of machines and many other products aiding in the formation of capital from advanced countries, an underdeveloped country, which is usually short of capital, is in a relatively favorable position with respect to development if it disposes of resources which are easily salable abroad. Thus, in Latin America, those countries which have mineral deposits producing metals or other minerals in extensive and continued demand abroad are among the most highly developed countries, if development is measured in terms of per capita national income. Venezuela's oil and Chile's copper and nitrates are the major factors determining the relatively high level of average gross national product in these countries. Of similar though somewhat less overriding importance is the availability of certain agricultural raw materials for which demand in the highly developed countries is strong. Coffee, bananas, sugar, cacao, rubber, and vegetable oils have been the chief commodities in this class, and countries which can produce large exportable surpluses of these commodities often have in them an important source of foreign exchange which can be applied to procuring some of the needed capital for development. Such exports, which may be taxed, also contribute revenue, lessening in this way dependence on foreign aid and easing the inflow of private capital.

Countries which produce few of these commodities in exportable quantities are considerably worse off. For even if they can save the necessary amounts to make investments in economic development projects, they are often in a difficult position if they need to obtain the foreign exchange with which to buy the machinery and other equipment going into the building of capital installations for development. In some instances, such countries may obtain the needed foreign exchange through triangular trade; that is, they may develop an export surplus with other countries, which in turn have one with the economically advanced countries, from which the machinery and equipment can be had. But in order to attain such an export surplus trade between various underdeveloped countries, they must be relatively free and unhampered, and, above all, unencumbered by exchange controls and other forms of rationing of the currencies in greatest demand internationally. Unfortunately, at present, the dollar, which is the currency most widely in demand in underdeveloped countries, is usually subject to exchange control, so that one underdeveloped country building up an export surplus with another usually does not thereby obtain dollars, but often merely a credit in the currency of the other underdeveloped country. The need for convertibility is thus an important aspect of the capacity of some countries to support their economic development programs by means of exports of their staple commodities.

Another important aspect imposed on a country's capacity to develop economically by its resource endowment, is the pattern of imports which it will require. We have seen in previous parts of this essay that the general path to development will be sought through industrialization. Now a large country with a relatively large population may look forward to developing a variety of industries for which a domestic market can be found, especially if the level of income of the population rises. Thus a large country will try to include in its development plans industries in various fields of consumer goods, as well as those capital goods industries which are intermediate in the production of consumer goods, such as machine building, chemicals, and various metallurgical industries. Its main limitation in industrial diversification will be imposed by the availability of minerals and power, although even power often may be imported.

A small country, on the other hand, will be limited in the number and variety of industries to be established there by the relative smallness of the domestic market. Hence it will be driven much more forcefully than a large country to specialize its industrialization program in those fields of production in which it has a clear comparative advantage, or in which it can best fit its production pattern into the gaps left by several larger countries with which it trades. This was precisely the pattern selected by countries such as Denmark or Switzerland in the 19th century. It is clear, however, that if a small country tends to be dependent in its industrialization program—and in general in its program of economic growth—on markets abroad, its pace of development will be dependent to some extent on the pace of development in the countries with which it trades. It can try to alter its trading pattern, but this will not always be possible, and may subject the country to temporary setbacks in its foreign exchange receipts. This means, however, that smaller countries in general are more interested in the general level of economic performance in the world at large than larger countries. A large country may concentrate on a pattern of "balanced growth" within its own boundaries. A small country will often not succeed in developing a program of fully balanced growth, and will to that extent remain more deeply dependent upon international trade and markets beyond its own frontiers.

2. Differences and similarities in governmental policies

In discussing the past experience of developed countries, we have pointed to the role governments have played in their process of economic development, and have pointed out that, on the whole, the role of government has become greatly enlarged in recent times. This statement is true of all countries, even those which are already more advanced. But in general, one might observe a close correlation between the general level of backwardness of a country and the relative magnitude of governmental operations in the development fields. This impact by the government is even enhanced if we take account of the social and political aspirations which were discussed in the final section of chapter II. It was explained there that the aspirations of peoples in underdeveloped countries usually require some form of ideological underpinning if they are to be transformed into realistic social action, and that this underpinning is provided normally by the more highly educated elite which also occupy positions of political leadership. In its outward manifestations, this ideology appears usually as an enhanced nationalism, which has both favorable and potentially unfavorable implications. On the one hand, it tends to destroy old-inherited local particularistic loyalties and to replace them by a sense of belonging to a common people. This makes possible the harnessing of human and nonhuman resources to the economic and political aims of the nation. At the same time, it creates potential and actual antagonisms against foreigners and provides a seedbed for various radical movements which may lead a country into the Communist camp.

In its impact on economic relations, this enhanced sentiment of nationalism tends to transfer to the government many functions which, in a period when public excitability ran less high, were left to private initiative. Thus we see that in most underdeveloped countries, the primary initiator of developmental programs is the government, and that the execution of a large portion of the economic development program is also left to the government or specified agencies created and supported by it. In all underdeveloped countries, development plans and programs have been set up which usually throw the main burden of development on the government, and even where provision for private action is made, this is rigorously circumscribed within the public effort.

The role of the government becomes enhanced not only through the ideological trends already indicated, but also through the apparent magnitude of the task of economic development in a country with very disappointing economic performance as compared with the more advanced countries. The difference in material levels of living is great, the aim of achieving rapid development requires an effort of unusual proportions, and that leaves only the government as the primarily responsible agent for economic growth. On the one hand, this creates certain advantages, in that it allows a more highly planned and presumably less wasteful program of development. It also makes possible the application of foreign aid through the channel of government. At the same time, it creates a serious danger to the survival of democratic institutions where they exist and an awesome block to their development where they do not as yet exist in any real way. In most underdeveloped countries, some form of totalitarian movement, either of a Communist or a nativistic Fascist variety, is constantly present.

With the government controlling not only the apparatus of political government and enforcement, but also in command of all the crucial economic installations, a concentration of power is created which may be used potentially for the good of the country, but may also be used for evil.

The situation is aggravated in many underdeveloped countries because of the almost total lack of a middle class. As was explained earlier, a middle class is as much a product of economic growth as one of its creators. In the advanced countries, the middle classes, composed of merchants and industrialists, intellectuals and opinion leaders, have, on the whole, exerted an influence of moderation. They have recognized clearly that they would only lose from war or civil disturbance and have therefore been a force favoring compromise and combatting extremism of various sorts. In the underdeveloped countries, the rising middle class is placed somewhat in a dilemma, especially if it is made up—as seems to be the case—to a large extent of intellectuals. Unless these persons can be integrated into the government machine or its branches, or find a place in political or voluntary organizations operating under the general guidance of the government, they are likely to become disaffected and to develop leadership ties among all sorts of freely floating disgruntled elements. The rapid growth of many capital cities in underdeveloped countries has led to a congregation in them of a large number of such homeless, shiftless individuals, and it is not too difficult for political adventurers to gain influence among them. Thus the danger of civil disturbance in underdeveloped countries is often great, and it sometimes takes only a slight setback in economic performance, or some relatively insignificant incident in international relations, to provide these leaders of the rabble with political ammunition of a deadly sort. The mass demonstrations in many countries of Asia in support of Nasser's position in the Suez Canal crisis are an example of the highly unstable situation existing in many capitals in underdeveloped countries.

Thus the political and social equilibrium in underdeveloped countries is highly unstable. A country which may at one time appear to be firmly within the free world camp, may turn the next day to Communist sympathies, and may turn back again the following day. Since economic affairs are largely controlled by the governments of underdeveloped countries, the changing sympathies of these governments, or an actual change in government owing to a coup d'etat are ever present possibilities which must be reckoned with. A program of economic aid to such countries may run the risk of eventually helping to build up strength in a country which will turn its back on the West and may become a partisan or sympathizer in the Communist camp.

At the same time, economic development and a genuine improvement in material conditions of living of the masses of the people are two of the most important prerequisites of democracy and genuine self-determination. Only a population which has risen above a level of abject poverty, which is literate and enjoys some of the fruits of its own efforts, can be assumed to take an independent and responsible interest in the fate of its nation, and can be expected to react through orderly, democratic procedures to actual or potential excesses of its rulers. To the extent, therefore, to which foreign aid can be applied to bring about a rise in material welfare, its ultimate political significance may lie in bringing about a greater degree of responsibility, moderation, and political stability.

It is as yet an undecided question what direction the underdeveloped countries, especially those crucial countries located on the southern and eastern rim of Asia, will go. A policy of timidity would advise no aid or a minimum of aid, since there is a possibility that they may turn their sympathies to the Communist orbit. At the same time, a more or less extended program of development would count upon the capacity of political leadership to be developed in these countries to lead them, if not into the political orbit of the free world, at least into an orbit of their own. One should not forget that if south Asian or Near Eastern nationalism turns against the "imperialists" of the West, it also recognizes that it has little to expect from the imperialism of Russia and its satellites. Perhaps the best that can be achieved in this part of the world is a policy of neutralism, and it may be the function of foreign aid to preserve this neutralist position and to prevent any further encroachments of communism in this part of the world. The danger of such encroachments is sometimes increased by Soviet aid programs. Many noncommitted countries try to receive aid from both the United States and the Soviet Union, so that part of the purpose of American aid to these countries would be to counteract the intended political effects of Soviet aid.

At best a policy of foreign aid in this part of the world is a calculated risk. It is foolish to expect that foreign aid programs, even if they were much larger than those at present, would gain the United States inalienable friends in Asia and Africa. But at the same time, it would be a foolish policy to be so stinting in aid programs that the chances for the success of communism were materially enhanced by the continued unfulfilled aspirations of the masses of poor Asian and African farmers and workers.

In the preceding paragraphs we have discussed some similarities facing currently underdeveloped countries in one general region of the world: in Asia, the Near East, and Africa. It was there that colonialism was most highly developed, and it is there that nationalism is most rampant and aspiration for higher living standards most vociferous. These are also the regions in which economic performance is relatively most disappointing, and in which the obstacles to economic development appear to be greatest.

In countries with somewhat more satisfactory economic performance, notably in the countries of Latin America and the poorer countries of Europe, the degree of political instability is greatly reduced. In these countries planning for economic development is also largely a function of government, and most of the developmental effort is inspired or at least channeled and regulated by the government or certain of its agencies. We do not wish to give the impression that our analysis is based on some modified form of economic determinism, i. e., that countries with somewhat higher levels of economic performance are safer from totalitarian encroachments than countries with less satisfactory economic performance. Among the countries which are safest against Communist inroads are Burma and Thailand, both of which have very low levels of average income. What matters, however, is apparently the fact that once a country overcomes the greatest bottlenecks to its economic advancement, it can devote its attention more to the business of economic improvement and less to the search for sudden and purely illusory panaceas, which all too often lead into the direction of Communist entanglements. The need for economic development and political recognition becomes less desperate, though they are still strong and even overriding motives of social action. But the procedures applied become more routinized and regularized, and though they remain important public issues, they cease to appear to be matters upon which hinge the apparent survival of the nation.

3. Differences and similarities in population density

Underdeveloped countries also differ in the density of population, especially rural population, with which they enter the phase of industrialization. This factor is merely a reflection of the one discussed earlier—differences in resource endowment. But whereas we discussed earlier the differences in the chances for development of a country with large or small area or with varied or unsatisfactoy natural resources, we now turn to a discussion of the differences depending on whether the general relationship between population and resources is favorable or not. It is in this field that some underdeveloped countries differ most markedly from the presently advanced countries which went through their period of early industrialization in the 18th or 19th century. A developmental pattern such as that open to the United States or Canada is completely beyond the reach of any currently underdeveloped country, unless technological inventions are made which will allow it to convert at low cost desert country into fertile agricultural land, or to overcome the barriers to transport and agriculture imposed by such masses of mountains as the Himalayas or the Andes. Only in the Soviet Union and to a limited extent in South Africa and Brazil could an overall expansionist pattern of economic development, characteristic of the United States in its crucial period of growth, be followed.

Thus as compared with the economically most advanced countries, the underdeveloped countries all start from a less favorable man-land (or better man-resource) ratio, and this is an important factor which influences, at least within the limitation of present technological achievements, their ultimate capacity to develop economically. The countries of Europe were less favorably situated in this regard than the United States, and there are some underdeveloped countries which resemble in the proportion of population to agricultural land, and possible other resources, the countries of Europe when they started their process of development. These underdeveloped countries are in the position of latecomers who are burdened with all the disadvantages, but also some of the advantages, all latecomers face. Some Latin American countries, some regions of Africa, and one or two of the smaller countries of Asia may be reckoned in this group.

But many of the presently underdeveloped countries have a population resource density which is considerably greater than that of even the most densely populated European countries at the time of their industrial revolution. Moreover, this dense population is due not to the abundance of large and populous cities, but rather to the high density of rural populations in all but the most niggardly regions of the country. Thus expansion of settlement is difficult, and an extension of the agriculturally usable area, though not impossible, is associated with very high costs. In this way, the problems faced by densely populated countries, such as India, Ceylon, or Egypt, differ fundamentally from those faced by some of the more highly industrialized countries. Even in Europe, where population was more densely settled than in the New Worlds of America and Oceania, it was still possible to extend agricultural settlement within most countries when their industrial revolution set in, and where this was not possible, the "surplus" population, to the extent to which it did not migrate to the cities, found new economic opportunities overseas. This alternative is virtually closed to the densely populated underdeveloped countries of today, and the only place where the rural "surplus" population can congregate is cities.

This situation enhances the need for capital formation, especially in industry, but also in agriculture. Industrial capital is required in order to provide opportunities for the productive employment of those individuals who leave the countryside where they are underemployed, as well as for new entrants to the labor force who cannot find suitable employment in agriculture because of the already existing overcrowding there. Capital investment in agriculture is required in order to increase the output of food and fibers which are needed in growing amounts in order to supply the population with more consumer goods. It is clear that in countries in which present levels of output are low, so that average real income is low, the savings necessary to form such relatively vast sums of capital are difficult, if not impossible, to procure. Among methods which might be applied to force the population to save are totalitarian policies, and such policies are tried with varying success in China. Terror and compulsion have the disadvantage of giving people little incentive to work hard and to take good care of tools. There does not seem to exist clear proof that totalitarian forms of compulsion are better suited to starting a poor economy on the road to relatively high levels of capital formation than a policy of less coercion and one in which more free play is left for private initiative and personal effort. Nevertheless, the Communist countries have succeeded in persuading many members of the intelligentsia in Asia and other underdeveloped countries that their methods have been successfully applied in Russia and continue to be successfully applied in China.

Since the successful overcoming of the basic obstacles to economic growth is one of the primary concerns of many governments in underdeveloped countries, the Chinese claim of having successfully tackled this problem will be observed by many statesmen and politicians in underdeveloped countries with a great deal of interest. It is for this reason that the achievements attained in Communist China are of concern to the free world. Not only is the power potential of China one which may have to be reckoned with, but of equal importance is the propaganda effect which Chinese economic growth is likely to exert on the minds of Asian and African leaders. If China's performance should succeed in outstripping that of other Asian and African countries by a noticeable degree, an important advantage for the Communist bloc will be gained. In the present international situation one may, therefore, consider it a matter of considerable importance for the countries of the free world to insure, as much as they can, that the non-Communist countries of Asia and Africa are provided not only with the military means of resisting Communist aggression by force of arms, but also with the means for developing their economies at a pace which is at least commensurate with that of Communist countries. For if these countries fail to satisfy at least some of the aspirations of their peoples in the economic sphere, their military arms against communism may prove to be a chimera.

We shall now turn to a discussion of some of the concrete problems and potentialities of economic development in Asian and African countries. We shall omit Latin America from our survey, because in that part of the world the problems are relatively simpler and may be solved by the more orthodox means of capital transfers and private investment. We shall concentrate mainly on economic factors, but, as will be seen, in some instances in which political factors loom large, their decisive influence upon the chances of economic growth must be considered.

B. DEVELOPMENT PROSPECTS IN SELECTED COUNTRIES AND REGIONS

1. India

India is a vast subcontinental area with a large population, predominantly agricultural, much rural "disguised unemployment," and a very low level of living which according to best estimates has been almost static in the last 75 years. India obtained independence in 1947 and had to deal with difficulties brought about by the separation of Pakistan. The first 5-year plan (1951–56) involved a planned Government investment of about $5 billion, of which less than $1 billion was to come from foreign aid. About one-third was spent on agriculture (including community development projects, irrigation, and flood control), one-fourth on transport and communications, one-fourth on social services, and the remainder on electric power, manufacturing, and minerals (most industrial development was under private auspices). Only about $4.2 billion was actually spent, and not all foreign aid granted was used.

As a result of the plan, total production increased 12 to 13 percent, which meant only 1 percent per year per capita, since population increased at a rate of about 1½ percent. Although industrial output rose by 50 percent from 1950 to 1954, employment in "organized industries" remained at 2,500,000, while real earnings of workers increased, but only to the very low 1939 level. Unemployment, both open and "disguised," actually increased, the total labor force increasing by about 9 million, while employment only increased by half as much.

The second 5-year plan (1956–61) involves a planned governmental investment of about $10 billion, a projected rise of total output of 25 percent, a greater stress on industry, an increase of 8 million in nonagricultural employment and of 2 million in agriculture, with unemployment expected to remain the same. This would require (allowing for private investment and $900 million new foreign aid) a rise in the rate of savings from about 7 percent of national income in 1955–56 to about 12 percent by 1961. It is doubtful, however, whether such an increase in savings or in output can be achieved, and it has been estimated that the gap between resources available and those needed to finance the plan may be as high as $5.5 billion. It is planned to stress industrialization, especially basic and heavy industries, to continue land reform, to place a ceiling on the level of salaries, and to encourage small-scale industries.

Despite difficulties, the prospect for Indian economic development appears to have some favorable aspects. The fact that as small a percentage of foreign aid as 10 to 15 percent of the development budget is planned shows that India is attempting to rapidly develop its own resources and productive capacity, even though this may involve great sacrifices. India also appears to be willing, quite independently of any foreign aid program, to engage in the necessary social changes required in the process of economic development.

2. China

Chinese development under Communist auspices differs from India in still greater stress on heavy industry, in a much more drastic agrarian reform, and in attempting to collectivize agriculture. Because of these and other differences in policies, investment in China was about 12 percent of the national income in 1952 (as compared to 7 percent in India), and may increase to about 20 percent by 1962 (as compared to a planned 12 percent for India). But it is not clear whether this will mean a faster rate of development in the next 5 years than in India. For the greater proportion of resources available in China may be offset by disadvantages, including wastes involved in centralized planning, the need to build a whole network of railways before China's natural resources can be used, emphasis on heavy industry which yields a more delayed return, and also the diversion of a larger portion of the total product to the governmental bureaucracy and to military purposes. But, like India, China appears to be breaking out of a long period of stagnation, and output may grow from 2 to 4 percent per year, but without a corresponding increase in consumption per head, or even the slow rise that will probably take place in India.

3. Southeast Asia

Apart from Java, parts of east Pakistan, and the island of Singapore, countries in southeast Asia are not heavily overpopulated, and the problem of "disguised unemployment" is less acute. The economies of these countries depend mainly on the export of raw materials and rice to India, China, Japan, and Europe. Several countries (e. g., Burma, Malaya, and Indonesia) have the difficult problem of sizable foreign immigrant groups—Chinese and Indian—which have performed in the past crucial economic functions, e. g., in commerce, and yet are the objects of a suspicion which is mutual. Several southeast Asian governments have established marketing monopolies. Since these operate like a heavy tax on producers, and since these countries have received proportionately more foreign aid, than India, for example, their ability to accumulate capital is enhanced. On the other hand, Government trading may not be a perfect substitute for foreign merchants, and native enterprise, whether private or governmental, has not yet fully replaced foreign enterprise.

Developmental prospects for South Korea, South Vietnam, and Taiwan, which receive proportionately the most foreign aid, are obscured by the effects of the heavy cost of defense against Communist aggression. Taiwan and South Korea have carried out land reforms and undertaken a fairly rapid industrialization program largely based on American technical assistance and aid in capital investment projects.

4. *The Middle East*

Population everywhere in the Middle East is increasing rapidly—at a rate of 2 to 3½ percent per year—mostly by natural increase, but in Israel by immigration. Except for Egypt, Jordan, and Lebanon, the problem of overpopulation and of "disguised unemployment" has not been very acute. Per capita income has probably fallen in Egypt and Jordan, and risen elsewhere, though data are fragmentary. Since water, rather than land, is the crucial agricultural shortage, irrigation is of great importance. Major irrigation projects have been started, especially in Iraq, and during the last 30 years, there has been a rapid increase in both agricultural area and output in Syria, Iraq, Israel, and Iran. Except in Israel, and in a qualified sense in Egypt, no full-scale revolution in the system of land tenure has been attempted, but some public lands have been distributed to small holders.

Despite the fact that some $1 billion per year in royalties and local disbursements derived from the extraction of oil becomes available, development prospects are not very favorable for the Arab countries of the Near East, largely because of political conditions. Outstanding among these is the tension between Israel and the Arab States, which deflects an inordinate amount of human and capital resources—which could otherwise be used for economic development—into the buildup of military power. Another important political impediment to the economic development of most Arab States in the Near East is the political fragmentation of Arab countries, resulting in insecurities arising out of mutual quarrels on the one hand, but having as a consequence also the fragmentation of markets and potential overinvestment in a few industrial spheres. Moreover, one must not omit mentioning the influence of large landowners, who are usually absentee landlords, enjoying often immense incomes. These landowners are content with matters as they stand. Improvement in agricultural techniques on their holdings might produce various new difficulties which they try to prevent by attempting to maintain traditional social and productive relations. Finally, the changing political relations between various Arab countries of the Near East and the Western

World on the one hand, and the Soviet on the other, make them poor risks for investments in other fields than oil and possibly a few minerals. Thus the economic development of the Near Eastern Arab countries is greatly hampered by the unstable political relations in that area, and is not likely to have much chance of success until this political instability is considerably reduced.

5. *Africa*

It is impossible to give even a brief sketch of developmental possibilities in Africa. This continent is composed of countries on different levels of political independence, and this is one factor which plays a considerable role in the developmental potential of the various regions. In addition, the European powers who have established colonial or trusteeship relations in various regions differ in their economic policy at home and with regard to the countries within their sphere of interest.

Among the African areas south of the Sahara which in the past have shown the greatest capacity for economic progress are the Sudan, the Central African Federation, and the two large British territories in West Africa, the Gold Coast and Nigeria.

All these countries have certain external similarities. All have a small number of valuable export products which have made possible the importation of consumer goods from the advanced countries, but also some capital investment. In the Sudan, Nigeria, and the Gold Coast, moreover, the main export crops are produced by small and middling native farmers, and these persons have, in an indirect way, thus been tied into the network of world trade. Although in Nigeria and the Gold Coast, the staple exports have been subjected to regulation by marketing boards, the resulting large revenue has been applied, in considerable degree, for the creation of social overhead, thus enhancing the chances of economic growth in these countries. In all three countries the masses of the indigenous population have succeeded in acquiring political rights, in general more extensive than those of Africans elsewhere, and the countries either have already gained or are close to gaining political independence. There are still great difficulties in the path of economic progress in all three countries, but they appear to offer rather good opportunities for economic development.

The Central African Federation (Southern Rhodesia, Northern Rhodesia, Nyasaland) unlike Nigeria, the Gold Coast, and the Sudan, where permanent European settlers form only a negligible minority of the population, has a relatively larger permanent European population. There are some 200,000 Europeans and about 6.5 million Africans. This Federation has developed rapidly in the past on the basis of European exploitation of minerals.

Just as cotton forms a staple export of the Sudan, and cacao and palm oil of Nigeria and the Gold Coast, so minerals form a major export staple of the Central African Federation. But whereas the agricultural exports of the three countries in northern and western Africa are grown by a large number of small farmers, the production and export of minerals from the Central African Federation depends to a large extent upon European enterprise. Nevertheless, investment rates in the Federation have been extremely high in the last few years, varying from above one-third of national income in Southern Rhodesia to about one-fourth of national income in Northern Rhodesia. Euro-

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pean settlers have also developed tobacco and tea for export and some manufactures for the small home market. Most of the skilled and professional labor is provided by whites, the unskilled by Africans.

The racial division and the serious obstacles imposed upon Africans to move upward in the social and occupational scale are among the most important impediments for continued economic development of the Federation, commensurate with its past performance. The rate of increase of Africans in the "westernized" sector of the economy has been very rapid in the last few years. However, this rate is likely to be reversed since migration of Africans to urban centers encounters increasing obstacles, and the main impact of the population growth among Africans is likely to occur among the "nonwesternized" subsistence farmers, rather than the dwellers of cities, towns, and mining camps. Unless greater freedom of movement (both in a geographical and occupational sense) is permitted for Africans, the rate of increase of income is likely to decline, and although further economic growth may continue, the aroused aspirations of Africans are not likely to be met in full. This may have one of two results. Either it may end in a policy of suppression of Africans, similar to that of South Africa, or it may develop into a period of internal strife, similar to that of Kenya. Under either alternative, the progress of economic growth is likely to come to a standstill.

This indicates that in Africa various patterns of development are possible and likely. The Portuguese colonies are likely to continue to stagnate, and west Africa and the Belgian Congo are likely to show the most satisfactory rates of progress. In east Africa, as in South Africa, the potential conflict of Africans and whites may exert an important impact upon economic development and political stability. The same is true of north Africa, where the problem is enhanced because of the traditional animosities between Moslems and westerners.

Thus, whereas in Asia the possibilities of economic advancement are profoundly dependent upon the question of what will be Communist strategy, in Africa they are dependent upon whether the conflicts between Europeans and Africans can be resolved and a more or less stable settlement reached. Whereas in Asia the abundance of population presents one of the most difficult impediments for economic growth, in Africa and the Near East it is the waste of resources for political or military aims and the rigidity and castelike appearance of the occupational structure. These problems cannot be solved directly by the application of economic aid, and can be solved only very partially by the granting of military aid. They are problems which each country must work out for itself, and which have deep roots in its historical traditions and its cultural and social relations. What foreign aid can do is to help economic development provide a more favorable framework within which these conflicts and obstacles to a final victory over economic backwardness can be overcome.

CHAPTER V

THE EFFECT OF FOREIGN AID ON THE PATTERN OF DEVELOPMENT IN UNDERDEVELOPED AREAS

A. THE ROLE OF EXTERNAL ASSISTANCE IN THE DEVELOPMENT OF ADVANCED COUNTRIES

As was already pointed out in earlier chapters, external assistance in a wider sense played an important part in the development of currently economically advanced countries, while assistance in the very narrow sense of the term was virtually nonexistent. There was no deliberate Government policy in early 19th century Britain of aiding the economic development of such countries as Germany, the United States, or even its own colonial areas. In fact, up to 1824, the emigration of skilled workers from Britain was prohibited, and up to 1842 the export of certain types of machinery was restricted. But despite these restrictions—which proved to be unenforceable—British businessmen, managers, and skilled workers started some of the first factories on the European continent and elsewhere. There was also some British foreign investment on the European Continent, although the bulk of British foreign investment went to overseas areas, chiefly the dominions, the United States, and Latin America.

In the United States, British investors helped finance railways, canals, and other enterprises belonging in the class of economic overhead. Some of this investment turned out to be unplanned economic assistance when States and railway companies defaulted on bonds. Perhaps the most important foreign contribution to American economic development was made by the hundreds of thousands of immigrants, whose education and early training and support had been paid for by the countries from which these immigrants came. This reduced substantially the amount of capital formation the United States had to undertake. We have already pointed to the fact that this flow was much larger than the present movement of technical experts from the United States and other economically advanced countries to the underdeveloped areas. Moreover, the important fact must be borne in mind that these immigrants came to stay permanently, rather than for a visit of more or less short duration.

Although most of the international investment and movement of skilled workers was an outflow of private initiative, government policy both in aid-giving and aid-receiving countries was not without importance. For example, the French Government induced private investors to finance strategic railways in Czarist Russia, although these investments, which were riskier than normal industrial investments, did not yield higher returns than other securities.

1. *Limitations of private investment as a means of economic development*

Since almost all economic assistance which the developed countries received was in the form of private capital—including capital invested in Government bonds—and since even technical assistance was being paid for by the recipient countries, we must inquire if private forms of investment and capital transfers would suffice in the presently underdeveloped areas to contribute in a similar degree to their economic development. This question must be answered in the negative for the following reasons: (1) Compared with the period before 1914, the total amount of private investment which is forthcoming is proportionally much smaller than at that time, and considerably below the capital needs of the developing countries; (2) private investment is distributed most unequally, both in terms of industrial fields, as well as from a geological viewpoint; (3) a relatively large amount of capital in underdeveloped countries is needed for the development of social and economic overhead. The creation of these forms of capital is normally the function of governments, and private investors would have to be willing to accept the bonds of the governments of underdeveloped countries freely if this type of capital accumulation were to be financed by private investment. Since rates of return in these types of investment are very low, though spread out over a long period of time, and since they are widely scattered over the economy, the private financing of many of these capital installations would meet with difficulties either on the part of investors or the borrowing government; (4) finally, private investment is discouraged in some of the smaller underdeveloped countries because of their limited markets. These markets are limited because the countries are poor and population relatively low. Thus, in spite of capital shortages in such a country, investment in industries other than export industries is not very attractive to private investors, both foreign and domestic. Thus private foreign investment tends to be concentrated in the production of exportable raw materials, which may have little stimulus to the rest of the economy, normally, because these export commodities are produced in plantations or mines which technologically are completely different from traditional forms of production.

In attempting to explain the first two points in this list, i. e., the relative decline in the magnitude of private foreign investment and its unequal geographical and industrial distribution, two sets of explanatory factors appear to be significant. The first is economic and the second political. Foreign investment in the 19th century was relatively greater than it is now because the overall difference in technological performance in the lending and borrowing country was smaller than today. For this same reason, private investors were willing to put their capital into installations which were similar to the ones created in their own countries, whereas today they are willing to put their capital, preferably, into only those lines of production which are clearly complementary to their productive or marketing position.

When the leading countries of Europe had built a reasonably complete railway network, the same persons who had financed the railway networks of France and Britain turned to exporting capital to Spain, Austria, Russia, and the United States, in order to produce comparable railway networks there, and after that to Brazil, Argentina, and South Africa, to repeat the performance. It was the same with power installations, with the development of harbors and ports, and with communications systems. Today this is not the case. A glance at the distribution of American private investment will show that the bulk of it is in extractive industries, and only a small part in industries which are adaptations of American forms of industrial or commercial enterprise to the needs of other countries. The reason for this difference between the patterns of private investment in the 19th century and today appears to be the relative difference in risks of various forms of capital investment in different lines.

Among the political factors, and these appear to be overwhelming, are mainly two: nationalism and the threat of Communist revolution. As concerns nationalism, we have already mentioned that it is widespread and deeply rooted in many important underdeveloped areas. In regard to foreign investors, it is based upon an attitude of the nationalist elite which, though founded in the past upon prejudice against the "foreign capitalist exploiter," has in some instances some foundation of truth. In many of the previously colonial areas in Asia, a large class of indigenous enterprises has not been developed, and to the extent to which anything approaching native free enterprise exists, it is only a thin imported veneer over more traditional types of economy. In some cases underdeveloped countries have, in effect, been governed by an alliance of foreign capitalists and local landlords who tacitly agreed not to interfere with one another's economic sphere. Thus, too often in the past, imported capital has failed to lead to the cumulative self-perpetuating patterns of growth that alone can lead to a substantial rise in material welfare of the population. Though this outcome was often prevented by other factors, such as natural-resource endowment and the quality of population, nationalists in underdeveloped countries have attributed it to foreign governments and foreign investors and have developed vigorous antagonisms against foreign investment, which prevent the flowing of private capital into many fields into which it normally would flow.

A second political factor discouraging private investment in many areas is the danger of political change, especially the danger of a Communist coup d'etat. Although this danger appears to be somewhat reduced after the decisive opposition which Communist aggression met in Korea and Vietnam, recent developments in the Middle East indicate that the appearance of Communist aggression is a constant threat which will exist as long as Communist regimes are in existence. Under these circumstances, private investors are not willing to sink their funds into industrial or agricultural investments in countries in which these dangers appear closer at hand than elsewhere. Apart from sheer Communist aggression, there is in many countries also a danger of actual or virtual expropriation of foreign-held investments, and these conditions, as well as governmental policies in general, are also a deterrent to private investment.

It appears that these factors account largely for the relative decline in the amount of investment and the change in its geographical and industrial distribution. But given these considerations on the part of private investors, it would be vain to expect private investment alone to meet all the legitimate demands for capital in underdeveloped countries. Thus there are certain politically or economically vulnerable areas where only governmental or internationally sponsored investment can contribute to capital formation. And there are, even in the politically and economically safe countries, certain forms of capital investment—especially in various forms of social overhead—in which prospective rates of return are so low that only intergovernmental loans and loans by agencies such as the International Bank for Reconstruction and Development will be acceptable.

Finally, quite apart from the problem of creation of real capital, there are areas of foreign aid in which private investment cannot function at all. One example is the carrying out of extended technical assistance programs, which private persons would not undertake. To be sure, the expert advice which is provided under technical assistance programs could be obtained by hiring the services of experts or expert agencies, but the point in technical assistance is often that the government of the country receiving technical assistance is unaware of the kind of expert advice it needs, and that only extended study by foreign experts contributes the knowledge of what developmental programs can and should be undertaken. There are other fields of foreign aid in which governmental action is required. Apart from military assistance and defense support, this is true of such forms of direct economic aid as the granting of loans under better than ordinary market conditions, or foreign economic aid given through disposal of agricultural and other surplus commodities, and of such forms of indirect aid as alterations in the country's tariff and trade structure, price stabilization of the exports of underdeveloped countries through commodity agreements or stockpiling of strategic materials, and other measures. Thus the intervention of government into the field of foreign aid has not only made possible an increase in the amount of aid granted, but also an increase in the variety of aid available to underdeveloped countries. This has increased the flexibility, and with it, in some measure, the efficacy of aid programs.

B. EFFECTS OF DIFFERENT FORMS OF DIRECT FOREIGN AID TO UNDERDEVELOPED COUNTRIES

The total size of American foreign economic aid is often exaggerated, largely because of a confusion between military and nonmilitary programs. Thus out of $4.6 billion spent on aid programs in the fiscal year 1956, $1.6 billion was spent on nonmilitary programs, of which not more than about $1 billion was aid that contributed to economic development. Of this, about $150 million was spent directly on grants for development assistance, $170 million was spent on technical cooperation, $200 million on loans, and the rest in such forms as the use of surplus farm products and part of defense support.

Another way of classifying economic aid is by those portions of aid which were spent for definite projects and those spent outside such products. Of the total economic aid extended in the fiscal year 1956, close to $400 million was spent in the form of project aid, close to $1 billion on nonproject aid, and somewhat more than $130 million on miscellaneous economic aid. The meaning of these different classifications is made clear in appendix IV.

1. *Direct cash grants*

In the last resort there is litle difference between the economic effects exerted on an underdeveloped country's economy by direct grants, loans, or other forms of governmental assistance. All forms of aid may be viewed as implying a subsidy, either by extending a grant or loan under conditions less onerous than would be the case under private investment, or accepting risks which private investors would not be willing to undertake. Some of the factors that discourage private investment also make doubtful the ability of countries to repay loans—even those granted on subsidized terms. Countries in comparatively early stages of development are able to save only a comparatively small proportion of the increase in income brought about by developmental aid, and these savings may be in forms which are not useful for repayments of foreign loans. In addition, in order to maximize the speed and ultimate chances of success of development, any such savings should be used for local investment. Thus, for countries in earlier phases of development, cash grants are the most effective, as well as the most straightforward and undisguised, form of aid. However, there is always the danger that because they do not have to be repaid, such grants may be used only to increase consumption—and in particular the economically wasteful consumption of a privileged elite. The result would be a temporary increase in consumption and no movement to higher production and development. Such an undesirable outcome could only be avoided by careful control, not only of the aid granted, but also of the local spending, in order to insure that the net result of the aid program was an increase in spending on development projects from domestic sources by an amount at least equal to the foreign grant.

Attempts have often been made to insure optimal use of direct aid by giving direct cash grants (as distinguished from commodities procured with aid money) only on specific projects, jointly agreed upon by the International Cooperation Administration mission in an aid-receiving country and the Government of that country. To some extent, this prevents the diversion of aid to consumption, especially when, as is usually done, the local government contributes its own funds to meet all or part of the costs for local labor and materials. But this does not prevent other, more indirect forms of waste. Some funds that might have been used for economic development projects in the absence of an aid program may be diverted to nonproductive uses. More important, perhaps, many projects that appear quite sound from an engineering standpoint may involve costs to the economy greater than the benefits produced by the investment. Such investments are actually worse than luxury consumption, for in the latter case the loss ceases when the money has been spent, while in the case of misinvestments, the loss may recur until the equipment is scrapped.

2. Commodity grants

Another form in which aid is given is the grant of staple commodities such as wheat, cotton, and steel, either purchased out of surplus farm stocks or procured directly with money appropriated for aid. It is estimated that 70 percent of all economic aid consisted in recent years of commodity grants, and only 30 percent of direct aid for meeting the dollar costs of specific development projects. Often such commodity grants are used to provide raw materials needed to keep the industries of a country going when, owing to heavy military spending or for some other reason, there is not enough foreign exchange available to pay for the required raw materials if these have to be imported. Though such aid does not directly contribute to economic development, it may permit consumption of goods produced with the use of these raw materials to be maintained, even though at the same time military or capital accumulation expenses are not curtailed. Commodity grants are made also in order to provide more consumers' goods, with the aim of preventing inflationary tendencies which might result from expenses by the aid-receiving government on defense and development.

Although commodity grants do not directly further economic development, they can support it indirectly in two ways: industrial raw materials, such as cotton and steel imported under a commodity grant, make the expansion of industry and agriculture possible; and counterpart funds arising from such imports may be applied to local development projects which would not be undertaken otherwise. The test of whether the use of a commodity grant is an indirect subsidy to consumption in the aid-receiving country or a contribution to its economic development consists in whether the resulting expansion of the economy will make possible the earning or saving of the needed foreign currency to purchase the raw materials required to maintain the expanded production. If this is not the case, the expansion would either cease with the cessation of further commodity grants, or else future aid would in effect be diverted from genuine development projects to subsidizing indirectly the losses resulting from previous misinvestments. These misinvestments may be assumed to have arisen because the new industries received raw materials imported on a subsidized basis. Yet in the long run, economic efficiency was not promoted by this subsidy sufficiently so that the goods of the aid-receiving country became cheap enough to be sold on the world market to pay for the raw material imports needed for the production of these new commodities.

The effects of the use of counterpart funds in local currency, whether obtained from the sale in the local market of commodity grants or of farm surplus commodities, will be discussed further below, in section 5.

Another form of commodity aid consists in the gift of war surplus material. In some circumstances such material may be useful for development, but in others it might be more economical to sell the surplus material to the highest bidders (unless this was precluded by security and other considerations), and instead give aid in the form of direct cash grants.

3. *Technical assistance*

(*a*) *Technical assistance programs by the United States.*—Technical assistance (or as it is sometimes called, technical cooperation) may be defined as an attempt to encourage, by deliberate government action, the transfer of specialized skills, techniques, and technical and productive procedures from one country to another. It consists in obtaining technical experts, advisers, and demonstrators, with a grant necessary to meet their expenses, including salaries and equipment. This latter may sometimes include the setting up of pilot plants.

Technical assistance is advocated both because it appears to be relatively cheap, and also on the ground that underdeveloped countries need, even more than capital, the technicians required to help them train their own technicians and to introduce new methods of production. Moreover, technical assistance projects embrace resource surveys, and in this way they form the basis for any further foreign aid, whether in the form of technical assistance or grants or loans of capital.

The amount of technical assistance aid granted by the United States amounted to more than $150 million in the fiscal year 1956, the highest amount on record. This sum includes a small amount of disguised direct economic aid, but it is limited primarily by the scarcity of experts who have the necessary technical and personal qualifications to work on such projects in underdeveloped countries.

On the whole, technical assistance has met with more widespread support than most other forms of foreign aid. For example, it is argued by some that giving an underdeveloped country money to finance the expenses of technical experts, and the import of equipment needed for demonstration purposes, is a constructive measure, helping the underdeveloped country to help itself, whereas donations for other purposes (except military aid, defense support, and aid to meet various emergencies) are demoralizing handouts and giveaways of the taxpayers' money. Yet it would be at least equally sound to argue that, if a country is unable or unwilling to pay for the comparatively small cost of the technical assistance, it will be equally unable or unwilling to pay the cost of the remainder of its local development program. Sometimes it is said that a country is able to pay the local currency costs of its development, including the salaries of its own experts, but not the foreign currency costs. But even this argument is not valid, since if the services of foreign experts or certain forms of foreign capital are considered particularly urgent for economic development, measures can usually be taken to increase exports or diminish imports in order to earn the needed foreign exchange to pay for technical assistance. Thus, in the last resort, technical assistance may be regarded as a form of foreign aid which can be substituted for other forms of aid. If a country receives technical assistance, it has more funds left for either import of capital or of additional consumer goods. If it receives a commodity grant or direct aid in the form of capital equipment, it can use foreign exchange to hire experts to get advice on technical matters. From an overall economic viewpoint, these different forms of aid are substitutes. The difference between technical assistance and other forms of aid has, however, important administrative implications, and if a distinction between technical aid and direct cash or commodity grants is made, it should not be made by regarding one as useful and the other wasteful, but rather by the different administrative and personnel problems arising out of these forms of aid. We shall not enter into a detailed discussion of these differences, since these matters are more appropriately taken up in other studies on personnel problems in foreign aid and administration of foreign aid programs.

The technical experts recruited by Government-financed technical assistance programs may be only a small part of the total international flow of technicians from developed to underdeveloped areas. These programs are intended to introduce new forms of techniques which can later be integrated into the ordinary Government development programs and extension services. Thus, one of the most effective forms of technical assistance is the servicio approach, which was pioneered (at least as far as United States programs are concerned) in Latin American economic development. In its report on technical assistance in Latin America, the National Planning Association has described a servicio as follows:

> A servicio is not a program. It is like a flatcar onto which a specific project can be loaded and carried to the point at which it can be transferred entirely to a wholly domestic agency of the host government. This flatcar can carry a number of projects simultaneously, unloading each at its appropriate destination, and taking on new projects * * *.

In some cases, however, the projects initiated by the servicios could not be transferred effectively to the governments of the Latin American countries. Sometimes this was due to lack of adequate administration on the part of these governments, and sometimes to the absence on the part of the Latin American governments of full conviction of the value of the projects, though they had approved them because they were induced to try them by a United States agency. Generally, however, the Latin American governments have been paying an ever-increasing proportion, ranging from 50 percent to 95 percent of the total cost of the technical assistance programs, gradually replacing United States technicians with their own nationals trained with the help of the program, and thus allowing the program to expand without an increase in the total number of United States technicians.

Officially sponsored technical assistance has greatly increased since it was made part of United States policy in 1949. Previous to that date, American governmental technical assistance had been confined to specific areas, mainly to Latin America and to a lesser extent China, as well as in a number of scattered projects in United States territories in the Philippines and the Caribbean.

To some extent, however, technical assistance has merely replaced movements of skilled people on private account. Some countries in Southeast Asia and in Latin America have laws restricting the number of foreign employees that a foreign-owned corporation can employ. Native-born citizens are favored in the distribution of import licenses and in other ways. Partly as a result of such laws, a large number of Indians and Britishers in Burma and Dutch in Indonesia, for instance, have left since these countries became independent. This has been a serious handicap to their economic growth, since these groups formed a large part of the small class of private enterprisers, as well as professional persons in government and business, and it will take some time before they are adequately replaced by local businessmen or by government enterprise assisted by technical assistance.

The emphasis in United States technical assistance programs has been shifting away from agriculture, health, and sanitation toward industrial and public administration projects, although the former are still predominant. Some projects which involve a greater degree of direct capital assistance—the expansion of already known techniques rather than the teaching of new ones—have been included in the technical assistance program.

(b) *Technical assistance of the United Nations and private agencies.*—The United Nations and most of its specialized agencies also furnish technical assistance, though on a more limited scale than the United States. Besides the large number of small programs undertaken by the United Nations expanded technical assistance program, there are the survey missions to underdeveloped areas sent by the

International Bank for Reconstruction and Development. These missions, undertaken at the request of the governments concerned, make comprehensive, book-length reports on the economy of the country visited. These reports deal with every aspect of the development of these countries, including not only strictly economic aspects, but also health and education systems. Governments are aided, by the survey missions and in other ways, to create coordinated development programs. Such survey missions have been sent to Colombia, Turkey, Guatemala, Cuba, Iraq, Ceylon, Surinam, Jamaica, British Guiana, Nigeria, Malaya, Syria, and Jordan. These survey missions try to estimate the amount of investment that each country can undertake with the resources at its disposal, recommend priorities for public investment among the various sectors of the economy, and economic and financial policies and administrative measures necessary to assure the success of a development program, as well as technical recommendations.

The International Bank for Reconstruction and Development, like the International Cooperation Administration, participates in other technical assistance programs, including training programs for junior career officials from underdeveloped countries.

Private programs which are similar in their aims to technical assistance have existed for many years. Besides some of the work of missionaries, especially in the field of education, medicine, and agriculture, and the philanthropic work of such groups as the Rockefeller International Basic Economy Corp., the Ford Foundation, and many smaller agencies, some business firms have been set up which offer their services as consultants in various fields, such as engineering, of economic development.

These private varieties of technical assistance have some advantages over government programs. Among them are (1) a somewhat greater flexibility, (2)no damage to the national prestige of the aid-giving country if a program fails; and (3) less suspicion on the part of the aided country that ulterior motives may be involved in granting technical assistance. These advantages of nongovernmental programs are, however, counterbalanced by a number of serious disadvantages. Among them are: (1) Many assistance programs may be too large in scope or too expensive for any one private corporation or foundation to undertake; (2) some projects that may be deemed to be in the national interest of the United States may not be financially attractive to private corporations or may not be capable of being executed by any but a public agency; and (3) most important, a technical assistance program executed by a Government agency, such as the International Cooperation Administration, may be integrated into a wider program of foreign aid and may be mutually coordinated with such an extended program of aid. This is usually impossible with private technical assistance projects. To some extent the advantages of both privately and publicly sponsored technical assistance projects may be combined by subcontracting a portion of a government program to a private organization. The International Cooperation Administration has gained some valuable experience by such procedures.

4. Loans

In the field of loans, a distinction must be made between regular loans given by one government to another, and so-called soft loans, which contain certain aspects of a direct grant in the outward garb of an intergovernmental loan. The general economic effects of a regular intergovernmental loan are not different from regular loans granted by other agencies, and we shall discuss such loans further below. First we shall turn to a short discussion of "soft" loans, which stand somewhat intermediate between straight grants and regular loans, and hence have some of the features of each.

(*a*) *Intergovernmental "soft" loans.*—Soft loans have, on the whole, very similar economic effects to straight grants, except that there is some expectation that the loans will be both serviced and repaid—usually at interest rates well below the rates acceptable to other lenders. Thus soft loans are always, to some extent, free grants, since private investors, and even semi-public institutions such as the International Bank for Reconstruction and Development or the Export-Import Bank, would not undertake loans on these terms. Soft loans, like grants, though they may contribute extensively to economic development, may not contribute in equal degree to repayment capacity, because the benefits of the development may either be spread too widely over the economy to be collectible in taxes, or may be concentrated in branches of production in which it is difficult or impossible to raise sufficient foreign exchange for repayment. Thus the distinguishing mark of a soft loan is the fact that the lending country realizes the difficulties in the way of repayment, and faces the possibility that interest service on the loan or final repayment in full may not be realized.

Soft loans are usually given for purposes in which political or military-strategic factors play some role. Hence the direct repayment of the loan is only a part of the expected recompense, and another part may be the expectation of reduced foreign aid in other forms, or reduced military expenditures, or other benefits which are difficult to measure. This ambiguity in the overall conditions of soft loans militates to a considerable extent against them. If the loan is to be repaid, and if it is expected that it can be repaid, it is preferable to grant a straight loan, instead of a doubtful soft loan. If it is expected that the loan cannot be repaid, in full or in part, it is preferable to extend a straight grant for that amount which cannot be repaid, and a straight loan for that portion which can be repaid.

The practice of granting soft loans is due to a number of coincidences which have primarily a political, rather than an economic, background. As concerns the aid-receiving country, it may prefer to receive loans instead of straight grants, even though it may finally have to default. Its prestige appears to be somewhat less affected if it can be regarded as receiving foreign aid in the form of loans instead of straight gifts. On the part of the United States, the granting of soft loans is influenced by legal provisions, among others the provision of the Mutual Security Act of 1954, according to which efforts should be made to give as much as possible of American aid in the form of loans. In a way, the extending of soft loans is an attempt to choose the least of several evils: since grants are either not acceptable or cannot be made under the law, but since aid is clearly in the national interest of the United States and the aid-receiving country, a soft loan is given. A combination of straight grants with regular "hard" loans, repayable at the market rate of interest, would be more suitable from a purely economic point of view than soft loans, especially in the case of those underdeveloped countries which can clearly be expected to meet their obligations arising out of international indebtedness.

(*b*) *Private, International Bank for Reconstruction and Development, and Export-Import Bank loans.*—Largely because of a record of defaults on foreign government bonds in the 1930's, there now is a very limited market for such bonds. But indirectly, through the International Bank for Reconstruction and Development, international lending has revived, since the International Bank for Reconstruction and Development derives part of its capital from bonds floated in the United States, Canada, Switzerland, and various other Western European countries, although the bulk of the bank's capital is subscribed by the member countries. Most International Bank for Reconstruction and Development loans have been made for projects such as improvements in railways, highways, and other forms of transportation, and electric power, though some loans to India have been for iron and steel plants, and some loans to Latin American countries for the importation of farm equipment. Up to January 1954, only three loans were made for general development programs.

Most of the loans of the International Bank for Reconstruction and Development have been not to the most underdeveloped countries, but reconstruction loans in Europe and loans to countries in an intermediate stage of development, such as Japan, Brazil, Chile, and South Africa, mostly at interest rates of approximately 5 percent. Among the factors considered in its loan policy are the effectiveness of government administration; the availability of managerial, supervisory, and technical skills; the currencies in which debts can be paid; and the capacity of the country to pay these debts. The International Bank for Reconstruction and Development does not finance "social" projects such as sewage systems, street paving, water supplies, housing, health, and education, although these are recognized to be an essential part of a development plan. These services must be financed out of the underdeveloped country's own revenues, since they do not lead, except very indirectly, to an increase in the ability to pay off foreign loans.

The effect of the loans of the International Bank for Reconstruction and Development has been to provide facilities such as electric power systems and improved transportation that created new opportunities for private investment. In a similar fashion, the Export-Import Bank also loans on a commercial basis. It emphasizes loans to Latin American countries, but follows, on the whole, a policy very similar to that of the International Bank for Reconstruction and Development.

The experience of both the International Bank for Reconstruction and Development and the Export-Import Bank seems to suggest that, since in no year has more than approximately $550 million been lent to underdeveloped areas by these agencies, their capacity to repay loans on anything like a commercial basis is limited. The coordination of direct grants with loans by these institutions, as well as with private investment, is likely to lead to a greater amount of development at a given total cost, since the endeavor to qualify for these loans would lead underdeveloped countries to improve their plans for economic development, including their taking steps to use their own capital.

With respect to commercial or near-commercial loans, as well as to soft loans—to the extent to which they are serviced and actually repaid—one further observation is in order. This relates to the actual mechanism of repayment. It is, of course, this repayment feature which differentiates loans from direct aid, grants, and other forms of assistance which do not require repayment. First, there is the problem of how the underdeveloped country raises the necessary funds for servicing and repayment of the loan, and secondly, there is the transfer problem. This last problem will be discussed within the context of the economic effects of indirect forms of aid in connection with United States trade and exchange policy, in section V.C.3.

The problem of repayment and servicing of loans is one of the central reasons for the economic surveys and similiar studies which the International Bank for Reconstruction and Development or the Export-Import Bank carry through in processing loan applications. It is this scrutiny of repayment possibilities which has been a chief factor in contributing to the overall limitation of loans granted, but it has at the same time had the effect of imposing upon borrowing countries more orderly forms of budgeting and administration of public projects than would have been the case without such studies. Thus, in the long run, the activities by the chief national and international loan agencies have contributed to the overall capacity for economic development in many underdeveloped countries, and the extension of loans by the International Bank for Reconstruction and Development and the Export-Import Bank should be judged not only in terms of the actual capital developments which they have made possible, but also in the improvement of overall development planning which they have promoted. These features have, in turn, contributed to the better capacity of the underdeveloped countries for servicing their loans, but have also made them more appropriate objects for further loans or grants.

5. Other direct forms of assistance

(*a*) *Defense support.*—"Defense support" is aid that is given to a country in order to enable it to support a larger military effort than it would undertake without such aid. Such aid is usually used to buy consumption goods or raw materials that are imported in order to replace the drain on supplies caused by the maintenance of an army larger than could be maintained without this aid. Some part of defense support contributes positively to economic development, since projects financed with the aid of defense support funds, such as roads, normally increase production as well as aid the military effort. Sometimes, a project that has little direct relationship to defense as such (like a fertilizer plant in Taiwan) is included in the defense support program. A large share of defense support currently goes to Taiwan, South Korea, and Free Vietnam, countries in which extreme military efforts are necessary, due to recently past and/or threatened Communist military intervention.

A little more than a third of the amount of approximately $1 billion per year spent on defense support represents an increase in investment in the economies of the aid-receiving countries. If all non-Communist underdeveloped countries were given proportionately as much economic aid, this would amount to about $3 to $4 billion a year, or an increase in total economic aid of between 2 and 3 times the amount allocated to it at present. At the same time this would constitute an increase in investment in all non-Communist underdeveloped countries by between 30 and 50 percent.

(*b*) *Offshore procurement.*—Offshore procurement may be briefly defined as the purchase of commodities (normally raw materials or military equipment) from countries other than the one giving aid (i. e., in our case, in countries other than the United States). If the goods purchased for aid to an underdeveloped country are bought in another underdeveloped country, then the offshore purchases aid both underdeveloped countries, the one directly, the other by supplying it with dollars to buy goods needed in its own development program. But a dollar's worth of offshore purchases does not help the second country's development effort as much as would a direct grant, since the production of the materials procured absorbs local resources.

However, only a small portion of offshore purchases has consisted of goods produced in underdeveloped areas, and most offshore procurements come from Western European areas. Offshore procurement in most highly developed areas to supply goods needed for foreign aid has four advantages: (1) It makes possible, by permitting the use of American dollars to buy goods for aid in the cheapest market, to reduce the cost of aid programs, or to have a larger aid program with the same outlay. (2) It helps the economies of the countries in which the goods are procured by providing them with dollars. (3) It contributes to the safeguarding of American raw materials in short supply which are required in a foreign aid program, by making possible the substitution of commodities produced elsewhere for the scarce American goods. (4) Since the demand of the rest of the world for American goods is limited mainly by the availability of dollar exchange, the offshore procurement program, by increasing the supply of dollars available to other countries (since part of the development plans result in increases of United States imports), stimulates American general exports, in comparison with a situation in which every dollar of aid is spent entirely in the United States. Thus, attempts to restrict offshore procurement in order to increase the exports of a particular United States industry will result in a decline in United States exports and a less effective aid program. If a particular labor surplus area, or strategically vital industry, such as merchant shipping, must be aided, the most efficient method is a direct subsidy, not an indirect subsidy that increases the cost of foreign aid. The most effective use of offshore procurement would require an amendment to the Mutual Security Act, since that act restricts offshore procurement of goods produced in labor-surplus areas of the United States, and also requires half of all aid goods to be shipped in United States merchant ships.

(*c*) *Counterpart funds and agricultural surpluses.*—Counterpart funds are funds in the local currency of the aid-receiving country which are obtained from the local sale of commodities procured through foreign aid. They do not form a source of funds for development additional to the dollars that were obtained in the form of foreign aid. Rather, the aid granted in dollars represents the net addition to the resources that the underdeveloped country can use for development, and the spending of the counterpart fund is only a particular way of utilizing the dollar aid. If the purpose of a foreign aid project is to increase the amount of development spending by at least the amount of the aid, the use of the counterpart fund should depend partly on whether foreign aid consists in the shipment of consumption goods or investment goods. If investment goods, for example, steel, are imported into the aid-receiving country, then an attempt to use the fund resulting from the sale of the steel for investment would result in inflation, since there would be no additional consumer goods corresponding to the added purchasing power caused by the spending of the counterpart funds.

If the imported goods are consumer goods, for example, food, the counterpart fund must be spent on local investment and, in particular, on the payment of workers employed in the investment projects. This results in an added demand for consumer goods, especially if these workers have been underemployed, and the added demand, despite the spending of the counterpart fund, does not raise prices, since it is met by the imported consumer goods.

Thus the use, in certain circumstances, of counterpart funds to pay off part of the national debt of an underdeveloped country and thus to reduce money supply in that country does not mean that the American taxpayer is paying off the debt of a foreign government. For the aid has already been given in the form of the commodities imported with the dollar grant. In fact, sometimes repayment of the internal debt in an underdeveloped country—which is prohibited by the Mutual Security Act—might help increase the effectiveness of foreign aid by combating inflation, and thereby discouraging some kinds of wasteful investment, for example, hoarding of commodities. In fact, in some cases such disinflationary repayment of an internal debt might lead to a dishoarding of gold and dollars on the part of private investors, and thus a reduction in the amount of American aid needed for development.

(*d*) *The use of agricultural surpluses in development programs.*—The sale of surplus farm products for local currencies, to be given or loaned to the aid-receiving country, can play an important part in economic development. One of the key factors associated with an industrial development program is the simultaneous production of a marketable farm surplus to support the workers employed on private or public development projects or in other nonfarm sectors of the economy.

Such a potential surplus, however, has already been accumulated in the United States. In a sense, the cost involved in using these accumulated farm products for foreign aid purposes had already been incurred (except for the cost of transport) when these products had been purchased under loan agreements by the Commodity Credit Corporation. Under Public Law 480, which provides for the encouragement of farm exports in ways that do not tend to "* * * unduly disrupt world prices of agricultural commodities * * *" (Section 2), and which, among other purposes, would "* * * encourage economic development * * *," some $1,350 million was authorized to be sold for local currencies up to June 30, 1957, but only a portion of the resulting United States owned local currency was spent on development projects, and the rest for such purposes as defense support. These local currencies were divided, by the Bureau of the Budget, among various United States Government agencies: the International Cooperation Administration was given funds for its aid programs, the Department of Defense for military aid, the Office of Defense Mobilization for the purchase of strategic materials, and the Department of State for international educational exchange activities. Some $750 million of various products were sold in the fiscal year 1956, including grains, raw cotton, fats and oils, textiles, machinery, iron and steel, and fuels. Sixty percent of the proceeds were used for specific development projects, and 40 percent for military activities and troop pay. A considerable amount of funds so raised was allocated for various relief purposes.

There are many difficulties involved in trying to finance the bulk of aid for economic development by the use of surpluses. Development results in the use of more machinery and other tools, as well as food and clothing. Hence, without the provision of funds to buy these capital goods, it will not be possible to expand the development program, and consequently employment on the development projects, in sufficient degree to provide an adequate market for the surplus food and cotton. A vigorous program of selling farm products for local currencies might reduce world prices of these goods and displace the exports of other countries (including those of some underdeveloped countries such as Syria, which exports wheat and cotton; the Sudan, which exports cotton; Burma, which exports rice; and others). This outcome is contrary to the stated aims of Public Law 480 and American foreign economic policy. The agreement to sell some $350 million worth of farm products to India for local currency to be loaned for purposes of the development program of India will not have these depressing effects on prices, since India's second 5-year plan will result both in a large increase in the amount of food the people of India can pay for (in local currency), and also in the production of steel and other capital goods to produce some of the equipment needed in the second 5-year plan.

C. INDIRECT FORMS OF FOREIGN AID

We have now discussed the various direct forms in which foreign aid has been given by the United States, international agencies, and some other governments. In the remainder of this chapter, we will discuss some indirect forms of foreign aid. Under this heading fall the following: the accumulation of stockpiles of strategic materials in the United States; the conclusion of commodity agreements regulating the international supply and price of raw materials; encouragement of American private investors who might supply capital to underdeveloped countries in place of public funds; and the foreign trade and exchange policy of the United States.

1. Stockpiles of strategic materials and commodity agreements

The stockpiling of strategic materials, like offshore procurement, is a form of international trade, which by increasing the demand for the products of underdeveloped countries, benefits them. These benefits, as in the case of countries where offshore purchases are made, are smaller than they would be from an equal amount of direct aid. But the purchase of materials for stockpiling supplies countries with dollars—which otherwise would not be forthcoming—and enables them to spend these dollars for imports of commodities and services needed in their economic development projects.

In general, the purchase of materials for stockpiling will thus be welcomed by underdeveloped countries and may be regarded as helping in a not inconsiderable degree either their balance of payments problems or their development problems. However, stockpiling should, in order to provide maximum benefits for the underdeveloped countries whose commodities are purchased, be carried on in a regular fashion, so as not to disturb price stability greatly. Provided the prices obtained for strategic raw materials are not depressed, underdeveloped countries are probably more interested in a stable level of prices than in a momentarily high level induced by a sudden increase in stockpiles. For these countries wish to have a reasonable assurance that the tax and other revenues they obtain from the export of raw materials will remain on a fairly steady level. If these revenues fluctuate widely, it is difficult, if not impossible, to make allowance for them in long-run development plans, and since exports of raw materials form in some underdeveloped countries one of the most important sources of foreign exchange, instability in the amounts and terms of these exports imposes a serious difficulty on the governments wishing to prepare careful plans for economic development.

Thus a program of stabilizing the prices of raw materials (which on the average would cost nothing, since it would not raise the average prices and might, by reducing the risk of investments in raw materials, actually reduce them) would make it possible for underdeveloped countries to use more of their own resources for development and thus reduce the need for direct aid.

2. Encouragement of American private investment

One of the arguments sometimes given for emphasizing technical assistance in foreign aid programs is the explicit or tacit assumption that, if only people in the underdeveloped areas had the necessary "know-how," any capital that might be needed for development could be obtained from private investors, if proper encouragements were given. For reasons explained earlier, conditions in underdeveloped areas are not similar to those that prevailed in the presently developed countries during the 19th century. Some countries with exceptionally rich deposits of high-grade raw materials can offer sufficiently favorable prospects to foreign capital to offset all the political and other risks involved in investing in present-day underdeveloped countries. Even in these countries, it is difficult to transfer the modern productive methods of the foreign-controlled raw materials sector to the rest of the economy, although some attempts have been made, for example, in Venezuela, to tax these foreign companies to provide expanded public services needed to make more widespread economic development possible.

Efforts to encourage the increased flow of private capital have included partial tax exemption (in the case of investments in the Western Hemisphere), credits for taxes paid to foreign governments, the negotiation of treaties with underdeveloped areas concerning the safeguarding of the rights of investors, United States Government insurance (called guaranties) against expropriation, insurance against inability to convert profits back into dollars, and other measures. But all of these steps have failed to induce much additional foreign investment. Little use has been made of the guaranty fund, and only $50 million of guaranties had been taken up by 1954. This was to be expected, since none of the attempts to encourage private investment could strike at the root of the matter, which is the antagonistic attitude toward foreign investors of important nationalistic groups in some underdeveloped countries, the political insecurity in some areas, and the poor prospects of yield in many industries in many underdeveloped countries. These conditions are to a large extent the result, as well as a cause, of underdevelopment. The signing of treaties against expropriation is less important than the day-to-day policy of the underdeveloped country toward capitalists, domestic as well as foreign. In some countries, many basic industries are reserved to government or to local capitalists. Foreign companies, because of their general unpopularity, dare not disobey the local labor laws, which may be very advanced considering the stage of economic development, while local enterprises can ignore them. Land reforms that may be undertaken for reasons of political stability and to provide the incentives needed for economic development may incidentally reduce the prospects for foreign investment in plantation agriculture. Rates charged by private utilities are sometimes limited to levels which make investment unprofitable.

Sometimes proposals are made to devise new means of encouraging investment. These include complete tax exemption of returns from foreign investment, the negotiation of stricter investment treaties, technical assistance in ways of attracting capital, more thorough guaranties, and greater use of the International Finance Corporation (a revolving, semipublic fund, affiliated with the International Bank for Reconstruction and Development, investing in industrial equities rather than in loans). Only the last really strikes at the root of the problem, by encouraging the growth of local financial institutions in the underdeveloped countries themselves.

Tax exemption will do little to encourage private investment, because even after the taxes of both, the United States and the capital-importing countries, are paid, the return on foreign investments is often higher than on domestic investment. What discourages investment is not the tax on profits, nor any threats of direct confiscation or inability to convert profits into dollars, but the numerous uninsurable risks of a bad "investment climate."

On the whole, private investments, apart from some exceedingly rich mineral or plantation products, play an increasing role in countries which are well along the road to economic development. These countries enjoy, in general, greater political stability and have a more predictable and equitable system of taxation. Thus private investment is, in general, most willing to flow into those areas where governmental inducements or guaranties are least needed. Some of these considerations explain why American foreign investors have favored such politically safe and economically sound areas as Canada, Latin America, and Western Europe as preferred regions for placement.

3. United States foreign trade and exchange policy

We have already in previous sections of this report pointed to the great importance which relatively free trade and a high degree of convertibility of currency have for many underdeveloped countries. This is especially true for those underdeveloped countries which are small in terms of population and hence internal markets, and those which have specialized resources which can be fully exploited only if export markets are available. Although at present most of the export commodities of underdeveloped countries are raw materials which meet with few impediments at the frontiers of the United States, the advance of industrialization in some underdeveloped countries will make them look for markets for their industrial products also in the United States. Japan, for example, is already in such a position, and it may be expected that some Latin American countries will soon also have exportable surpluses of industrial goods. For these countries wider access to the markets in the United States will become important. Such access to the United States markets may, moreover, be of importance to enable underdeveloped countries to earn the necessary dollar exchange with which to service and repay loans from the United States.

Although American import duties have been substantially reduced in the last two decades, the present provision of the Reciprocal Trade Agreements Act may not be sufficiently liberal for many countries, because of the escape clause and the peril point provisions, which prevent reduction of tariff duties which may harmfully affect competing American industries. Although, compared with costs of production abroad, such industries might be uneconomical in the United States, they are to be protected, according to present laws.

It cannot be doubted that a further liberalization of American tariff provisions would be of considerable benefit to underdeveloped countries. Even in the case of industries which supply commodities not produced in underdeveloped countries, but in Western Europe or Japan, lower duties and larger imports would benefit underdeveloped countries, because a large amount of dollars would be made available to the world at large, part of which would find their way to the underdeveloped countries by way of triangular trading relations. Thus a further liberalization of American foreign trade would aid not only, to a certain extent, in the development potential of underdeveloped countries, but would also contribute to an earlier reestablishment of convertibility, which in turn would have benefits for underdeveloped countries.

Short of actual reductions in American duties under the reciprocal trade agreements system, the championship of the United States for freer multilateral trade is, as already mentioned earlier, a significant move in the long-run interest of economic advancing countries.

D. THE INTERRELATION OF THE PATTERN OF FOREIGN ASSISTANCE AND EFFECTIVE DEVELOPMENT

To state rigid generalizations about the order and size of various types of foreign aid needed for the most effective economic development is impossible, because conditions vary too much between underdeveloped countries. It would be necessary to make a detailed study of each country, somewhat along the lines of the International Bank for Reconstruction and Development reports, and even then, only the broad outlines could be given. Although there is less scope for private initiative in underdeveloped areas than in the United States, planners in all but Communist countries try to encourage it as much as possible, especially in small industry. They also attempt to encourage local cooperative movements in the villages. The form and impact of foreign aid should optimally fill in the gaps in the development pattern which are left open by limitations of domestic funds or skills. Moreover, foreign aid should optimally be arranged so that these result in as "balanced" a development program as is feasible. By "balanced development" is meant one which avoids serious bottlenecks and in which capital and other scarce productive factors are allocated among competing uses in such a way as to attain maximum contribution to output within a planned development program. If, despite all efforts, such bottlenecks appear, then foreign aid, to be most effective, should be directed toward eliminating these bottlenecks.

In countries which are economically stagnant at a peasant, subsistence level, the most important measure in a balanced development program would probably lie in the fields of local community development projects, improvement in the civil service, the creation of planning and budgetary procedures, agronomic research, and the improvement of transportation and communications. Except for the last item, these measures would require little more than better internal government, and little foreign aid apart from technical assistance. The aim of these programs would be to create the leadership and the incentives needed to make further development feasible. There would thus be more of a preparation for economic development than economic development itself in this stage.

But most underdeveloped countries, even such poor countries as India and Indonesia, have already largely gone through this stage. In these somewhat more advanced underdeveloped countries, major emphasis is to be placed on relatively simple improvements in agricultural techniques, adult education programs, the development of small-scale industries, and an extension of social overhead capital. Countries in this class require more capital, and probably more outside capital, including foreign aid, but much of this might still be in the form of technical assistance. Development would take place, but at a slow rate.

The next phase would be one of rapid transformation in production techniques, social and economic organization, the development of large-scale industries, mining, and possibly the entry of private foreign capital in substantial amounts. In this phase substantial amounts of foreign aid, in the form of grants, loans, and technical assistance projects, may be called for.

In general, development moves from the simple and relatively inexpensive projects at first, to more complex capital intensive projects later on. But if more capital is available at every stage, through foreign aid, the development process can move at a faster rate. In any case, however, the rapid development visualized in the third phase of rapid advance must have a prior foundation in the psychological attitudes of the people toward development and in technical proficiency.

In practice these phases overlap considerably, because in almost all underdeveloped countries, there has been some development in projects and industries pertaining to the later stages, and this development must be integrated with the generally backward state of the rest of the economy. The problem of development may lie as much in enlarging the already existing islands of modern technique and enterprise as in improving the most backward sectors.

A balanced pattern of development necessarily involves not only consistency in the projects undertaken at present, but also consistency in planned future projects for which the present projects will lay the basis. Otherwise, the pace of development might be slowed down for lack of some basic public service in the future. Thus, for aid to contribute to a balanced pattern of development, it must itself be planned on a long-term basis.

CHAPTER VI

FOREIGN ECONOMIC AID AND THE AMERICAN NATIONAL INTEREST

A. THE MOTIVES OF AMERICAN INTEREST IN FOREIGN ECONOMIC AID

In the preceding chapters we have discussed the conditions under which economic growth may take place in the underdeveloped countries of today and the role which foreign aid may play in this process. We now turn to a brief evaluation of what place a foreign aid program may have in the context of American foreign policy, and what might be the approximate magnitude and direction of such a program.

American interest in foreign aid is based upon three major motives. First, there is a strongly felt humanitarian sentiment among the American people, which has been reflected at various times in official American policy in its relief and rehabilitation programs in war-torn areas after the last war, in shipments of food to areas of famine, the support of victims of disaster and war, relief for the heroes of the Hungarian resistance movement, and similar projects. In addition to official programs of relief, a number of philanthropic organizations and religious missions have operated in various underdeveloped countries, and the humanitarian sentiment of the American people has proven itself again and again in generous subscriptions to various private programs of assistance for persons in all parts of the world who suffered disease, hunger, and misery. Though this motive is, on the whole, strong and meets with general approval among the American people, it cannot provide the substance of a large-scale foreign aid program.

American interest in foreign aid is also based upon economic objectives. Though it may be exaggerated to assert that prosperity is indivisible, it is doubtless true that the United States economy can gain from a high level of real income and economic performance in other parts of the world. If other countries within the orbit of the free world are better off, they form better markets for American exports, and they are better able to supply the United States with the commodities we need to maintain a high level of economic activity at home. More important than this, if the economies of the other countries of the free world are sound, they are stronger militarily and better able to defend themselves against aggression. Finally, a high level of economic activity is, on the whole, more favorable to genuine stability and responsibility in government than poverty and misery. Hence the extension of stable political relations, which offers greater scope for economic opportunity not only for the people in foreign countries, but also for the people of the United States, is in the general interest of the United States.

But the overwhelming interest of the United States in foreign relations, and that aspect of its foreign relations which centers around a foreign aid program, is the security of the United States. If an appraisal is to be made of the foreign aid program in its relation to American national interest, we must emphasize the security interests above all others. American security may be very narrowly conceived, in terms of the military defense of the territory of the United States, or at most, in terms of the military defense of its own territory and that of its allies. If this conception of the American security interest is adopted, foreign aid programs would play only a small role, and would at best be confined to some aspects of defense support and military assistance.

But American security should, in our opinion, be defined in a wider and more comprehensive sense. It is not limited to the military safeguarding of American territory and that of its allies, nor is it limited to a policy of deterrence or even containment of the Soviet Union and its allies. Unless Amercan security is viewed in terms of the relation between the United States to the Soviet orbit on the one hand, and the mass of countries, located chiefly in Asia and Africa, who form an as yet uncommitted neutral group, one is leaving out of consideration a potentially most dynamic factor of future world political developments. For the third countries have, as we argued earlier, very high aspirations for economic advancement. They will attempt to realize these aspirations to the best of their abilities and resources, and this in itself will impose a dynamism into the international political and economic arena which it otherwise would lack. The fact that these nations are as yet uncommitted has, however, a twofold meaning. On the one hand, they are uncommitted in taking sides in the cold war. On the other hand, they are uncommitted as yet in terms of the kind of society they are to develop. Within the next 20 years, the most crucial decisions concerning the future internal and external political and economic status of these countries are likely to be made. It is eminently in the American security interest, in the long run, that these decisions should be made in a way which will benefit rather than damage the American position on a world scale.

The main obstacle for the rapid realization of the aspirations of underdeveloped countries is the relative backwardness of their economy. The United States on the contrary, is a country of vast and rapidly increasing wealth, and is able to transfer substantial amounts of resources to foreign countries, not only without sacrifice in domestic living standards, but even with continuously rising living standards. In addition there have been developed in the United States techniques in administration, business enterprise, the application of technology, education, and other fields, which are intimately bound up with the ability to improve man's situation by his own collaborative efforts. Many of these skills are unknown in other societies, and their adaptation to local conditions in various underdeveloped countries would contribute to the development of more positively oriented and politically stable societies.

From these considerations, it follows that a comprehensive and sustained program of American economic assistance, aimed at helping the underdeveloped countries of the world to create within the next 2 or 3 decades the conditions for self-sustained growth, can, in the short run, reduce substantially the danger of conflict arising out of attempts by countries within the Soviet orbit to penetrate into areas where they suspect power vacuums. At the same time, it may have the result of proving to all underdeveloped countries that their development program may be carried out without coercion and violence. Finally, it may absorb the energies of the underdeveloped countries in their own economic and social progress to such an extent as to minimize the triggering off of international violence derived from a deflection of national aspirations into the political sphere, because the solution of their domestic economic problems appears hopeless or overwhelming.

In order for this result to ensue, the following propositions must be accepted as true: That American assistance if it is substantial and sustained can lead to economic growth of noticeable proportions in all or most underdeveloped countries. That the extension of American economic assistance and the resulting economic growth will lead to politically more stable and mature societies. That successful economic development, contingent upon American aid, of a substantial number of underdeveloped countries, chiefly in Asia, is likely to lead to a decrease in political tension in the world at large by substantially reducing the chance of Soviet political successes in that area. That American economic aid, supporting the self-devised development plans of underdeveloped countries, is capable of demonstrating that over a period of 15 to 20 years, the underdeveloped countries are able to meet and progressively resolve their internal problems without resort to totalitarian measures. That the end result of this process is a likely strengthening of democratic forces in the underdeveloped countries and that the establishment of more stable political relations in them, coupled with their nationalistic aims directed toward the maintenance of political independence, will leave open to the Soviet Union only one rational option, namely a negotiated settlement with strong built-in safeguards against international violence and aggression.

These prospects are sometimes caricatured by saying that such a policy would mean to buy peace and democracy with dollars, which, it is further said, is not possible. Rather than enter into a discussion of the merits of these conflicting views, we will attempt to discuss the ways in which a program of foreign aid should be implemented in order to meet the objectives outlined above, or at least to come close to meeting them.

The main questions which must be answered in dealing with the problem of implementation of such a program are: (1) who should be the recipients of assistance; (2) what distinction should be made between economic development aid and other aid (military aid or assistance in the case of disaster relief); (3) what should be the magnitude of an economic development aid program; and (4) what are the preferred mechanisms by which an aid program should be implemented.

B. WHO SHOULD RECEIVE ECONOMIC ASSISTANCE?

From what has been said in the preceding section, it follows that economic assistance (as distinguished from military assistance) should be extended to all underdeveloped countries outside the direct Soviet sphere. This assistance should be independent of whether these countries are or are not in a military alliance with the United States, and even of whether at a given moment the public speeches of some of the political leaders of an underdeveloped country are friendly or

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unfriendly to the United States. In other words, economic aid should not be an instrument of either rewarding our friends or a means of gaining political influence and approval in certain countries. There is an open or thinly disguised suspicion in many countries that American aid is often used a a bribe. The more impartially economic aid is extended the less basis will there be in the long run to such a charge.

But the main reason for the general extending of economic aid is not the sentiment of others, or their beliefs and feelings about the United States. It can hardly be in the national interest of the United States to make a particular country (or its leaders) like us. The reason why economic aid should be given to all underdeveloped countries—except those within the Soviet orbit—is the similarity of overall conditions and of potential effects of economic development in all of them.

We have already explained in chapter II that in most underdeveloped countries the emergent middle class, and especially the educators, government officials, and intellectuals, are the motivating force in the push for economic advancement and the changing social relations. These social groups often are inclined to see in communism, or other forms of totalitarianism, the only alternative to the existing order, and the only means to economic development. They are aware of the necessity for expanded capital accumulation and investment; indeed, they often exaggerate the need for capital by emphasizing heavy industry in their ideology of economic development. They are equally aware that the traditional social orders which are breaking down due to western influence, do not provide the necessary political, social, and cultural conditions for development. They know that Soviet Russia has been successful in accumulating enough capital and in bringing about social changes necessary to development. Either they are ignorant of the ruthless means by which this was achieved, or they excuse them as steps necessary in order to break out of the age-old vicious circle of poverty breeding poverty that is characteristic of so many underdeveloped areas. Often, these groups gain as allies the peasants, who seek land reform, and the emerging industrial working class.

But though many of these persons are not frankly antagonistic to communism, they are not committed to it and would turn from it if a nonviolent alternative of achieving the aims of economic development at approximately the same pace as that allegedly possible by totalitarian means were shown to them. Hence the strategic function of American economic aid in such a case would be to show these middle classes a third alternative between the semifeudal status quo and totalitarian revolution. It is meaningless to say that in giving aid there must be no "intervention in the internal affairs" of the aid-receiving country, for any aid necessarily affects these internal affairs. In some countries this difficulty of intervention is less severe, since there the power of the upper classes has already been weakened, so that aid can be directed to helping non-Communist groups committed to changing their social environment remain in power and to help steer them in nontotalitarian directions.

This internal social transformation is the crucial determinant of the future political development of the countries of Asia and Africa, and such a development appears the best guaranty of their future political independence and noncommitment to the Soviet orbit. If such a middle class imbued by an ideology of economic progress by nonviolent means could have been created in Egypt after the anti-Farouk revolution, the intelligentsia of that country, instead of indulging in pan-Arab "imperialism," might have been so deeply concerned with the solution of the country's internal economic problems that the glamor of enlargement of Egypt's sphere of influence would have paled in comparison.

C. HOW MUCH ECONOMIC AID SHOULD BE GIVEN?

The social development sketched earlier depends in large part not only on the conditions under which it is offered, but also on the total magnitude of the aid. Before entering into a discussion of this problem, a clear distinction must be drawn between economic aid for development and other forms of aid—for military purposes, disaster relief, or other aims. This distinction is not aided by the general confusion which exists in the United States in classifying different forms of aid. Although a relatively clear distinction is made between economic aid and military aid, the category of defense support contains elements of both. In what follows we will confine ourselves to discussing economic aid in the form of technical assistance, grants, and soft and hard loans for capital investment purposes, commodity deliveries which supplement the productive effort of an underdeveloped country, and other measures which directly or indirectly contribute to the raising of productive performance.

Given this description of economic aid, it may be said that a small aid program, like the present technical assistance and development assistance programs, more or less as a token of America's interest in the development of the poorer countries, would be useless. For the achievement of a rapid rate of growth without resort to totalitarian methods implies a rapid rate of investment, but a slower rate of voluntary savings. Part of this gap between savings and investment needed for rapid development could be met by drastic changes in the tax laws and their administration in underdeveloped countries, especially if the taxes could be imposed so as to fall on those who invest their savings in socially unproductive ventures. Another part of the gap could be covered by emphasis on community projects and other comparatively low-cost investments, aided by technical assistance. Judging from the experience of India under the first 5-year plan, this would result in an increase in income per head of only about 2 percent per year—better than stagnation, but not sufficient for setting in motion a genuine process of self-sustained growth in the underdeveloped countries.

Thus, if economic aid with long-term political objectives is to be given at all, it must be on a scale that enables the recipient countries to use substantially more resources for development than they can save. Probably at present not more than about 9 or 10 percent of the incomes of most of the underdeveloped countries could be saved without resort to totalitarian methods of forced savings. The rate of investment needed for a more rapid rise of per capita income at a rate of 3 to 4 percent per year (assuming an average rate of increase of the population of 1.5 percent), would be from 14 to 16 percent of incomes as a minimum. Private foreign investment of the type most useful for aiding development probably would contribute only relatively little. Since the total income of the "underdeveloped" countries in Asia, the Near East, and Africa (excluding China and underdeveloped countries in Eastern Europe) was approximately $110 billion in 1955, the gap to be filled annually by foreign economic aid would amount to a minimum of $3 billion, allowing possibly for private investment of the type most useful for economic development of about $1 billion. Some of this aid would doubtless be supplied by some of the more highly developed countries of Europe, especially to those parts of Africa where they have special political interests. For this reason a smaller lower limit might be applicable for economic aid extended by the United States. A lower limit would also apply if not all underdeveloped countries outside the Iron Curtain were eligible for inclusion in the program. The size of the program would also depend on the ability of the aid-receiving countries to use capital for purposes of development. The amount of aid needed for any such integrated program of development would remain close to the lower limit in the early stages of the program, since the absorptive capacity of many underdeveloped countries for genuinely productive development projects must first be improved. But gradually, as technical assistance speeded up the training of increased numbers of skilled workers, managers, technicians, and others, an expansion in the rate of development could take place. This training program would soon provide also fairly full employment for the potentially discontented elements of the middle class. It would reach a peak level of perhaps $5 billion per year in about 10 or 15 years, and then decline, since as the people in the aid-receiving countries might save voluntarily from one-fifth to one-fourth of any increase in their incomes, their savings would eventually increase faster than their ability to absorb capital for development. Also, as the strength of the capitalist sector of the new middle class grew, the climate for private foreign investment would improve, a fact illustrated by Latin American events in recent years.

But all estimates of the amount of foreign aid necessary for a long-term economic development program which would be in the American national interest are extremely uncertain, owing to the many factors impinging upon the relationship between foreign aid and economic growth. The estimates provided in this section were intended not as hard and fast amounts, but only as illustrations of the rough order of magnitude of the amount of aid which might be required to achieve the objectives stated in this report. On the one hand, expenditures on foreign aid of a few hundred dollars per year would fall far short of the need, but, on the other hand, spending of tens of billions of dollars would be wasteful and unnecessary from the viewpoint of national security of the United States.

D. WHAT KIND OF ECONOMIC AID SHOULD BE GRANTED?

In considering the kind of economic aid that should be granted, two general considerations have to be borne in mind. In the first place, we must not forget that the overall pattern of development of presently underdeveloped countries differs from that experienced in the past by the advanced countries, and especially by the United States, and, above all, that the role of government planning for economic growth is much more widely accepted today than was the case in the 19th century. Hence economic aid should not be made contingent upon its being applied primarily for the fostering of privately owned capital. It would be a serious mistake to assume that some form of democratic, labor-party style socialism is merely a watered-down brand of communism. In fact, as was already discussed in earlier chapters of this report, the intervention on a rather wide front by governments in underdeveloped countries appears to be necessary due to the existing low educational and social level of the mass of the population. This provides the emerging middle-class intellectuals with great importance in these countries, and enhances the overall role the government is destined to play, at least in the initial phase of economic development.

Thus economic aid programs may have to be adjusted to the government-sponsored and often socialistic or quasi-socialistic development plans of underdeveloped countries; and, although some features of these plans may be very different from those of a private enterprise economy, foreign aid programs may have to be developed so as to fall roughly in line with development plans of the governments of underdeveloped countries. This does not mean that economic aid may not be given also to strengthen private enterprise in underdeveloped countries; in fact, it may be expected that even fairly socialistically inclined governments in underdeveloped countries will not object to private capital formation and the exercise of private entrepreneurial initiative, provided that this initiative is not centered on projects with little or no expectation of social (as against private) benefit.

The second problem toward which an economic aid program should be directed is the promotion of economic development as its central focus. Since, as we have explained in previous chapters, the main problems of economic advancement in underdeveloped countries consist in the development of more highly qualified personnel, more and better suited resources, and a greater quantity of productive capital, economic aid programs should feature prominently the creation of these three factors for development. This will require that in the administration of economic aid programs constant attention is paid to the long-run potentialities of economic growth of the aid-receiving countries. It also means that an economic aid program must be conceived as a long-run enterprise and that some guaranty of its duration is as important as is the total magnitude of the program. For, as was pointed out repeatedly in this report, the process of economic development takes time, and the execution of an effective development plan requires a fairly high degree of assurance that sufficient funds will become available as the program unfolds in coming years. Without such an assurance, some of the most basic programs of creating various forms of overhead capital cannot be undertaken, because the probability as to whether the supporting investments can ever be made is too low. Thus, an important aspect of an effective economic aid program is its being conceived as a long-range program; i. e., a program which will continue on a sustained magnitude over a period of 10 to 20 years, as a minimum.

One further point should be mentioned which affects the nature of the administration of an economic aid program. As is well known, the receipt of economic aid is regarded by many underdeveloped countries as a sign that they are not fully mature or equal; and in the face of old resentments against those who in the past have treated them as inferior, because they lacked political independence, the need to receive grants-in-aid is considered as a continuation of their status of political immaturity and deficiency. An aid program must be administered so as to minimize these sentiments of inferiority. We do not claim that Americans have shown an overbearing attitude in their behavior toward people in underdeveloped countries. On the contrary, we believe that the American matter-of-fact, let's-get-down-to-business attitude has compared favorably with the stiffer and more formal behavior patterns displayed by many Europeans or even Asians and Africans. The point we wish to stress is that in many underdeveloped countries, economic aid includes not merely the transfer of funds, technical assistance, and the like, but also the actual cooperation and advice in the working out of plans and programs of development. Not every underdeveloped country is in the position of India, which has technically competent people to work out a development plan, and whatever developmental planning is executed in some underdeveloped countries is sorely in need of improvement. It is in this field in which American expert advice and a proper administration of an economic aid program can bear considerable fruit. Yet, it should be recognized that it is a delicate matter to insist on improved plans for development without offending the sensitivities of officials and others in underdeveloped countries.

E. CONCLUSION

If a program of economic aid incorporating the principles outlined in this chapter can be adopted, it is fair to expect that it may result in a successful instrument of American foreign policy. Of course, there is no guaranty that matters will go as they have been sketched above, and the implementation of a sizable program of economic aid for development always will contain a noticeable factor of risk. However, in this it will not differ from any action taken in the field of foreign relations. Moreover, we have discussed here only a program of economic aid and this may and will be supplemented by a program of military assistance going to some of the same countries which are eligible for economic development aid. In the case of political developments which may endanger the success of the economic aid program, other measures, from military aid to actual forms of armed resistance to aggression, may have to be taken, if the situation demands. Thus a program of economic aid is neither a cure-all, nor will it create necessarily close friends among the underdeveloped countries. But if it can be successfully implemented, it is likely to lead to a stabilization in world political relations which should do much to reduce international tension and to improve the overall objectives of American foreign policy.

APPENDIXES

APPENDIX I

Estimates of National Product

Table 1.—*Estimates of total gross national product and national product per head, 1954 and 1955*

Country	1955		1954	
	Total (millions of dollars)	Per capita (dollars)	Total (millions of dollars)	Per capita (dollars)
United States	387,200	2,343	360,474	2,220
Canada	26,000	1,667	24,081	1,585
New Zealand	2,673	1,249	2,595	1,242
Switzerland	6,116	1,229	5,881	1,195
Australia	10,920	1,215	10,400	1,182
Sweden	8,460	1,165	8,090	1,121
Iceland	180	1,146	172	1,117
France	45,195	1,046	42,730	994
Belgium	9,311	1,015	9,040	991
United Kingdom	51,100	998	49,745	974
Norway	3,320	969	3,247	957
Finland	3,984	941	3,868	923
Denmark	4,051	913	3,972	902
Germany	38,100	762	34,633	699
Venezuela	4,400	762	4,020	717
Netherlands	7,604	708	7,014	661
Soviet Union	150,000	682	140,000	651
Uruguay	1,500	569	1,470	567
Israel	944	540	902	534
Austria	3,711	532	3,376	484
Eire	1,481	509	1,436	490
Italy	21,220	442	19,740	413
Union of South Africa	5,208	381	4,864	362
Argentina	7,150	374	6,990	373
Cuba	2,180	361	2,050	347
Panama	320	350	305	345
Colombia	4,180	330	3,960	320
Costa Rica	292	307	276	302
Malaya	2,170	298	1,900	269
British North Borneo	310	298	274	269
Yugoslavia	5,207	297	4,691	272
Turkey	6,463	276	5,915	267
Lebanon	380	269	400	289
Brazil	15,315	262	14,952	262
Spain	7,369	254	7,154	249
Nicaragua	315	254	300	250
El Salvador	530	244	510	240
Japan	21,300	240	20,300	231
Greece	1,996	239	1,845	222
Dominican Republic	494	205	471	201
Ecuador	746	204	678	190
Portugal	1,765	201	1,720	198
Philippines	4,400	201	4,230	197
Iraq	960	195	900	183
Mexico	5,548	187	5,315	184
Chile	1,220	180	1,200	182
Guatemala	580	179	569	181
Algeria	1,680	176	1,730	185
Saudi Arabia	1,160	166	1,145	164
Morocco	1,512	159	1,515	162
Peru	1,315	140	1,270	138
Honduras	228	137	230	143
Gold Coast	624	135	614	135
Central African Federation	945	134	900	131

TABLE 1.—*Estimates of total gross national product and national product per head, 1954 and 1955*—Continued

Country	1955		1954	
	Total (millions of dollars)	Per capita (dollars)	Total (millions of dollars)	Per capita (dollars)
South Vietnam	1,600	133	1,675	146
Egypt	3,065	133	3,035	135
Tunisia	490	131	540	140
Indonesia	10,500	127	10,400	128
Ceylon	1,050	122	1,030	123
Syria	445	111	495	127
Paraguay	168	108	165	108
Liberia	155	103	150	100
Taiwan	1,640	102	1,575	100
Thailand	2,050	100	1,750	88
Iran	2,110	100	1,920	93
Sudan	885	100	885	100
Belgian Congo	1,639	98	1,549	94
Jordan	135	96	160	115
Libya	99	90	90	82
South Korea	1,780	80	1,730	79
Haiti	260	75	320	94
India	27,400	72	26,410	70
Nigeria	2,250	70	2,165	68
Portuguese Africa	776	70	735	67
Bolivia	211	66	209	60
Kenya-Uganda-Tanganyika	1,214	61	1,182	61
French West Africa	1,020	58	972	56
French Equatorial Africa	270	58	255	56
Pakistan	4,560	56	4,510	56
China (mainland)	35,000	56	33,000	54
Afghanistan	650	54	650	54
Ethiopia	860	54	830	52
Burma	1,012	52	964	50
Nepal	340	40	337	40

NOTE.—Precise comparisons of the levels of gross national product between the United States and other countries are not possible. The conversion into dollars has been made on the basis of the latest official exchange rates, and the purchasing power of the dollar equivalent is appreciably higher in most foreign countries than that of the dollar in the United States. Comparisons of the converted dollar figures between other countries are subject to similar limitations.

Source: Office of Statistics and Reports, International Cooperation Administration.

TABLE 2.—*Estimate of world gross national product at market prices by regions, 1954 and 1955 (converted into United States dollars by latest exchange rates)* [1]

Region	Gross national product, 1954				Gross national product, 1955 (in 1954 prices)			
	Total			Per capita dollars [2]	Total			Per capita dollars [2]
	Billions of dollars	Percent of— Total world	Percent of— Free world		Billions of dollars	Percent of— Total world	Percent of— Free world	
World gross national product, total	$993	100.0	--------	$373	$1,055	100.0	--------	$390
Free world, total	772	77.7	100.0	443	820	77.7	100.0	464
Western Hemisphere, total	432	43.5	56.0	1,216	463	43.9	56.5	1,276
United States	361	36.4	46.8	2,220	387	36.7	47.2	2,343
Canada	24	2.4	3.1	1,585	26	2.5	3.2	1,667
Latin America, total	46	4.6	6.0	264	48	4.5	5.9	268
Central America	(11)	(1.1)	(1.4)	(207)	(12)	(1.1)	(1.5)	(209)
South America	(35)	(3.5)	(4.6)	(291)	(36)	(3.4)	(4.4)	(296)
Other	1	.1	.1	499	2	.2	.2	617
Western Europe, total	217	21.8	28.1	648	230	21.8	28.1	680
NATO (excluding Greece and Turkey)	172	17.3	22.3	755	182	17.3	22.2	794
Greece and Turkey	8	.8	1.0	249	8	.7	1.0	265
Other OEEC	20	2.0	2.6	853	21	2.0	2.6	895
Other	17	1.7	2.2	332	19	1.8	2.3	348
Asia, total	85	8.6	11.0	104	88	8.3	10.7	106
Arc of free Asia	78	7.9	10.1	101	81	7.6	9.8	103
South Asia	(33)	(3.3)	(4.3)	(68)	(34)	(3.2)	(4.1)	(69)
Far East	(45)	(4.5)	(5.8)	(157)	(47)	(4.4)	(5.7)	(161)
Near East	6	.6	.8	136	6	.6	.8	139
Other	1	.1	.1	150	1	.1	.1	150
Africa, total	23	2.3	3.0	109	24	2.3	2.9	110
(NEA, total) [3]	(51)	(5.1)	(6.6)	(85)	(53)	(5.0)	(6.5)	(87)
Oceania, total	15	1.5	1.9	1,041	15	1.4	1.8	1,069
Soviet bloc, total	221	22.3	--------	240	235	22.3	--------	251
Soviet Union	140	14.1	--------	651	150	14.2	--------	682
European satellites	48	4.9	--------	516	50	4.8	--------	538
China mainland and other	33	3.3	--------	54	35	3.3	--------	56

Source: Office of Statistics and Reports, International Cooperation Administration.

NOTE.—Precise comparisons of the levels of gross national product between the United States and other countries are not possible. The conversion into dollars has been made on the basis of official exchange rates, and the purchasing power of the dollar equivalent is appreciably higher in most foreign countries than that of the dollar in the United States. Comparisons of the converted dollar figures between other countries are subject to similar limitations.

[1] Except for the Soviet Union and European satellites.
[2] Computed on basis of unrounded total figures.
[3] Near East Asian countries, Greece, Turkey, Egypt, Ethiopia, Liberia, Libya, Afghanistan, Ceylon, India, Nepal, and Pakistan.

APPENDIX II

Selected Statistical Data on Nonmonetary Measures of Material Welfare

TABLE 3.—*Nonmonetary measures of material welfare, selected countries, 1955 or closest year*

Country	Caloric intake per person per day (numbers)	Protein consumption per day (grams)	Infant mortality (number of deaths per 1000 live births)	Literacy (percent of population 10 years and over)	Inhabitants per physician (number)
I. COUNTRIES WITH PER CAPITA INCOME ABOVE $750					
United States	3,090	92	27	98	770
Canada	3,120	98	32	(1)	950
France	2,785	96	42	97	1,100
United Kingdom	3,230	86	26	98+	1,200
Denmark	3,300	89	27	99+	950
Germany	2,945	77	43	(1)	750
II. COUNTRIES WITH PER CAPITA INCOMES BETWEEN $750 AND $300					
Uruguay	2,940	99	43	85	(1)
Israel	2,711	81	39	[2] 75	380
Austria	2,790	83	48	97	650
Italy	2,595	80	53	(1)	800
Argentina	2,800	96	62	[3] 86	1,300
Cuba	2,730	[4] 67	[4] 99	76	(1)
III. COUNTRIES WITH PER CAPITA INCOMES BETWEEN $300 AND $150					
Turkey	2,678	86	(1)	35	3,100
Brazil	2,355	57	107	48	3,000
Japan	2,180	58	49	[2] 95+	1,000
Greece	2,540	80	44	76	1,000
Philippines	2,280	(1)	109	62	12,000
Iraq	2,338	(1)	44	[2] 12	6,400
Mexico	2,210	(1)	81	55	2,400
IV. COUNTRIES WITH PER CAPITA INCOMES BELOW $150					
Egypt	2,338	69	127	25	3,600
Indonesia	2,040	(1)	[2] 200+	[2] 55	71,000
Ceylon	2,052	47	72	58	5,300
Syria	2,131	(1)	102	[2] 50	5,000
Thailand	2,080	(1)	65	54	6,800
India	2,004	50	119	18	5,700
Burma	1,612	(1)	102	31	4,700
Pakistan	2,124	53	125	14	13,000

[1] Not available.
[2] Estimate.
[3] 1947.
[4] 1948–49.

Source: Statistical Office of the United Nations, and Office of Statistics and Reports, International Cooperation Administration.

APPENDIX III

Some Statistical Relations Between Gross National Product, Gross Capital Formation, and the Distribution of the Labor Force

Table 4.—*Investment, population growth, and proportion of the labor force in agriculture in selected countries*

Country	Per capita gross national product in 1955 (in dollars)	Percentage of gross investment of GNP (1954)	Percentage growth of population per year (1955)	Percentage of labor force in agriculture (1955)
United States	$2,343	18.7	1.6	12
New Zealand	1,249	19.8	1.6	18
France	1,046	15.5	.7	36
Belgium-Luxembourg	1,015	15.5	.6	13
United Kingdom	998	15.9	.5	5
Denmark	913	18.1	1.0	24
Germany (Western)	762	26.0	(1)	23
Netherlands	708	14.2	1.5	19
Israel	540	25.3	4.0	15
Austria	532	23.8	.4	33
Italy	442	21.6	.9	40
Argentina	374	19.0	2.0	23
Cuba	361	14.0	2.1	42
Yugoslavia	297	32.1	1.8	66
Turkey	276	12.6	3.0	75
Lebanon	269	11.5	2.4	50
Brazil	262	17.7	2.4	68
Spain	254	15.9	1.1	49
Japan	240	24.1	1.2	45
Greece	239	15.4	1.0	60
Portugal	201	15.1	1.2	48
Philippines	201	8.4	1.9	71
Mexico	187	10.9	2.8	58
Chile	180	15.3	1.8	35
Guatemala	179	10.3	3.2	71
Peru	140	23.4	2.0	42
Egypt	135	5.0	2.5	75
Central African Federation	131	27.2	(1)	(1)
Indonesia	128	6.0	1.6	71
Ceylon	122	10.2	2.8	75
Thailand	101	10.3	1.7	80
South Korea	80	8.6	1.7	70
India	72	10.0	1.3	70
Nigeria	68	12.0	(1)	(1)
Bolivia	66	12.0	1.2	71
Pakistan	58	5.1	1.1	80
Burma	52	22	1.0	70

[1] Means data are not available.

Sources: Office of Statistics and Reports, International Cooperation Administration; and Statistical Office of the United Nations.

APPENDIX IV

Major Divisions in Appropriations and Expenditures in Current United States Foreign Aid Programs

Table 5.—*Appropriation for foreign aid programs for fiscal years 1956 and 1957*

[In millions of dollars]

Class of aid	Appropriation for fiscal year 1956		Appropriation for fiscal year 1957	
	Amount	Percent	Amount	Percent
Military assistance	1,022	38	2,018	53
Economic assistance:				
Defense support	999	37	1,162	31
Development assistance	162	6	250	7
Technical cooperation	153	5	152	4
Asian development fund	100	4	0	0
Middle East and Africa fund	0	0	0	0
President's contingency fund	100	4	100	3
Other	167	6	85	2
Total	1,681	62	1,749	47
Total aid	2,703	100	3,767	100

Source: 1956 data from the mutual security program, fiscal year 1957, A Summary Presentation, April 1956; 1957 data from addendum to this same document.

Table 6.—*Project-type versus non-project-type assistance expenditures in fiscal year 1956*

Type of assistance	Amount	Percentage
Project type assistance [1]	$252,697,000	15
Nonproject country programs [2] Miscellaneous economic aid	1,380,097,000	85
Total economic aid	1,632,794,000	100

[1] Project-type assistance is an activity designed to attain a specific, limited, defined objective. It is mutually developed or agreed upon by the ICA and the cooperating country. It requires ICA technical participation through advice or supervision in the planning and implementation of the project. It is a project in which the sequence of actions and the requirements can be projected in reasonable detail at the time of development of the project plan. The implementation of the project must be initiated not later than 6 months after an agreement is signed by the ICA and the cooperating country.

[2] Non-project-type assistance consists of the grant of any form of commodity financing where the commodities, whether imported through governmental or commercial channels, are intended for general distribution or resale within the civilian economy of the cooperating country. ICA assistance and participation in the transaction is limited to financing and to subsequent end-use checking. The commodities are not in themselves required for the physical accomplishment of a specific project. The primary purpose of ICA financing is one or more of the following: Budgetary support, counterinflationary action, or the generation of local currency sales proceeds.

Source: International Cooperation Administration.

APPENDIX V

(This outline was prepared by the staff of the special committee to serve as a guide for the Research Center in Economic Development and Cultural Change of the University of Chicago in preparation of its report to cover subjects of interest to the committee.)

The Role of Foreign Aid in the Development of Other Countries

Purpose.—This project will examine the process of economic development in nations and its interrelationship with social and political change. It will set forth the potentialities, limits, and dangers, if any, of foreign aid as an inducer of change with due regard for its varying influence at different stages of development. *It is designed to assist the committee in determining what kind of aid, in what set of circumstances, if any, will stimulate an economic development in other countries in accord with the national interest of the United States.*

Scope.—The study will seek to answer the following questions:

I. *What is the state of economic development in the world?* A brief survey and classification of nations by stages of economic development and in the framework of the different political and social settings in which development occurs.

II. *What brings about the economic development of nations?* An analysis of the principal factors which create a potential for development and the catalysts which may set the process in motion. The section will consider the influence of factors such as the following:

A. The factor of resources.

B. The factor of wants, incentives, and human capacities.

C. The factor of population growth and pressures (in terms of resources).

D. The relation of mining, agriculture, transportation, power development to industrial development.

E. The economic processes of savings and capital formation.

F. The economic prerequisites to sustained economic development.

G. The relation of public health, education, and training to sustained economic growth.

H. The nature of cultural changes prerequisite to (and accompanying) sustained economic growth (including changes accompanying industrialization and urbanization).

I. The relation of ideologies, governmental structures, and political orientation to the process of economic development.

J. The factor of external social, political, and economic influences.

III. *Why do nations undergoing economic development evolve differently?* A survey of the principal differences and similarities characterizing the economic evolution of the United States, the Scandinavian countries, Soviet Russia, or other selected countries. An analysis of the reasons for the differences and common elements in terms of factors considered under II above.

IV. *What are the potentials of development of the present underdeveloped countries?* An analysis of the factors enumerated under III as they apply to the principal underdeveloped countries or regions.

V. *What effect can foreign aid have in the pattern of development of the underdeveloped areas?* An analysis of the role, if any, played by foreign aid in setting the pattern of development in the countries mentioned in III above. A discussion of the similarities and differences, if any, in the role of external assistance in the development of the United States (and other developed countries) as compared with the development of the present underdeveloped areas. An analysis of the effects of different types of assistance at different stages of development.

A. The role of external assistance in the development of the United States and other developed countries.

B. The effects of different types of economic assistance at different stages of development, including—

1. Direct cash grants;
2. Direct commodity grants;
3. Technical assistance;
4. Loans;
5. Other direct forms of development assistance;
6. Indirect forms of assistance.

C. A discussion of the interrelation of the pattern of foreign assistance and effective development (i. e., the order and ratio of application of such measures as health, education, and agricultural assistance and aid in transportation and industrialization, etc., which will encourage effective development in other nations at different stages).

VI. *Can United States aid act to produce a pattern of total development in other countries that is likely to be in accord with our national interest?* The extent to which the findings in part V are and ought to be applied in order to serve the objectives of the United States aid program (coordinate with project II on objectives).

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