THE ROLE OF THE STATE
IN ECONOMIC DEVELOPMENT

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Signature of Author

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Professor Philip Franklin
Secretary of the Faculty
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Cambridge 39, Massachusetts

Dear Professor Franklin:

In accordance with the requirements for graduation, I herewith submit a thesis entitled "The Role of the State in Economic Development."

Sincerely yours,

Edward Ney Dodson III
ABSTRACT

THE ROLE OF THE STATE IN ECONOMIC DEVELOPMENT

by

Edward Ney Dodson III

Submitted to the School of Industrial Management on May 19, 1961, in partial fulfillment of the requirements for the degree of Master of Science in Industrial Management.

The purpose of this thesis is to develop an understanding of the process of contemporary economic development. Specifically considered are those factors which prompt a greater role of the state -- the central national authority -- in the process of emergence from economic retardation. The argument is developed for a greater governmental role than is evident in more advanced western economies, or than was evident in earlier examples of economic development. This study is general in scope, i.e., the comments and conclusions are directed to no particular country or area, although specific examples are given in support of broader observations.

If an understanding of the modern, struggling nation is of value, it is equally vital that its greatest potential benefactor and, in a sense, beneficiary -- American private capital -- be examined. This consideration is structured within a framework of incentives and insights that the overseas government may offer in order to attract private expatriate investment.

In short, the thesis attempts to profile the two major parties of what is perhaps the most pressing and significant problem of the time: economic development. If "the alluring promises of Communism" are not to prevail, an understanding and rapport between the governments of the underdeveloped nation and American private industry is essential. The thesis concludes with the observations that the actions of these two are highly inter-related, and that the entire process of economic development is dependent upon economic reforms together with social, psychological, and political transformations.

The method of research was essentially one of literature survey, augmented by numerous informal discussions and interviews.

Thesis Advisor: Carroll L. Wilson
Title: Professor of Industrial Management
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CHAPTER 1

Introduction
This study is undertaken within the general field of economic development, and represents an attempt at greater understanding of the world's developing, but still -- by some standards -- underdeveloped countries. The current challenges manifest in these nations have been widely voiced and, it is hoped, widely considered. As one example of notable concern are the words of President Eisenhower:

"An increased flow of United States private investment funds abroad, especially to the underdeveloped areas, could contribute much to the expansion of two-way international trade. The underdeveloped countries would thus be enabled more easily to acquire the capital equipment so badly needed by them to achieve sound economic growth and higher living standards. This would do much to offset the false but alluring promises of Communism."

But, response to this challenge requires understanding -- of the process of economic growth, of the countries in the process, and of the relationships of these countries with the world about them.

A search of the substantial literature on the subject of economic growth is not particularly satisfying, in terms of yielding a resolved group of axioms-for-development. While Professor Lincoln Gordon calls for a greater private share, Alexander Eckstein sees a greater public role.

1. President's message to the Congress of January 10, 1955.
Hirschman\textsuperscript{4} is concerned about a general capital shortage; Ragnar Nurkse\textsuperscript{5} perceives the problem to be one of demand shortage. E.E. Hagen\textsuperscript{6} challenges the universality of Rostow's "takeoff," and also questions\textsuperscript{7} the population barrier thesis, as embraced by George Washington University.\textsuperscript{8} Government service is not a good training ground for management according to Murray Bryce,\textsuperscript{9} while it is according to the U.N.'s Bureau of Economic Affairs.\textsuperscript{10} John H. Adler\textsuperscript{11} assails the hypotheses of balanced growth, the "big push," and the need for greater marginal propensities to save. One publication\textsuperscript{12} offers inflation, another offers deflation.\textsuperscript{13} Nurkse's "low-level trap" and "demonstration effect" are questioned, the social dissatisfaction hypothesis is challenged, and the dispute between Alexander Gershenkron and David Landes\textsuperscript{14} de-

\begin{itemize}
  \item \textsuperscript{7} ibid., p. 129.
  \item \textsuperscript{8} \textit{Population Growth and the Development of South America}, George Washington U., 1959, p. 45.
  \item \textsuperscript{9} M. Bryce, \textit{Industrial Development}, McGraw Hill, 1960, p. 46.
  \item \textsuperscript{10} Management of Industrial Enterprises in Underdeveloped Countries, U.N., 1958, p. 9.
  \item \textsuperscript{14} \textit{Explorations in Entrepreneurial History}, Harvard U., Dec. 1953, Dec. 1954.
\end{itemize}
generates into brickbats. Finally, to cap these differences among economists, Dr. J.W. Saxe comments that -- in general -- macro-economics and economists aren't much good as far as the underdeveloped economies are concerned.

I mention these (and I could continue) because such differences are symptomatic of the understanding and the very nature of the whole development process. The issues between the authors do not imply that one is wrong (except where he may claim universality) but rather that each may be correct within the context of his experience or observations.

Then, it might be anticipated that someone would address himself to the task of resolving these diversities to the end that a general hypothesis of economic development might be set forth. For my part, I can only acquiesce to Professor W.W. Rostow when he expresses doubt that:

"even after we have pursued the analysis of growth for several further decades, we will emerge with what a modern economic theorist would regard as a theory of economic growth. There are too many variables to be disciplined into forms where the number of equations is equal to the number of unknowns; and even more important, the kinds of variables we would wish to see introduced from the side of politics, social structure and culture do not lend themselves to a Newtonian kind of theory, elaborated from clear minimum arbitrary hypotheses."15.

---

What then can be said of the process of economic growth and development? My interests have been quickened by the all too common resort to doctrinaire assertions about public and private roles in development. As Jan Tinbergen says,

"The question of the best line of demarcation may perhaps be called the most controversial issue of today's discussion and thinking... As might be expected, there is on both sides of the Iron Curtain much dogmatic thinking about this issue."

Then, is there a rational basis for the prevailing dominance of government among the developing economies, or does this merely reflect some ideological commitment? I have attempted to set forth those factors in economic development today which prompt a greater role of government than is perhaps seen among the western advanced economies, or than was evident in earlier examples of economic growth and development.

If my initial concern is for a greater understanding of the under-developed nation in the throes of industrialization, my second might be for an understanding of American private enterprise in the throes of meeting the economic challenges and opportunities posed by this "revolution of expectations." I have framed this second consideration in

the form of measures that the government of an under-developed country might pursue in order to attract American private enterprise.

I have not attempted a grand distillation of contemporary economic thought to the end that a comprehensive development plan may be set forth. My introductory list of development dichotomies defies that. But I have attempted to clarify what is indeed a major aspect of most development programs, viz attracting private overseas capital.

My general conclusions are first, that a public role of greater proportions than perhaps our western experience might anticipate can be explained with rational criteria; and while reasoned analysis may be clouded with ideological dogma in many areas of the world, the predominance of government activity in a particular area does not perforce reflect a commitment to any such ideology.

Second, even given a major state role, there is much that can be done to attract private enterprise to a country. There are many aspects of development in which the interests of the two parties are not in congruence -- but there are many where they are.

Third, and to my mind, of great significance, is the conclusion that "economic development" is perhaps a misnomer, for social and political development appear to be of more immediate import. To be sure, these are directed to economic betterment, but they are so vital in themselves that they are deserving of greater attention. Many are concerned with these aspects, as the title of one very fine periodical suggests, viz. ECONOMIC DEVELOPMENT & CULTURAL CHANGE; but I do not feel that the specific application of political and social science to the process of development has reached its full potential.

I do not offer this conclusion on the basis of a specific argument within the thesis -- but it emerges as a constant thread throughout the paper.

My research method has been essentially one of literature survey, augmented by numerous informal discussions with members of the academic and business communities.

There are a number of basic questions which are not considered in this writing and/or which are assumed as "givens". I do not attempt to justify industrialization as a part of the process of economic development; in fact, on occasion the terms are used synonymously. I do not attempt to draw Tinbergen's "line of demarcation" between public and private sectors, although in specific sectors I do assert a dominance of the public role. I do not advance the many factors speaking in favor of private enterprise.
My treatment of these problems of under-developed nations is general, i.e. I have not examined a particular country or world area, but rather have considered general aspects of economic growth. I have utilized specific examples in illustrations of what I offer to be broader observations -- I recognize that this can be a most specious form of argument -- but I believe that the general conclusions set forth are fair.

A Few Groundrules....

Throughout the paper I refer to under-developed countries, countries in the process of economic development or growth, developing economies, etc. I recognize that those countries I refer to as "advanced" are still developing, but in general, I have reserved these appellations for countries still in the earliest stages. They are what W.W. Rostow refers to as "societies in the process of transition,"18 or what The Center For International Studies calls "societies in Category A".19. My comments and conclusions are directed to this phase of the total development process.

I use the term -- state -- in the sense of the

central national authority, and in the interests of relieving verbal monotony, employ it interchangeably with "government."

The role of the state in economic development is described in two categories: those functions which are generally within the province of government; and those functions which, in the western experience, have been part of the private sector but which, in the underdeveloped country of today, default to the state. By this I mean that the private sector may be non-existent or incapable of discharging the particular responsibility, in which case the government must assume the task so that development may continue. I should like to enlarge upon this latter point. This "default" may arise because the private sector may not be sufficiently mature to exercise efficient control of a particular economic activity. On the other hand, it may be within the "capability" of the private sector, but at the same time be of such magnitude or sufficiently different in its relation to the whole economy that the government legitimately assumes a dominant role.

The first of these categories of state roles is discussed in Chapter I, while the second is given in Chapter II. Chapter III deals with those measures which the government of an under-developed country may pursue in order to attract

20. I say "legitimately" in the sense that continued development may depend upon a course of action that only government may pursue.
United States private investment. I restrict this to United States investment because the surveys and studies I found dealt only with American investment desires, problems, etc., although I suspect that the conclusions drawn from them may have general application to all private investors. The final chapter is a summation and conclusion, together with some recommendations and considerations for further study.
CHAPTER II

Normal Functions of Government
SOCIAL OVERHEAD AND INFRASTRUCTURE

This chapter refers to those activities generally given to government, e.g., the infrastructure and social overhead. The reasons for government predominance in this area need no lengthy explanation. Suffice it to say that the long pay-off period, the indirectness and general public benefit of the return (the external economies), the magnitude of the outlay, and its often all-or-nothing character (you either make a whole dam or none) decree that governments play a leading if not the entire role.

Transportation...

Is all this important? Professor W.W. Rostow notes that "the introduction of the railroad has been historically the most powerful single initiator of takeoffs. It was decisive in the United States, France, Germany, Canada, and Russia; it has played an extremely important part in the Swedish, Japanese, and other cases." In many of the less developed countries - "Afghanistan, Ethiopia, Nepal, New Guinea, South West Africa, for example - transport difficulties have been a major force tending to inhibit industrialization altogether. In many others - Brazil, Mexico,

for example - transport difficulties have tended to rein-
force those centripetal influences making for industrial
localization.... In most of the under-developed countries
that have been undergoing industrial expansion in recent
years, transport has tended to become a bottle-neck, re-
tarding the pace of further development. 2.

That a major part of this segment of United
States' development was undertaken by government may not
be generally appreciated. Within our federal structure
the larger share fell to the states. In his study of ex-
penditures on railroads in the south, Heath 3, concludes
that public investment should be credited with more than
55% of the total investment in that area. He writes that
4.7% of these expenditures were federal, 56.7% were
state, 26% municipal, and 12.6% county. Hartz notes the
great role of the state of Pennsylvania:

Originating in the banking field in the
late eighteenth century...(the mixed
enterprise) program flourished with in-
creasing strength for half a century,
eventually being extended to transpor-
tation and embracing various kinds of
enterprise there. In 1844 over one hun-
dred and fifty mixed corporations were
currently listed in the official records
of Pennsylvania, with public investments
ranging from a few shares of stock to

2. PROCESSES AND PROBLEMS OF INDUSTRIALIZATION IN UNDER-
DEVELOPED COUNTRIES, United Nations, p. 12.
3. Milton S. Heath, "Public Railroad Construction and
Development of Private Enterprise in the South before
several thousand. It is hard to view such a policy as an incidental phase of state action worthy of only marginal notice. Nor is it easy to regard as incidental the role of the state as entrepreneur exclusively in its own right... It was with the inception of the public works in the 1820's, where a steady expansion and increasing investment was promised at the outset, that the entrepreneurial function of the state assumed major proportions."

In other areas there were direct governmental undertakings, as the federal construction of the Cumberland Pike, and the digging of the Erie Canal by New York State.

Economic statistics are misleading with regard to government participation in the development of American infrastructure. Major government capital contributions do not appear in the figures, e.g., land grants, exercising of eminent domain, offers of public credit, tax exemptions, services of public officials, right-of-way grants and banking facilities. Hibbard points out that land grants "were a major part of the whole episode of conscious development of the nation through public action. It was believed that private action was too uncertain and too slow."

Education....

The vital role of education in the process of economic development has been widely discussed. W.A. Lewis

5. ibid., p. 14.
asserts that "limited horizons"\textsuperscript{6} are a major impediment in the "will to economize." Education is one of Rostow's major "preconditions"\textsuperscript{7} and a prime element of Hagen's "program" for development\textsuperscript{8}. A U.N. report sees education as a major instrument for the "impacting of necessary skills and knowledge... for entrepreneurial growth."\textsuperscript{9}

I suspect that importance of transportation, power, education, etc., needs no further emphasis to many of the clamoring economies. In fact, it appears the hand may have been overplayed. Malenbaum notes that "in India today, and without doubt in other more or less comparable countries, this role of public investment can be exaggerated. For the existing social overhead facilities are themselves underutilized."\textsuperscript{10} Doctor J.W. Saxe commented that in his experience, a major (and most difficult) task of an economic advisor is to dissuade the government from sweeping educational programs; other examples of conspicuous capitalization are legion (and perhaps legend).

\textsuperscript{6} W.A. Lewis, \textit{THEORY OF ECONOMIC GROWTH}, Allen\& Unwin, 1958, p. 29.
\textsuperscript{7} W.W. Rostow, \textit{op. cit.}, p. 30.
\textsuperscript{8} \textit{INVESTMENT CRITERIA \& ECONOMIC GROWTH}, CIS-MIT, 1954, p. 70.
\textsuperscript{10} W. Malenbaum, "The Role of Government in India's Third Plan," \textit{ECONOMIC DEVELOPMENT AND CULTURAL CHANGE}, April, 1960,
FOREIGN AFFAIRS

There are several factors bearing upon foreign activity within a developing economy which prompt a governmental or state concern. First, is the recognition of a great need for foreign capital. Foreign trade alone will generally not suffice as the means of acquiring this capital because of the amount required, the strain on foreign exchange, and the deflationary impact of heavy capital imports.

Nearly every developed state has had the assistance of foreign finance to supplement its own meagre savings during the early stages of its development. "England borrowed from Holland in the seventeenth and eighteenth centuries, and in turn came to lend to almost every other country in the nineteenth and twentieth centuries. The United States of America, now the richest country in the world, borrowed heavily in the nineteenth century and now is called upon to become the major lender of the twentieth."11. This need is especially true of the smaller countries, for as Bert Hesselitz observes, "they can find fewer of the resources needed for development within their own territory, and hence must import a greater share of them than large countries."12. But even the larger under-developed

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11. W.A. Lewis, op. cit., p. 244.
nations are generally less richly endowed with the total resources for development than were their historical predecessors.

And yet, external commerce is of immense significance to the developing economy — it is deemed "key" to industrialization in South America, \(^{13}\) a "chief method" in Asia and the Far East, \(^{14}\) and a "crucial point" in the development of several African countries. \(^{15}\) W. Arthur Lewis observes that "at low levels of economic activity, production for the foreign market is usually the turning point which sets a country on the road to economic growth." \(^{16}\)

But, it might be asked, does this imply any state role different from other historical examples? I suggest there are two factors concerning foreign affairs in today's world which prompt greater state participation. One has to do with the character of the industrializing "elite," while the other concerns the nature of the world environment.

E.E. Hagen\(^{17}\) and others\(^{18}\) have advanced the

\(^{15}\) THE STRUCTURE AND GROWTH OF SELECTED AFRICAN ECONOMIES, U.N. p. 5.
\(^{16}\) W. A. Lewis, op.cit., p. 275.
\(^{17}\) E.E. Hagen, op.cit., p. 127.
hypothesis that economic development has depended upon the emergence of a disaffected minority. Generally, these have been religious elements, e.g., Quakers, Huguenots, Parsees, Dissenters --, or ethnic groups, e.g., the Antioqueños in Colombia, Scots in Britain --. The contemporary elite carries the banner of nationalism. Often the focus of this nationalism is upon the large scale plantation or industrial organization directed by a foreign or traditional minority. Upon its ascendancy, the new elite naturally casts a wary eye upon private activity, and particularly upon foreign private activity. Consequently, close governmental scrutiny of expatriate concerns ensues. Certainly this has the trappings of a new ideology, but the economic facts of prior exploitation and subjugation upon which it is based are quite real.

A second and related element -- the nature of the world environment -- leads to a greater state participation simply by virtue of the total global competition between the United States and the Soviet Union. Economic development has become part of the political struggle and, following from the Kissinger thesis, is the modern substitute for ships-of-the-line.

Given external governments vying for influence, and internal governments spurred on by nationalism, all within a framework of international trading and investment, it strikes me that there is a natural impetus to
greater state involvement in the processes of economics. This touches upon political science which I believe has not addressed itself in an effective manner to the whole problem of development.

However, there are real economic consequences of the Cold War. The withering of trade, capital, and immigration flows between East and West, and the vast allocations to the military have greatly distorted the "natural" economic patterns. The political struggle has injected new and greater elements of risk in international investment, and as Gunnar Myrdal notes, "has certainly retarded the establishment of institutions for the internationalization of aid."^{19} However, it is debatable whether the net amount of international assistance is greater or less than it would have been in a less-troubled world. I suspect that it is considerably greater.^{20}

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20. Gunnar Myrdal discusses these and other aspects of the contemporary scene in his chapter entitled "The Consequences of the Cold War," ibid., p. 137-148.
MONOPOLIES

Another general category of governmental activity is the curbing of the abuses of monopolies or unfair competition. "The dangers of monopoly are especially great in countries where the market is too small to allow real competition and often allows room for but one plant in an industry." 21. And yet, the market factor, together with the shortage of managerial, supervisory, and labor skills may leave no alternative to a monopoly status for a desired industry. Many industries may take on the trappings of public utilities in that their output may be basic to the total national welfare. Just as the electric power works which can be supported by an American town may rightly be controlled by the municipality, so the fertilizer plant in an under-developed region may be controlled by the regional government. That the government may do well to avert private control in these circumstances is given support by the observation of Professor John M. Hunter that there is less responsibility to the public felt by businessmen in these countries than in the United States. "They are going through the 'public-be-damned' stage which is said to characterize

U.S. Business seventy-five years ago. 22.

Among the private sector in an under-developed country there is considerable pressure for monopoly status. This has been recognized as a prime investment incentive to the extent that "exclusive franchises are being granted in many countries to desirable new industries. This device is not new of course, for it played a role in early European industry.

More recently in Uruguay, for example, over 100 concessions with exclusive privileges for nine-year periods have been granted since 1921. In Panama in 1937, exclusive rights were granted.... In Jamaica, special protection amounting to virtual monopoly was accorded to such industries as matches, condensed milk, and cement. 23. Other examples are plentiful for Asia and the Middle East. 24.

Here again is an example where a larger state

22. J. Hunter, "Dilemmas of Public Control in Underdeveloped Countries," BUSINESS TOPICS, Michigan State U., Summer 1959 ---- It seems that the charge of "public-be-damned" ethics is appropriate for some American concerns as well. An executive of a major U.S. chemical firm speaking before a Harvard audience related how his company took advantage of certain African beliefs and superstitions (to cure a cold a medication must get into the bloodstream) by stating that their ointment went at directly to the blood.


24. e.g., ECONOMIC DEVELOPMENT AND PLANNING IN ASIA AND THE FAR EAST, U.N. 1953, p. 20; and THE ECONOMIC DEVELOPMENT OF JORDAN, Johns Hopkins, p. 127.
role is required -- not necessarily in terms of direct action or participation, for this may be inimical to efficient and beneficial management of a desired monopoly. Rather, the larger governmental role must take the form of increased perceptiveness to possible abuse or to actions contrary to the goals of increased development, technical innovation, and the improvement of society.
STABILIZATION

Today, another of the "conceded" state roles is that of control of cyclical fluctuations in the national economy. Recall the previous remarks concerning reliance upon foreign trade; Professor Raul Prebisch asserts 25. that such dependence means a greater susceptibility to international economic fluctuations. This contention is based upon a number of observations: there has been no equilibrating flow of labor to meet the higher productivity (and wages) enjoyed in the advanced economies. This (in logic developed in several successive chapters), together with greater technological progress in the advanced areas, has prompted a widely varying range of import coefficients 26. within the cyclical center(s). These coefficients show a tendency to rise with increasing national income, and to fall with downturns in the economy. In short, then, a drop in United States' national income is reflected by a greater percentage change in imports. Countries dependent upon their trading center's propensity to import will thus experience a loss of export trade, and consequently,

26. defined as value of imports/national income.
the loss of a major means of financing capital imports.

Prebisch goes on to say that there are delays in the transmission of these effects which serve further to aggravate foreign exchange problems (the basis for another Forrester model, no doubt.)

My conversations with several economists have cast doubt upon Professor Prebisch and his general assertions. His case rests upon particular relationships of income elasticity and mechanisms of exchange regulation. Obviously not all commodities and countries meet these conditions, but I think his remarks -- if not his explanation of them -- have general plausibility.

There is one careful analysis of a developing nation's sensitivity to fluctuations within its "cyclic center." Gideon Rosenbluth demonstrates that over the past fifty years there has been a marked reduction in Canada's sensitivity to economic fluctuations in the United States. Prior to 1920, Canada's cycles followed those of the U.S. and exhibited greater amplitudes; however in recent years there has been less

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27. see also Kindleberger, op. cit., pp. 246-249, and Higgins, op. cit., p. 371.
28. The "cyclic center" is Prebisch's term for the origin of economic fluctuations.
sensitivity, and on occasion the Canadian recovery has preceded that of the United States. I realize that the logician's stipulation of *ceteris paribus* is not satisfied, but this change in sensitivity has followed considerable change and diversification of the Canadian Economy. The Royal Commission on Canada's Economic Prospects reports that while the dependence of Canada's export trade upon a few commodities remains virtually unaltered, there have been significant structural alterations. "Even in the past few years of heavy inflows there has been much less relative overall dependence upon foreign investment to supplement Canadian savings than in earlier periods of rapid Canadian development." Concerning diversification, the Commission report states that, "still another approach to diversification places primary emphasis on the variety and regional breadth of domestic production. In these terms -- and by any statistical measure -- there can be no question that the Canadian economy has undergone increased diversification since World War I."32.

30. although the "mix" has changed considerably, with metals, metal products and forestry products rising fairly sharply.


32. Ibid., p. 70.
While this analysis does not "prove" any general assertion, it does qualify as evidence — and the Royal Commission concurs — that diversification means greater insulation from foreign economic fluctuations, or conversely, the less diversified and dependent the economy, the more sensitive it will be.

Benjamin Higgins adds to this discussion in his observation that within underdeveloped, but developing, economies outside the arid zone, there is instability mainly because of their orientation towards exports, often combined with concentration on a very small range of raw materials and foodstuffs. In recent decades, the markets for these exports have been extremely unstable (see Table I). According to a report of the Economic Commission for Asia and the Far East, "it has been estimated on a global basis that a change of only five percent in average export prices is approximately equivalent to the annual inflow of private and public capital and government grants to underdeveloped countries."33. Yet the figures given in Table I indicate average 10-15% fluctu-

Average Year-to-Year fluctuations * in Exports, 1948-53, 1953-6

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<tr>
<td>Pakistan</td>
<td>22.7</td>
<td>26.5</td>
<td>25.2</td>
</tr>
<tr>
<td><strong>Jute</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pakistan</td>
<td>31.5</td>
<td>9.3</td>
<td>24.3</td>
</tr>
<tr>
<td><strong>Manila hemp</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Philippines</td>
<td>23.3</td>
<td>19.4</td>
<td>11.5</td>
</tr>
<tr>
<td><strong>Sugar</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taiwan</td>
<td>28.1</td>
<td>19.8</td>
<td>23.7</td>
</tr>
<tr>
<td>Philippines</td>
<td>23.8</td>
<td>5.1</td>
<td>5.6</td>
</tr>
<tr>
<td><strong>Copra</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Philippines</td>
<td>30.0</td>
<td>10.3</td>
<td>23.9</td>
</tr>
<tr>
<td><strong>Tin</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>21.2</td>
<td>10.9</td>
<td>15.2</td>
</tr>
<tr>
<td>Malaya</td>
<td>18.3</td>
<td>6.3</td>
<td>15.2</td>
</tr>
<tr>
<td><strong>Petroleum</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brunei</td>
<td>20.9</td>
<td>6.0</td>
<td>13.4</td>
</tr>
<tr>
<td>Indonesia</td>
<td>15.9</td>
<td>7.3</td>
<td>9.9</td>
</tr>
<tr>
<td><strong>Rice</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Burma</td>
<td>11.7</td>
<td>10.4</td>
<td>13.5</td>
</tr>
<tr>
<td>Thailand</td>
<td>15.5</td>
<td>13.3</td>
<td>10.7</td>
</tr>
<tr>
<td><strong>Tea</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ceylon</td>
<td>8.4</td>
<td>15.0</td>
<td>10.5</td>
</tr>
</tbody>
</table>

* A year-to-year fluctuation is defined as the change from the average for one year to the average for the subsequent year, expressed as a percent of the higher of the two.

** Proceeds are based upon export value in terms of United States dollars. In each of the columns there are several slight inaccuracies in that the figures given may refer to somewhat different time periods; e.g. The first Pakistan cotton figures actually represent 1942-1953.

Source: Higgins, E. op. cit. p.556

TABLE I
ations for Thailand rice, Ceylon tea, Indonesian and Malayan tin, with 15-20% variations in Philippines copra and Pakistan jute. Rubber prices display an average fluctuation of 30%. The volume of exports from these countries show similar variations in the same direction -- all this adding up to substantial fluctuations in export earnings.34.

Added to these considerations might be several politico-economic factors. A companion of industrialization is urbanization,35. yet urbanization generally brings an accentuated impact of downturns in the cycle. On the farm there is a reduction in income but perhaps no loss of jobs or the means of subsistence. However, in urban areas, employment is directly affected, hence volatile groups will give protest at a time when political institutions are most tenuous and the governing elite least secure.

Gunnar Myrdal makes a final observation regarding the effect of the cold war upon economic stability. He notes that increased international tension

34. While this might be regarded as "evidence" for Prebisch's basic assertion, it cannot be regarded as substantiation for his explanation of the destabilizing process.
35. In THE PASSING OF THE TRADITIONAL SOCIETY, Free Press, 1956. Daniel Lerner develops a correlation of urbanization, industrialization, and several other factors. He shows how urbanization & industrialization are necessary steps to modernization.
of the Korean War period prompted the United States government to act as a destabilizer by stockpiling. "Ideally stockpiling should act like a stabilizing speculator, buying when a commodity is cheap, selling when it becomes expensive....but the United States acted in quite the opposite way....buying as the prices went up and withdrawing from the market -- or as in the case of tin, even preparing to sell -- as prices came down. This policy greatly reinforced the fluctuations of raw material prices and had far-reaching unstabilizing effects on the economies of European countries, as well as of countries in Asia and Latin America."36.

A RAINFALL THEORY

In many of the dryer regions of the world, there is a great dependence upon rainfall as a major factor in output, income, and employment. Benjamin Higgins observes that "however inadequate a 'rainfall theory' of economic fluctuations may be for advanced countries, there can be no doubt of its importance in underdeveloped arid zone countries, especially those without petroleum." That there are cycles in rainfall is illustrated by Professor Higgins who proceeds to develop the relationships between changes in rainfall and fluctuations in income. When cycles are generated in this fashion, a different kind of stabilization is required from that suggested by orthodox fiscal policy. In these cases the downswing does not start because of an excess of effective supply over demand, hence measures designed to sustain effective demand are irrelevant. "Under drought conditions no amount of internal spending will maintain the output of the private sector of the economy. A major problem in such countries is simply to maintain

58. Ibid., p. 549.
the physical supplies of foodstuffs, ... and if supplies are not made good by imports or sales from stocks, unemployment and inflation can occur side by side.39.

I mention these various aspects of instability not with any presumption of their universality, but to the extent that they are true of a particular underdeveloped country they indicate situations in which the problems are different and more severe than they may be within more advanced economies. Consequently, the government's role of stabilization assumes greater significance, and its actions take on greater magnitude.

Some evidence of a general concern for these modes of instability is seen in the recent proceedings of the Organization of American States. On September 13, 1960, nineteen members40 of the Organization signed the ACT OF BOGOTA, thereby stating their intention to cooperate for the achievement of social and economic progress. One of their major topics was instability, and a final recommendation was offered that urgent attention be given to the search for effective and practical ways, appropriate to each commodity, to deal

40. Of the twenty-one members, Cuba voted "no", and the Dominican Republic was not represented.
with the problem of the instability of exchange earnings of countries heavily dependent upon the exportation of primary products."41.

INFLATION

Another aspect of the government's task in stabilization of the national economy is seen in the following observation from the International Monetary Fund's Staff Papers: "Because of the inadequacy of savings and the difficulty of directing them into productive investment, there is great temptation to raise the level of investment by expanding bank credit -- that is, by inflation. The rationale of such policy is that inflation acts on each of the elements essential to an increase in investment. By raising profits, inflation materially raises the return from investment and induces enterprises to expand the scale of their operations. The expansion of bank credit to businessmen provides them directly with the means of acquiring the initial resources for investment. At the same time, inflation transfers real income to a "saving" group, and the savings out of profits enable businessmen to maintain indefinitely a higher level of investment." 42.

Testimony to the appeal of this rationale

is given by numerous observers. In South America, "inflation is the rule rather than the exception," and the Economic Commission for Asia and the Far East speaks of its prevalence in those areas. But these speak more of its occurrence by inadvertence, and not particularly occurrence by design. If inflation must be risked in quest of development, then the risk must be accepted. As another United Nations Department has observed:

During a period of economic development which involves a high level of investment, countries in which incomes and the capacity to set aside savings are very low, are likely to find inflation an ever present danger."

There seems to be some concurrence among observers that a little bit of inflation can be a good thing. Typical of these comments is Higgins': "judicious inflation may call forth increased output which, if properly allocated, could significantly accelerate development. The accompanying forced saving helps to reallocate demand from consumer goods to capital goods."  

44. Problems and Processes of Industrialization in Under-Developed Countries, U.N., p. 54.
The extremes of inflation have been described by Dr. Bresciani-Turroni in his study of the German experience following World War I. The inflation "was the most colossal thing of its kind in history; and next probably to the Great War itself must bear responsibility for many of the political and economic difficulties of our generation. It destroyed the wealth of the more solid elements in German society, and it left behind a moral and economic disequilibrium, apt breeding ground for the disasters which have followed. Hitler was the foster-child of inflation."46.

The extent to which inflationary investment can be used to stimulate industrial expansion varies from country to country and from period to period within a given country. Bernstein and Patel conclude that the "profits" of inflation do not find their way into additional fruitful investment, hence "credit expansion is more likely to stimulate investment in early than in late stages of continuous inflation."47. As inflation proceeds there will develop distortions in the economy and private enterprise will concen-

trate its investments in inventories,\textsuperscript{48} some types of construction, and foreign assets. In many of the less developed countries, however, the limitations upon inflation policies are most stringent: there is comparatively little slack within the existing economic framework, and the impediments to increased production are not financial but are much more deeply rooted in resource inadequacy and unfavorable social and organizational conditions.

Thus is prescribed a delicate balance of inflation -- a little perhaps, but not too much. But preserving this balance may prove most difficult. The "automatic stabilizer" -- progressive income tax -- is generally not found, or not collected in the more retarded economies. Then too, in most of the underdeveloped countries, the money market does not lend itself to accurate control. "In Southwest Asia for example, it has been estimated that about two-thirds of the total volume of money in circulation consists

\textsuperscript{48} This raises an interesting question. Given a heavy commitment to inventory purchases during inflationary excursions, and noting the impact of inventory policies within a simple economic model (as described by Professor Jay Forrester, HARVARD BUSINESS REVIEW, July/Aug. 1958), is there not reason to believe that this reaction to instability breeds further instability?
of currency notes," as distinct from demand deposits. The monetary activities of the banking system touch only a small fringe of the population, "and the rate of interest is rarely an important factor in determining the volume and direction of investment.... nor is the rate of interest a very sensitive tool when inflationary forces are strong.... Between 1940 and 1950 in Peru for example, the rate of interest which varied between eight and twelve percent per annum was not likely to be very effective when the average price increase was of the order of fifteen to twenty percent." The Department of Economics and Social Affairs goes on to say that credit control through changes in the reserve requirements are generally of little effect.

In short then, the normal apparatus of inflationary controls, so sensitive in many advanced economies, is largely inoperative in most of the less developed countries. Inflationary forces must be countered on a broader front. Because credit restric-


tions may be inimical to further development, there is considerable pressure towards other means of controls. Thus the distortions of inflation may invite counter-distortions in the form of price controls, exchange rate manipulations, discriminating tax rates, or wage controls (there are several sociological ramifications of inflationary pressures which will be considered in a later chapter). Each of these is of such magnitude and consequence that only the total national authority can be responsible for their formulation and execution.
CHAPTER III

Functions "Defaulting" to Government
A CASH ECONOMY

My second category of state roles in economic development embraces those functions which "default" to government because of private incapacity or unconcern. The foremost among these arises from the observation that "deficient channeling of savings in productive private investment remains the outstanding feature of capital formation in under-developed countries."1 But this poses larger questions which get beyond the realm of economics. The social reforms implicit in the act of saving may be immense; savings implies money, for barter goods are not generally "investable."

Despite its value, the invention of money has spread so slowly that there are large areas of the world where it is only just coming into general use. For example, in some of the great nations of Asia, where money has been used in one form or another throughout their recorded history, it is still the case that as much as forty percent of their national output, on the standard definition, is not exchanged against money. The use of money is associated with specialization and

trade; where people are so poor that they have little surplus to trade, they have little use for money.

The use of money alters social institutions by increasing the importance of the market; "even more important perhaps, it also alters human attitudes. Once money begins to circulate in a community, and production for markets becomes common, economic relations move increasingly to an impersonal basis. Status and kinship count for less, and money counts for more. Wealth is easier to accumulate in cash than in cows or in sacks of corn; the acquisitive instincts -- the desire for wealth -- are therefore easier to exercise, and grow as they are exercised. The 'capitalist' relations of moneylending and of wage employment also spread more easily with money than without it. Hence, forms of organization which are feasible in societies which do not use money, such as the extended family system, or systems based largely on status, cease to work effectively when money comes to be widely used."²

In this light, commitment to a venture which promotes the utilization of money may be viewed as one having "external economies." Richard Robinson cites the example of a sugar refinery in Turkey which was

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² W. A. Lewis, op. cit., p. 76.
vigorously criticized as being uneconomical -- it would be less expensive for Turkey to have its sugar refined elsewhere or to purchase refined sugar on the world market. And yet, there were many external economies to be realized by the venture. To many it introduced the notion of a cash economy, together with concepts of scientific farming, cooperative marketing, and eventually, of capital investment (in crops and in the refinery itself).
ECONOMIC MAN

Even given a monetary basis of exchange, there is much discussion of Ragnar Nurkse's (or rather Thorstein Veblen's) "conspicuous consumption." Every author has his examples of extra income going towards feasts, Cadillacs, baubles and wives. These might evolve from a desire for prestige, or may be satisfying some religious or cultural obligation to serve their family elders -- there may be no single social prescription for the same symptom. That western transgression -- nepotism -- is a fond and honorable practice in other areas. And yet, there seems to be an unwarranted degree of acceptance of the thesis that underdeveloped man does not act in such a manner as to maximize his gain. One observer writes that: "the emphasis on the dilution of incentive to save because individuals are involved in wider networks of kinsmen than they are in our society is a product of armchair anthropology, rather than the result of research. For example, Belshaw\(^3\) indicates that extended families may be important in the initial aggregation of capital and also

in the channeling of investment." 4.

Dr. J.W. Saxe opined that, within his experience, the African is a fairly astute economic individual. He thinks in terms of real (and not just money) income -- a view substantiated by a study report of Rhodesians by William J. Barber. 5. Both he and Dr. Saxe dispute the claim that the supply function of African labor is backward sloping, to which Bernstein and Patel might add their remark that "the desire to accumulate moderate savings is much stronger in low-income countries than is generally assumed." 6. Additional "evidence" of an economic motivation on the part of indigenous personnel in these countries is perhaps seen in the compilation of stock-subscription data by Mr. J.D. Nyhart. The extent of African participation in several Nigerian issues is termed surprising. One thousand fourteen local shareholders represented 9.9% of the capital in one Nigerian enterprise.

The dispersion of the shares is indicated in the following tabulation:

<table>
<thead>
<tr>
<th># shares</th>
<th># shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 - 50</td>
<td>297</td>
</tr>
<tr>
<td>50 - 100</td>
<td>272</td>
</tr>
<tr>
<td>101 - 150</td>
<td>166</td>
</tr>
<tr>
<td>151 - 200</td>
<td>70</td>
</tr>
<tr>
<td>201 - 300</td>
<td>113</td>
</tr>
</tbody>
</table>

The average holding was 134 shares.

For another Nigerian concern there are the following figures:

<table>
<thead>
<tr>
<th></th>
<th>Ordinary shares</th>
<th>Preference shares</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td># Nigerian stockholders</td>
<td>427</td>
<td>714</td>
<td>1141</td>
</tr>
<tr>
<td>Nigerian / total stockholders</td>
<td>81%</td>
<td>97%</td>
<td>90</td>
</tr>
<tr>
<td>Nigerian holding / total holdings</td>
<td>6%</td>
<td>35%</td>
<td>12%</td>
</tr>
<tr>
<td>Average value, Nigerian holding</td>
<td>£ 62</td>
<td>£ 49</td>
<td>£ 54</td>
</tr>
</tbody>
</table>

But if these observations indicate that there is some measure of entrepreneurial bent, there remains a net judgment that the shortage of what Schumpeter called the "innovator's creative response" is a major bottleneck to economic development. In Africa, "there are two immediate obstacles more cru-
cial than a shortage of capital. The first is the absence of Africans having the qualities of the entrepreneur. The second is the number of investment opportunities felt to be economic in view of the restricted local market and the existing competition."7 From a comparatively advanced area of Africa there comes the following comment: "for a country as firmly committed as is South Africa to the general principle of private enterprise, publicly owned undertakings play a surprisingly large part in her economic life .... Government has found private entrepreneurs unable or unwilling to undertake the development of sectors regarded as of primary national importance and has therefore been compelled to act."8 The general tenor of these remarks is pertinent to other areas. Higgins contends that "although India is blessed with a considerable number of capable and vigorous managers and entrepreneurs, management and entrepreneurship still constitute a bottleneck."9 He speaks similarly of Indonesia, and other Asian

countries.

There are finer distinctions in this social-cultural attitude towards savings: "Indian capitalists, with few exceptions, remain merchants by temperament and inclination. They are interested in buying, selling, in quick turnover, however small. As a class they would rather sink their profits below ground, in gold, than reinvest them in expansion or modernization of their enterprises. They would rather obtain oblique control of a business through the managing agency system .... than risk their capital in a straight deal."\(^{19}\)

This same characterization has been made of other Asian entrepreneurs, but I think this is indicative of a keen economic sense. In the face of volatile price levels and general instability, the actions of the Asian are only prudent. Samuelson writes of numerous countries where chronic inflation conditions many investors to put their money in real estate or inventories, not manufacturing -- "no less than 55% of Brazil's 1947 investment was in the form of construction. And observers are struck with the fact that, in many of the poorest regions of the world, luxury apartment dwellings seem to mushroom, at the same time that industry is lan-

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guishing for lack of new equipment."11. Thus is required
a redirection of an existing "will to economize" through
stabilization, education, and encouragement -- all po-
tential tools of the state.

Another aspect of the plight of private enter-
prise in many of the underdeveloped countries is seen
in the observations12. that in much of Asia and Africa,
university students seldom plan to become businessmen
or engineers or doctors. They want to be politicians
or government officials. This reflects the lowly re-
gard or "status" of the private entrepreneur, according
to some of these observers; but I think the conclu-
sion may be somewhat oversimplified. Under colonial
regimes, too often the "enterprising young native" has
been one who was serving the expatriate commercial in-
terests. Consequently, this form of entrepreneurship
may be distasteful in the popular mind; however,

12. For example -- S. Alsay, "What Africa is Really Like,"
- J. D. Nyhart, op.cit., p. 4.
- DEVELOPMENT OF PUBLIC INDUSTRY THROUGH PUBLIC AID,
- "Economic, Social and Political Change in the Under-
developed countries & its Implications for United States
- In an article in CAPITAL FORMATION & ECONOMIC GROWTH,
Marion Levy contrasts the esteem in which businessmen were
held in China and Japan. He finds the greater esteem in
Japan highly significant to its relatively advanced de-
velopment.
given independence, I should imagine that public regard for an individual who prospers in trade or manufacture might be considerably different. Then too, I suspect that a large part of the attraction to government is the feeling that "here is a place where I can do something, can bring about rapid change ..."

And yet I cannot deny or refute the claim that private enterprise has a tarnished reputation within many of the currently under-developed areas. This poses problems for the nation itself as it attempts to solve the economic and social problems, of basic development, and most certainly offers a major challenge to those who represent private enterprise as they attempt to solve the political problems of continued development.

But again, it might be asked if all these socio-psychological conditions were not a part of the development of the now-maturing economies. There seems to be some consensus that these "preconditions" are in a more retarded state in today's struggling economies than was the case in the early stages of western development.

"The social situation in most under-developed countries today, whether they are pre-industrial economies or are at an early stage of industrialization, is essentially different from that which prevailed in most of western
Europe on the eve of the industrial revolution. There, society had been conditioned for impending technological innovations by several centuries of slower change, not only in production techniques, but also in social and economic organization. In under-developed countries, this process of slow organic growth towards industrial maturity, with its associated evolution of technology, is not likely to be repeated, nor indeed is it compatible with the demand for rapid industrialization. Even where small scale industries can play their appropriate part, these countries face the problem of instituting and expanding an industrial system not in its early elementary forms, but to a large extent, at a much more advanced technological stage. 13.

Professor Edward S. Mason asserts that "most of the underdeveloped world is more illiterate and probably less permeated by economic rationality than was western Europe and the United States around 1800." 14.

Gunnar Myrdal concurs, stating that "the initial impediments to social change (in earlier ex-

examples of development) were much smaller than in
most under-developed countries today. 15. To these
assertions of socio-psychological distinctions, the
U.N. Department of Economics and Social Affairs would
add notice of the relatively greater population pressures
in contemporary developing countries. 16.

The upshot of these greater goals, but also
greater obstacles, 17. is a consequent social trans-
formation of larger dimensions. In earlier examples
of economic development -- most notably that of the
United States -- immigrants were a major vehicle for
the infusion of new technical and entrepreneurial
skills; but, with notable exceptions, immigration
has not been the ready source of entrepreneurs in
contemporary examples. Consequently, "not so much
for ideological reasons but by sheer necessity, govern-
ments in under-developed countries become the engines

15. G. Myrdal, AN INTERNATIONAL ECONOMY, Harcourt
Brace, p. 170.
16. see discussion in PROBLEMS AND PROCESSES OF INDU-
TRIALIZATION IN UNDERDEVELOPED COUNTRIES, p. 119-120.
17. a dissent to this "sociological obstacle" thesis is
registered by P.T. Bauer & B.S. Yamey, THE ECONOMICS
OF UNDERDEVELOPED COUNTRIES, pp. 86-93. Their view
is criticized by G.M. Meier in ECONOMIC DEVELOPMENT
& CULTURAL CHANGE, Jan. 1959, p. 83, and Higgins,
op.cit., p. 284 (among others).
of change, cajoling and pressuring a change-resistant society."

In an article devoted to the role of the state in economic development, Alexander Eckstein concludes that:

"the greater the range of ends and the higher the level of attainment sought; the shorter the time horizon within which the ends are to be attained, that is the more rapid the rate of economic growth desired; the greater the institutional barriers to economic change and industrialization; and the more backward the economy in relative terms, the greater will tend to be the urge, push and pressure for massive state intervention if a breakthrough, and not a breakdown, is to be attained."

It is within this context that recent developments in a country like Ghana may be explained. As Stewart Alsop observes, Nkrumah is trying to replace tribalism (although this may not be his sole motivation) with nationalism. In order to surmount the obstacles of traditional tribal factions, he has been forced to assume the posture of a quasi-emperor: the Osagyefo, (Redeemer).

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20. S. Alsop, op.cit.
Another aspect of this default to government arises from the commitment of the private sector to non-productive activities, or to activities once profitable, but now declining. Although the advanced non-Soviet world produces "more than two-thirds of the industrial raw materials (including those emanating from agriculture), exports of primary goods account for nearly ninety percent of the foreign exchange earned by under-developed countries."21. To be sure, the trend of relative prices of primary products has not been the same for all products; for example, "prices of forest products -- making up about one quarter of the total output of industrial raw materials -- have for several generations been moving upwards in comparison with other primary prices. This is one of the factors explaining the spectacular economic development during the last century of a country like Sweden,"22. However, most under-developed countries have very little in the way of forest products to export,23. and many in fact

22. ibid., p. 230.
23. Although I note that at least one African country places hopes in timber "as the greatest immediate source of potential expansion" (The Ivory Coast, American Universities Field Staff Letter, Oct. 16, 1956).
import large quantities of timber, pulp and paper.

"With individual exceptions, the under-developed countries have had rather bad luck in the historical development of international prices of their typical export articles, which have not, on the whole, been the dynamic industrial raw materials essential to industrial development. On the rare occasions when they have had such export articles, as in the case of rubber or nitrates, they have often encouraged the discovery of substitutes."24. Thus far, oil has been an exception, but again "most of the underdeveloped countries are saddled with a basket of traditional export goods — like copper, lead, raw silk, tobacco, tea, tin, zinc, and various foodstuffs — the prices of which have been lagging behind."25.

Where these earnings have declined, it might be expected that private capital formation would suffer. In fact, as noted in THE ECONOMIC SURVEY OF AFRICA SINCE 1950, there has been a general reduction in capital formation within the private sector since 1956. Ghana and Nigeria were affected, and the "growth of output was slowed down considerably in Mauritius,

25. ibid., p. 231.
Uganda, and the Union of South Africa; or even arrested, as in the Congo and the Federation of Rhodesia and Nyasaland.\(^{26}\).
AGRICULTURAL AND LAND REFORM

To discuss a matter related to the previous one -- there is general agreement that among the "preconditions" of economic development is a general agricultural transformation. W.W. Rostow sees three distinct and major roles that agriculture must play "in the transitional process between a traditional society and a successful take-off.

First, agriculture must supply more food."27.

The products of agriculture are needed to feed the urbanized - industrialized populace which is certain to emerge and grow during the transition. "And in most cases, increased agricultural supplies are needed as well to help meet the foreign exchange bill for capital development; either positively by earning foreign exchange, as in the United States, Russia, Canada, and several other nations which generated and maintained agricultural surpluses while their populations were growing (and their urban populations growing faster than the population as a whole); or negatively, to minimize the foreign exchange bill for food -- like a whole series of nations from Britain in the 1790's to Israel in the 1950's."28.

27. W.W. Rostow, op.cit., p. 22.
28. ibid., pp. 22-23.
For his third factor, Rostow draws upon Adam Smith's observation that surplus income derived from ownership of the land be transferred out of the hands of "those who would sterilize it in prodigal living" into the hands of more productive men who will invest in the modern sector. Caught up in this transfer today is a more salient political element, for ownership of the land is, in many areas, the burning issue within a whole panoply of national issues. Subdivision becomes a goal in itself: "the critic must also keep in mind the object of land reform. Primarily, it was to provide opportunity for landless workers to become owner-operators."29.

Greater productivity calls again for straightforward attack -- technical assistance, training and research --, together with a more subtle sociological concern. Crop planning, maintenance techniques, and the whole process of acquisition (seeds, tools, etc.) and marketing may be so culturally rooted as to make the social transformation of greater significance than the technical change. The size of the agricultural sector, the scope of the new technology, and the implications of the social change require a governmental

29. N. Lowry, LAND REFORM IN ITALY, Nat'l Planning Assoc., p. 45. There is historical precedent to this. In Mexico in 1911, Russia in 1917, and Europe after World Wars I & II, the price for political participation by the peasantry was the break-up of many of the large estates.
concern and participation.

The economies -- or lack thereof -- of the more politically inspired element of land reform, viz. division of the land into small individually held plots, are moot. Kindleberger observes that "as a general rule, land reform cuts down production, increases consumption, reduces supplies available for shipment to the city and for export, uses up capital, and cuts down capital formation. These are major economic arguments in favor of retaining land in large blocks."30. He recognizes the political significance of landholding, and goes on to say that "it is not always true that the break-up of large estates shifts production to a less efficient scale, and requires more capital for the same output, as well as increases farmers' consumption. Absentee owners of latifundia on occasion have consistently undercapitalized their holdings. Thrifty peasants may then build up their land/capital ratio even outside the money and market mechanism. In addition, land reform may furnish the spark to economic development, or release the energy to make it effective. The theme of

S. A. Musk's INDUSTRIAL REVOLUTION IN MEXICO is that the rapid rate of growth in income had its origin in the breaking up of the feudal pattern of society in the 1911 Revolution. 31.

31. ibid., p. 226.
PUBLIC HEALTH

Yet another problem of the national development which may assume such proportions that only governmental action will suffice is that of pestilence and disease. These may have immediate economic consequences, such as the fact that "two hundred tons of cocoa may be lost annually (in Ghana) through swollen shoot disease and attacks of the capsid bug."32. Or the impact may be upon the labor force; "low health levels of the working population inevitably result in low rates of efficiency and high rates of absenteeism. The prevalence of endemic and debilitating diseases is obviously detrimental to all kinds of productive activity; but industrial work is in general much more sensitive to its effects than peasant farming, for in the factory efficient production depends upon continuous, concentrated, and cooperative effort from a closely interdependent team of workers."33.

There is ample testimony that public health is a major concern within the less advanced countries. The American Assembly34. has pictured these areas in Africa

34. THE UNITED STATES AND AFRICA, The American Assembly, 1958, p. 236.
in which are found such endemic diseases as malaria, leprosy, yellow fever, filariasis, amebic dysentary, sleeping sickness, and relapsing fever. They seem to blanket the area between the Sahara and South Africa. Similar graphic demonstration of the prevalence of disease in Asia and the Middle East is available.

Like each of the preceding topics of discussion, this matter of public health is not only an object of straight-forward attack. In addition to inoculations and insecticides (or capital, stabilization, transport, education...) there is required a major social transformation, for public health depends greatly upon public attitudes towards sanitation, diet, cleanliness, disease, and medical treatment.
A CONCLUSION

The discussions of social overhead, stability, entrepreneurial attitudes et al. lead only to the conclusion that "natural market forces" alone cannot be relied upon in the process of economic development. This is no novel assertion; it is amply fortified by more expert opinion. For example: Higgins -- "Our whole analysis of the development problem, especially in poor and stagnant countries, led us to the conclusion that current market choices are a very unreliable guide to development policy."

Gunnar Myrdal asserts that natural market forces perpetuate, in fact widen, international disequilibria. Lewis gives partial explanation for this in his observation that, up to a point, there are increasing returns to capital, hence investment naturally flows to more developed economies. Where overseas investments have gone to under-developed areas, it has "moved mainly into the extraction and production of raw materials for exports". A University of Chicago study adds

35. B. Higgins, op. cit., p. 434.
36. E. Mason, op. cit., p. 50.
that the greater political and economic stability of more advanced countries makes them the more preferable investment risk for private capital. Consequently, the underdeveloped country must take action to distort these "natural market forces;" it must restrict, urge, push, .... in short, it must plan.

A broader statement of conclusions is left to the final chapter, however at this point I would express the hope that in my role of investment broker, the task is half-completed. In other words, I have introduced the investor to the recipient and to some of his problems and desires. The next part of the broker's task would be to acquaint the recipient with the investor and his problems and desires.
CHAPTER IV

Incentives to Private Investment
PROMOTION

Perhaps foremost among the various expedients and devices that an overseas government might employ is promotion (although this must be spiced with real incentive measures). Puerto Rico -- with its widely discussed and eminently satisfactory.

OPERATION BOOTSTRAP -- is a fairly long standing example of the success of an aggressive promotional effort. More recently, Malaya has enjoyed an investment boom following a concerted campaign of persuasion and advertising. While still largely dependent upon exports of tin and rubber, Malaya has been expanding in other areas. At the beginning of 1960, thirty new enterprises with a total investment of more than seven million dollars were given "pioneer" status. These were in large part ancillary to new foreign investment in manufacturing plants. Dunlop Tire established a production facility for rubber goods. Standard Vacuum began construction of a fifteen million dollar refinery. Beatrice Foods, in conjunction with a Malayan firm, set up a canned milk plant in

1. "Potential mainland investors got invitations to Puerto Rico, promises of a free hand for free enterprise. The government chipped in by relaxing tax rules, training the workers, sometimes even constructing factory buildings. By 1961, 680 plants employing 50,700 Puerto Ricans were established on the island."

TIME, April 7, 1961, p. 30.
Petaling Jaya, and the American International Assurance Company has spent over $3.3 million in new facilities. IBM is presently reported to be greatly interested in direct investment activity in the country of Malaya.

Testimony to the need for better dissemination of information is given in a study conducted under the Harvard Law School's International Program in Taxation. The study reports that among those executives not interested in foreign investment, a lack of interest is usually accompanied by a lack of knowledge....A variety of misconceptions exists concerning the possibilities (of overseas investment), and there is a tendency to exaggerate the risks and problems....executives talked primarily about the problems of exchange convertibility and an unfavorable climate. Often, however, the executives were misinformed. For example, many thought that it was completely impossible to bring back dollars from particular countries, and were quite surprised to discover that foreign investors had regularly withdrawn profits."

2. FORTUNE, December 1960, p. 100.
INFORMATION AND STATISTICS

Closely related to promotion are the facts and figures with which to promote and with which a potential investor can appraise a prospective commitment. The International Cooperation Administration recommends that developing countries establish an agency -- perhaps within the Ministry of Commerce or a development bank -- charged with the gathering of technical information and statistics concerning economic development. The scope of this activity might include data of markets and competition, raw materials, transportation and location, production processes, labor supply, management requirements, profit calculations, and general environment factors including taxation, regulation and law enforcement.

This will generally involve effort beyond the mere compilation of existing data -- research is required in the forms of geological surveys, soil analyses, population census, commercial records, etc. However these are not serving the interests of foreign investors alone, for such information is vital to the whole national development effort.

EXCHANGE RESTRICTIONS AND EXPROPRIATION

In virtually all of the many reports concerning private overseas investments which have been submitted to the President of the United States, exchange restrictions and fear of expropriation were given as major deterrents to increased overseas activity by American business. The Gray Report, Rockefeller Report and Paley Report submitted to President Truman, and the Randall Report submitted to President Eisenhower all highlighted these factors. These have been somewhat alleviated by the United States Investment Guaranty Program administered by the International Cooperation Administration. The program was authorized by Congress in the interest of promoting new private investment abroad which would further the purposes of the Mutual Security Program. It provides for insurance protection against the risk of:

1. Inconvertibility of foreign currency receipts into dollars;
2. Loss through expropriation or confiscation;
3. Loss through damage to physical assets caused by war.

As of 1959, agreements had been concluded with thirty-eight countries on guaranty coverage against currency inconvertibility. In all but four of these, guaranty can also be obtained against losses due to expropriation. Guaranties against war risk are a more
recent addition to the insurance package, and were available in only six of the countries.

The cost of the guaranties, which may extend for a maximum term of twenty years, is generally \( \frac{1}{2} \) of 1\% per year of the dollar coverage sought.

Countries not signatory to such an agreement might make their own expressions of guarantee -- in fact, a major factor in the Malayan example was the Investment Charter established by Prime Minister Abdul Rahman. The Charter "guaranteed" private enterprise against nationalization, confiscatory taxation, and discriminatory regulation.

These individual expressions are apparently more important to investors in that few companies have availed themselves of the guaranties of the Program.

Exchange Restrictions ....

Restrictions upon transfers of foreign exchange are worthy of additional comment in that balance of payments difficulties and foreign exchange shortages are so commonplace throughout the world, and are perhaps most prevalent in areas which have greatest need. "Of the measures adopted to minimize balance-of-payments deficits, the most familiar are exchange controls and
import regulations (more on the latter in a subsequent section).... Exchange restrictions proper are of concern to the foreign investor not only because they may operate to preclude or restrict the remittance of earnings and royalties and the repatriation of capital, but also because they may prevent the investor from obtaining the foreign exchange needed to pay for imports of machinery, equipment, and raw materials required in the operation of the local enterprise. 5.

Special problems may be created by the existence of multiple exchange rates. Generally the official rate of exchange of foreign units per unit hard currency is lower than the free rate. Some countries, e.g. Brazil, and until recently, Colombia, have found it expedient to offer the foreign investor the option of making his investment at the official rate or at the free market rate, with the right of making future transfers of profits and capital at the corresponding rate of transfer. Other countries, with greater problems perhaps, and with less regard for incentives have required that foreign companies sell the exchange produced by goods exported at the official rate (of for example ten units/dollar) while dollars for remis-

5. Friedmann & Pugh, **op.cit.**, p. 737.
sion of profits must be purchased at the free rate (of twenty units/dollar). In addition to reducing the pressure on foreign exchange resources, such multiple exchange rates may be utilized by capital-importing countries as an indirect means of limiting enterprise profits and as a source of government revenue.

As for my particular counsel on this subject, I have no single recommendation. A country's policy concerning repatriation of capital depends upon its own peculiar exchange and market problems. I would point out that, because this matter is so salient in the minds of the American investor, the greater interests of the host country may well be served by permitting the profits of investment to leave the country. Thus, success begets success.

Expropriation...

The discussion of expropriation cannot be concluded with the impression lingering that the local government offers the guarantee or even a major element of a guarantee against expropriation. Its own natural interests are paramount and as Richard Robinson pointed out, it is incumbent upon the foreign firm itself to keep its role vital and continuing. When it is con-
tributing nothing unique -- technical skills, research, global marketing or production advantages -- it is ripe for expropriation. Friedmann and Hugh conclude their book with the following observation:

"The foreign investor's main safety, however, must reside in the correctness of his estimates as to the economic and social stability of the country of investment, and in the establishment of a moral as well as an economic position in the foreign country, which will make drastic interference with his interests unlikely."

6. Ibid., p. 783.
SOCIAL OVERHEAD & INFRASTRUCTURE

In addition to foreign exchange restrictions and fears of expropriation, a National Industrial Conference Board survey revealed that lack of railway and harbor facilities, etc., and shortage of trained personnel were high on the list of reasons given for lack of interest in overseas investment. It is not only that these facilities and personnel are not available; the companies feared that they would have to assume the greater part of the burden of supplying them, either through taxation or as "Fringe benefits." An executive of National Cash Register, which is active in over one hundred countries, stated that while direct labor costs were low in many countries, the fringes benefits -- e.g., company housing and schools -- expected in the more paternalistic foreign industrial environs drove up total labor costs.

The lessons regarding social overhead and infrastructure have been duly considered (see pages 10-14), however their effect upon private investment decisions warrants these additional comments.
INDUSTRIAL ZONES OR ESTATES

Closely related to the social overhead factor is a device discussed by Paul N. Rosenstein-Rodan. He observes that the establishment of industrial zones or estates has proved to be a "most effective instrument to induce the inflow of small and medium sized industrial units to a new area. It constitutes a strong inducement to invest because it can capture the otherwise volatile external economies of agglomeration."7.

There are economies of scale in factory construction, installation of public utility services, technical and repair services, and transportation and various social facilities. Rosenstein-Rodan gives examples of industrial zones operating in India, Brazil (the industrial district of Belo Horizonte) and in Italy (e.g., the industrial zone of Catania in Sicily). While these have been primarily directed to indigenous enterprise, they have attracted some smaller foreign concerns that might otherwise have been unable to invest in the area.

Several countries have extended this principle to the extent that government pays for the con-

struction of factories, in addition to providing the site free of charge. Puerto Rico is an early example; more recently Ireland has offered to erect the factory and share in any additional capital costs, if the venture is deemed to be of benefit to the nation. This appears to be a massive incentive effort, but Ireland's experience to date indicates the limitations of even this scale of enticement. The fact remains that Ireland does not offer the market for industrial goods that is required to sustain an investment, and thus its efforts have not met with the success that might have been anticipated.

I think there is a valid generalization to be drawn from this. Enticements and incentives can only be marginal in their effect -- the greatest attraction for an overseas investor remains a substantial body of customers.
"FEATHERBEDDING"

A survey among its subscribers by THE MAGAZINE OF WALL STREET also points out a concern for the burden of laws which extend the protection of labor "to absurd limits". The article about the survey notes, as an example, that sugar companies in Cuba -- before they were totally dispossessed -- were required to bag their sugar, although it would have been more economical to deliver it in bulk. Also, in most Latin American countries it is very difficult to effect the discharge of an employee. The Brazilian auto workers' severance pay formula was once described to me as being one month's pay for each year of service up to ten years, at which point it becomes two months pay per year of service. This has resulted in a somewhat prevalent practice of firing persons with 9.9 years of service.

The Harvard, Department of Commerce, and NICB surveys do not mention this item specifically, although it certainly might be incorporated within the comments re "unfavorable climate". If this be a significant matter, the government's course of action is most difficult to chart. Perhaps the lessons of the United States in this regard would be appropriate to the underdeveloped country -- if in fact these problems can be resolved in this country. The solution
may lie within increased education and vocational training; responsible, educated and secure labor leaders; and an astute dissemination of the costs (direct and alternative) of such labor practices to the public. Each of these strikes me as a mandate for governmental action and concern.
FISCAL INCENTIVES

The significance of taxes for overseas investment is multiform and somewhat controversial. The Paley Report and a 1952 Department of Commerce survey found foreign and United States taxes to be a major limitation to foreign investment, while the Harvard survey "found no evidence to suggest that U.S. taxes had been an impediment that had prevented particular investments in foreign countries. More important, we found no instance where executives believed that total exemption of foreign income from United States taxes would have tipped the balance and changed a decision that had been made against a particular investment."8.

A study prepared for a Senate Foreign Aid Committee corroborates the Harvard finding, stating that tax exemption will do little to encourage private investment, the overriding concern being "bad investment climate."9.

These comments are not exactly contradictory, for in the years between these apparently differing expressions, much has been done to alleviate

"double taxation" of overseas income. With but two exceptions the current practice of tax credits generally tends to restore parity between taxation of foreign and of domestic income. Two devices in exception of this policy (in that they tender more favorable treatment to overseas income) are the Western Hemisphere Trade Corporation Act and "tax sparing" agreements. Countries which can appeal to potential investors under the provisions of either of these devices add considerable force to their economic argument.

If a domestic corporation conducts all of its business in the Western Hemisphere, and 95% of its income is from sources outside the United States, then the rate of United States corporate tax applied to it is fourteen percentage points less than the regular rate of 52%. Such concerns are termed Western Hemisphere Trade Corporations. Stanley S. Surrey relates the history of this tax provision and leaves the impression that this legislation reflects not so much a concern for increased economic development as a response to particular pressure groups. To excerpt from a colloquy in 1955 between

Senator Paul Douglas and Professor Roy Blough, who was the Treasury economic expert on taxes in 1942:

"Mr Blough - I was in the Treasury at the time that the fourteen percentage points was first put in, and my recollection is that there were a very few specific corporations which had particular financial problems, and which were represented by some pretty influential people, and Congress...."

"Senator Douglas - This is not an economic argument. It may be a political argument, but it is not an economic argument...."

The National Planning Association notes that few firms utilize the Act, and that most of these few are not manufacturers, but rather exporters. The Association joins with Professor Surrey and the Barlow and Wender report in general reproof of this device, although certainly not in such forceful terms.

The costs and the non-selectivity between types of investment are most common among the criticisms.

Tax sparing agreements grew out of a Conference of Finance Ministers of the American States at Rio de Janeiro in 1954. As a means of stimulating private foreign investment the Secretary of the Treasury announced a policy of negotiating tax treaties under

which credit would be given for foreign taxes including those from which the investor might be exempted or "spared." In other words, a corporation can apply a credit for a tax not paid against its United States taxes.

Several tax sparing agreements have been concluded with various countries although none of these has as yet been ratified by the Congress. The first of these was the result of an income tax convention between the United States and Pakistan in June, 1957. Under the provisions of the Pakistan income tax law, businesses in "favored new industries" were granted an approximate ten year waiver from the Business Profits Tax, and a five year exemption from the Income tax and supertax. The amount of income tax and supertax may be considered as paid for purposes of calculating the credit against the U.S. tax liability. 12.

12. For example, a U.S. corporation which manufactures rope established in Pakistan a branch to which it transfers cash and property worth $420,000. This capital is invested in a factory using electric energy and employing more than 100 persons. The enterprise is recognized as qualified for the exemption benefits. During the first year the enterprise earns a small profit equivalent to $10,500. As this is less than 5% of the capital investment, all of it is exempt from the three taxes mentioned above. The income tax and supertax would have been equivalent to $5906.; this amount may now be credited against the $5460. (52% of the profit) which would be due the U.S. treasury. In other words the entire tax obligation is thus discharged. This, and other examples are given in the NATIONAL TAX JOURNAL, June 1958, p. 150.
Professor Surrey soundly denounces this device in another article in the NATIONAL TAX JOURNAL. He offers sixteen points for consideration and then concludes that "the tax sparing proposal is a fundamentally unsound and dangerous approach to the problems of international taxation. It should be firmly rejected...." 13. While his criticisms are structured primarily within the United States' national interests, several of the points deal with the effect upon the capital-importing country. "This tax reduction could encourage operators to seek a quick profit - to operate for the period, obtain a United States tax reduction, and then end their operations. This has been the case in some under-developed countries. Such a situation is hardly beneficial to the under-developed country and this is hardly the kind of activity which the United States should induce and favor with a U.S. tax reduction. The treaty proposal is thus an incentive to the quick repatriation of foreign profits rather than a continued reinvestment of those foreign profits - whereas one would think that just the opposite effect would be desired." 14.

14. ibid., p. 160.
Professor Surrey then enlarges his argument, asserting that tax "incentives" in general are fundamentally unsound and ineffective. Perhaps this has been recognized in Pakistan in that the period of these concessions was not extended beyond March 1958.

If this be taken as conclusive to the fact that tax incentives here and abroad are "bad," there remains one nagging factor. Criticisms of tax measures for purposes of stimulating domestic and foreign income are based upon highly rational calculations of gains and of losses (to the Treasury); and reductions in tax rates are duly reflected in determinations of increased percent return on investment. But the Harvard Tax report observes that most overseas investors have no quantitative investment criteria -- no "threshold" or minimum required rate of return. Instead, investment decisions more generally hinge upon some assessment of the "climate" -- and no small part of this assessment may depend upon evidence of a favorable government attitude towards business, e.g., a tax exemption.

Surrey dismisses this argument of "symbolic value" and "emotional appeal" from the viewpoint of the United States policy maker. However, the under-developed country, competing for the world's limited private capital, may find the tax reduction to be an effective and
desirable expedient -- even if it has only symbolic value.
REINVESTED EARNINGS

The Harvard taxation survey found that while many prospective investors were reluctant to venture into overseas areas, many of those that had were quite content to leave their earnings abroad and reinvest (in view of the current tax regulations a not-too-surprising mode of behavior). There seemed to be a feeling that the initial investment was like "mad money" -- to be risked along with its subsequent earnings, but not to be augmented by new funds from the corporate treasury.

Of the $4.8 billion required for additions to assets in 1959 by companies in mining, manufacturing, and petroleum, "over half....were provided out of retained earnings of $.9 billion and depreciation and depletion charges of $.8 billion....The largest and most consistent source of funds for financing foreign operations is the annual charge for depreciation and amortization of existing fixed assets, including small amounts of depletion charges."\textsuperscript{15}.

Thus additional investment may be realized if the capital-importing country offers accelerated

or excess amortization. While the investor's ultimate tax obligation (to the United States plus the local country) would not be affected, the fact that U.S. taxes are deferred until profits are remitted, and that the immediate local tax burden would be reduced, does release some cash for reinvestment. The local government must decide this issue on the basis of whether it can utilize the difference in tax revenues to greater advantage than can the private enterprise.

A United Nations publication cites\textsuperscript{16} the dangers in relying upon reinvested earnings as a prime source of industrial financing. In the first place, there is the danger that profits tend to be reinvested primarily in the same or closely associated line of activity, thus possibly promoting unbalanced development. Secondly, there is danger that reinvestment of earned profits may interfere with the development of capital markets for the utilization of savings since the retention of profits bypasses the capital markets. Thirdly, dependence upon reinvested profits lays the foundation for the strengthening of monopolistic conditions. This may have the effect of reducing the

\textsuperscript{16} \textit{METHODS OF FINANCING ECONOMIC DEVELOPMENT IN UNDER-DEVELOPED COUNTRIES, U.N. 1949.}
pressure towards economic efficiency.

I find these criticisms unimpressive. To be sure, the comments are appropriate in extremis, but this is no basis for general policy. Reinvestment does not occur instead of some other method of financing, thus the interests of a capital market would not be served if reinvestment were discouraged. The profits would go elsewhere. There are dangers of unbalanced growth, but again this is a matter of scale. I find the arguments for deliberate and successive unbalancing quite appealing. By such a policy, immediate pressures upon the "bottlenecks" are developed and the balance restored. Hirschman notes that "backward imbalance" (i.e., a bottleneck at the input of factors to the enterprise) is most effective. Immediate steps are taken to relieve the obstruction, and thus a new local enterprise is established -- for example, the supplying of crates for packing and shipping. Then too, reinvestment need not take place within the same sector. Many overseas investors, e.g., United Africa Co., and Compagnie Francaise Afrique Occidentales, have exhibited a great diversity of reinvestments. This raises the possibility of monopolization through vertical integration, but I am told that the pattern of reinvestment by these companies has not been one of ac-
quiring successive stages of production.

Because I have directed my considerations to American investment, this has been somewhat of a digression -- for it is true that most U.S. investors have confined their activities to their primary industrial objectives.

The final criticism concerning monopolistic tendency is again a matter of degree, and I think that as a point of general policy, the host country would do well not to discourage reinvestment because of a fear of monopoly and attendant inefficiency. The investment is probably of value -- and again, the alternative is probably no investment -- and there are other means of curbing monopolistic abuses.

I am sure the U.N. publication meant its remarks for extreme situations, and that short of these conditions, the host government should encourage additional investment by expatriate private interests.
"RED TAPE"

Aside from his major maxim -- "the most important thing government can do to help private industry is to avoid getting in the way"17 -- Murray Bryce counsels that the primary role of the government should be that of expeditor. "Spare parts should be placed in a preferred category and application to import them given special or entirely automatic approval. . . . Raw materials for specified industries should also be placed in a preferred category for fast clearance."18 Bryce goes on to suggest "express service" for foreign exchange applications, duty free and expedited customs procedures, prompt payment by the government for services rendered to it, and a general curtailing of bureaucratic procedures and "red tape."

A general conclusion to be drawn from the earlier chapters is that government is compelled "to get in the way" in many facets of the development process. In Thailand and many other countries, exchange control authorities must give assent to all capital transfers. In Iran, profits may be exported

18. Ibid., p. 93.
in foreign currency only upon examination of balance by the Committee on Foreign Investment. Imports are subject to review in many countries, e.g., Chile and India. In Greece, a license from the Ministry of Industry is necessary for the creation of any new industry, or expansion of an existing one. In Pakistan, all issues of securities must be screened according to the Capital Issues Act of 1947. Each of these reflects the fact that planning implies restriction; but the sense of Bryce's advice is still pertinent. Government can plan, urge, review, restrict -- and still expedite. While this may bear primarily upon those investments already committed, William Whyte's remarks about the potency of word-of-mouth advertising seem appropriate, thus favorable experience by one investor may be considered as incentive for another.
ARBITRATION ASSURANCES

A previously noted survey by THE MAGAZINE OF WALL STREET noted some apprehension on the part of investors concerning possible commercial disputes in overseas jurisdictions. Prospective investors voiced fears of hostile judgments, unknown and differing legal standards and notions of "fair play" wholly variant with those in the United States. A notable example is retroactive change in taxation laws: "although ex-post facto laws are absolutely contrary to an Anglo-Saxon sense of fair play, many countries will yield to the temptation to make a 'killing' by the sudden imposition of retroactive taxes. CREOLE PETROLEUM'S expected 1958 net income was slashed when Venezuela boosted its income tax retroactively; CREOLE considered it unwise even to protest very vigorously against this action."19.

Most legal questions should be carefully resolved in the initial investment agreement or corporate charter; but since it is impossible to foresee all potential controversies and problems, some practicable mechanism for the settlement of disputes -- a grievance procedure -- is vital to the success of any

investment agreement. John S. Glass notes that "licensing agreements have usually included arbitration provisions which call for the use of rules of either the American Arbitration Association or the International Chamber of Commerce in the case of disputes." 20.

Friedmann and Pugh note the salutary effect of an arbitration agreement:

when such agreements are respected, and this will be the normal case, the resultant arbitrations will not only produce impartial resolutions of specific controversies, but will also lead to the development of settled practices and precedents in questions of foreign investments, which may contribute to the gradual growth of an international commercial code. Where, moreover, the capital-importing government refuses to submit to arbitration, the existence of the arbitration clause is of utility to the foreign investor in that it will enable him to seek the intervention of his government on the ground of denial of justice by the capital importing government, without first having to exhaust local remedies." 21.


However, there is the caution that such an agreement by no means immunizes the foreign investor from arbitrary action by the capital importing country. As noted in the consideration of expropriation, the investors' main assurance must reside in his own moral and economic position in the country.
INDUSTRIAL DEVELOPMENT BANKS

Currently an immensely significant mechanism for growth, development banks have grown into prominence rapidly since World War II. While most are government sponsored and not all are dedicated to the encouragement of private industry, many countries have found development banks to be an effective means of stimulating private investment of both domestic and foreign origin.

Perhaps the first appearance of this form of banking was in 1822 when a joint stock company, The Societe Generale pour Favoriser l'Industrie Nationale, was founded in Belgium. Its aim was to help finance new commercial and industrial ventures, with funds derived from the sale of the bank's own stock and bonds. Belgium's lead was followed in France by the creation of Credit Foncier, which engaged mainly in making long term mortgage loans to agricultural interests, and to a lesser extent in financing urban and industrial development. In the 1850's, the most famous of the early development banks -- The Credit Mobilier -- was established. The Credit Mobilier promoted and financed many private ventures in French industry and commerce, and extended its influence to other countries by participating in similar
development banks which it helped organize in most of the leading nations of the European continent. It served as inspiration for a similar bank created in Japan in 1902. Although most of these banks were privately owned, they worked closely with governments in their goals to industrialize the country.

The recent growth of development banks has been attributed to the existence in many less developed countries of a new political independence, strong nationalistic feeling, and rising economic expectations; to foreign aid programs and to foreign private investment; and to the advance of the production sciences which open up new industrial opportunities. Even in relatively advanced countries, it is now common to find development banks financed wholly or in part with government funds.

Murray Bryce sees the development bank as a most useful institution for development. It affords a means of overcoming the barriers of long-term capital shortage. The bank can act in such a fashion as to adjust debt-equity ratios of a business so that it is most appealing to joint private venturers. Less government money is required for the same amount of development than if government invested directly and supplied the total cost of all the projects. Access
to government funds may mean lower interest rates. The development bank permits a flexibility of private management, and yet the government can stimulate selective projects without the "rigidity inherent in a system of direct controls." The bank may afford a measure of insulation from the caprices of political intervention by government administrators; and yet it carries a measure of government sanction and guarantee for its enterprises, thereby giving perhaps some comfort to the wary joint investor. As a consequence, the raising of foreign equity may be facilitated. To quote Bryce:

"There is perhaps no more single useful action which a government can take in the industrial development field than assisting the establishment of independently operated industrial development banks."{22}

To date, most United States investors have been chary of partnership in ventures with government-based development banks, their general preference being to "go it alone." "Most American managements seem to take doctrinaire positions against such mixed enterprises and refuse them serious consideration."{23}

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{22} M. Bryce, op. cit., p. 89.
In fact these sentiments extend in large part to consideration of joint ventures with any foreign parties. In this respect the development bank may not serve as a spur to investment. But the fact remains that the development bank does offer advantages to the foreign investor, and is growing in acceptance, if not in favor.
JOINT VENTURES

Joint ventures may involve development banks -- as previously noted -- or may comprise a U.S. contribution together with local private investors, or the government directly. In many countries, e.g., Japan, India, Spain, Mexico..., the joint venture is required if foreign investors are to establish in the area. Foreign participation may be of many forms: equity participation, loans of cash, credit, machinery..., technical assistance, etc.

These have been ably considered and discussed by John S. Glass24, however, I would add some notes of caution offered by Richard Robinson and others. As the title of Robinson’s article, "Conflicting Interests in International Business Investment," may suggest, he is concerned with the fact that while there are areas of mutual interest between the expatriate investor and the overseas country, there are equally significant areas of conflict. In many ways the joint venture serves as compromise of these divergencies, but in several, the conflict is sharpened. The foreign partner in

a joint venture is usually subsidiary to a larger U.S. firm, and the local partner participates in the profits of only the joint venture... Hence, the pricing of parts and intermediates by the foreign (the U.S.) parent is a matter of real concern. The attitudes of the partners with respect to profits may differ. The American firm may prefer to plow back its earnings, maintaining its profit level from enterprises elsewhere. For the local partner, this may be his single large investment, from which he must have immediate income. Or the reverse may arise. "In a rapidly developing foreign market, the United States firm may face real difficulty in maintaining its equity position. Examples of such pressure are found in the chemical industry in Japan and Italy. The American firm may not wish to commit more capital and hence, if in control, may hold back expansion, thereby acting contrary to the interests of both the local investors and the host government." 25.

As with the consideration of Development Banks, there has been considerable reluctance to joint ventures on the part of American private in-

dustry; but its advantages are being recognized to the extent that joint ventures are coming into increasing usage. 26. A government role of encouragement -- manifested most effectively perhaps in a "hands-off" policy -- will serve to stimulate further investment.

26. One report of this increase in joint activity is given in BUSINESS WEEK, Jan. 3, 1959, p. 31.
CHAPTER V

In Conclusion
SUMMARY AND CONCLUSIONS

In summary, I have directed my efforts to an understanding of those factors prompting a greater role of the state in economic development today. Then, having developed some of the rationale for government participation, I have considered how that government might stimulate American private investment to supply some of the capital so vital to its economic, social, and political enhancement. There is little doubt in my mind that mutual understanding and interaction between overseas underdeveloped nations and American industry is one of the great challenges and needs of the day. So I rest assured my subject is topical.

It is generally agreed that there are several economic functions which "properly" rest with government. Among these are the range of items included in social overhead and infrastructure, together with stabilization of the economy, regulation of economic excesses, and concern for the impact of foreign affairs. Each of these assumes such proportions in the affairs of contemporary under-developed economies that the role of the state is greatly amplified in relation to that evident in more advanced nations. Certain as-
pects of these functions today are unique to the extent that historical examination of economic development is not indicative of the "proper" or most practical role of the state.

Then there are additional factors vital to the process of contemporary growth which in some instances have evolved within the private sector -- or in some others, have not arisen because the obstacles seen today did not present themselves then. Today, the notion of a cash economy and all its ramifications are unknown in many areas. Also, the traditions and customs of a backward people are often out of tune with a modern economic pace; or in other cases, the character of economic life within a struggling area has been such that economic man is conditioned to a mode of behavior which, in the aggregate, defeats the very gain for which he is striving.

The under-developed nation is often committed to agricultural crops and techniques which serve to perpetuate and, in fact, widen the disparities between the advanced and retarded economies. Generally the society is plagued with problems of public health. In short then, the natural flow of economic factors offers no solution to current retardation. And each of these obstacles is of such magnitude that only the
state -- the total national authority -- can surmount them. I can not improve upon Marion Levy's observation that "it is extremely unlikely that the highly modernized systems of the world today could have developed indigenously on the basis of any systems other than ones which relied very heavily indeed on private individual operations, and it is extremely unlikely that latecomers can carry out such development without relying very heavily on public operations."1

Then, presuming a guiding, leading government in an underdeveloped nation, what can be done to attract the greatest source of monetary and technical capital to it? American private industry is largely uninformed about several aspects of business within the less developed overseas territories, and is greatly concerned about attitudes and actions of foreign governments. Information and promotional programs have proven valuable to those seeking capital commitments. There are many purely economic incentives to investors, each of which may have additional value as a symbol of favorable governmental attitudes. I conclude this chapter with several sections which touch upon additional incentives, but which also serve warning upon the investor that the best keeper of his own interests is

himself. This is not warning to the extent that he should forego an overseas commitment; quite the contrary -- his ultimate interests are served by such an investment, but he should continue to be an astute businessman throughout the life of the commitment, and not just at the first negotiating session.

I have presented the discussion of private investment in a separate chapter, but I do not mean to imply that it is a truly separate discussion. The several factors discussed in Chapters II and III each bear upon the willingness of private investors to commit their capital overseas. Certainly economic stability, control of inflation, availability of "economic-minded" laborers, and adequate social overhead and public health are of great significance to the prospective investor. And equally certain is that the decision of the private investor will have a bearing upon the ability of the under-developed nation to get along on its way to economic maturity.

The success of the overseas venture is largely dependent upon a mutuality of interest between the host government and the private concern. In many respects, the desires and goals of the parties are common: greater productivity, economical utilization of production factors, adoption of a wage basis
of employment, sharing of business revenues....But in several respects the aims of the parties are not in congruence. Because the host country is so lacking in many of the facilities and institutions of a more advanced nation, it takes a longer view of the economic returns of the enterprise. It is concerned more with the external economies of the venture, and may resist the company's policies designed for quick profits. And yet, if the company attempts to establish its own facilities for "social overhead," it becomes a political rival of the local government. A case in point is the experience of FIRESTONE in Liberia. The company established banks, schools, towns, transportation facilities, etc., and then found itself feared, or at least resented, by the local government as an alienator of affections and dependence. I can offer no formula in resolution of these quandaries; rather the investor must be ever perceptive to the political forces at work within the country, and must remain alert and vital to the economic and social role it plays in the community.

A general conclusion growing out of my examination of "economic development" is that the phrase does not do justice to the magnitude of the problem. Throughout the paper is the recurrent theme that eco-
nomic growth is first dependent upon social and political development. But it seems to me that the full concern of the political and social sciences has not been brought to bear upon the under-developed nations. Furthermore, the extent of the required sociological transformation is such as to be unique in relation to earlier examples of economic growth. Thus, a new and dynamic approach to these aspects of development is required.

Here again is a situation of positive feedback -- success begets success -- much like the previous consideration of development and private investment. The maturity of political and social institutions is greatly dependent upon economic satisfaction, which in turn is dependent upon social and political institutions. Hence my plea is not so much for a greater application of one or two of the social sciences, but for a total interdisciplinary approach by all these fields.

2. There is one new book which, according to one reviewer, promises much in way of an examination of the political phenomena in the developing nations of Asia, Africa, and South America. The book (THE POLITICS OF THE DEVELOPING AREAS, edited by Almond & Coleman, Princeton U. Press) is applauded as being notable and unique in making use of an interdisciplinary approach to the analysis and prognosis of current political institutions. (See THE ASIAN STUDENT, March 26, 1961).
AREAS FOR FUTURE EFFORT

In my opinion, the most appealing areas for future study fall within the realm of political science. My contention has been that the role of the state in economic development today is justifiably greater than:

1. that of the state in the more advanced economies today,

2. that of the state in the developing economies at a similar stage years ago,

3. that of the same economy in a more advanced stage years from now.

But, of this last point it might be asked, is there something inherent in the political process which will not permit a withdrawal of the state from the nation's economic affairs? Numerous examples are to be found in which state development institutions have expressed their intent to withdraw from certain enterprises as the private sector is developed, but indeed the ultimate pressures upon the government have been for continued and greater commitment.

Further, is there something inherent in the political process which inexorably erodes the ability of the state to lead the process of economic development? Is Albert J. Nock right when in 1935 he asserted that "state power has an unbroken record of
inability to do anything efficiently, economically, disinterestedly, or honestly?"3 Jan Tinbergen says not, citing the state owned coal mines and steel industry in The Netherlands. Steel "has not the slightest difficulty in competing in the European Coal and Steel Community with private steel manufacturers of Germany, Belgium, and France,"4 while of coal: "whatever may be said of the efficiency of the two types, the state mines are not less efficient than the private ones."5 However the issue is not resolved, and there is a considerable body of opinion that state direction of economic development is self-defeating.

A third consideration grows out of the commitment of political concerns of the nation to economic development. Many writers have described the natural protest of workers to industrialization, e.g. Veblen, Perlman, Ricardo.... But work stoppages, walkouts, slowdown, etc. are inimical to a faster pace of development; consequently, many countries have found it necessary to ban strikes and emasculate labor organizations. To keep the work force committed

5. Ibid., p. 66.
to industrialization -- to focus their protest elsewhere -- some states have resorted to "crisis tactics" involving expressions of great danger to national interests. Kerr, Dunlop et al. observe that conventional worker protest is declining throughout the world, but in another written effort I have asserted that this protest now finds its outlet in international crises (and offered as examples, Japan in the 1930's and Russia now.) I might phrase this third consideration thusly: is there something inherent in the contemporary political commitment to economic development which promotes international political instability?

By dwelling upon these political considerations I do not mean to imply that there are no areas for additional economic study. In fact, whole books have been given to just such a topic -- THE COMPARATIVE STUDY OF ECONOMIC GROWTH & STRUCTURE, SUGGESTIONS ON RESEARCH OBJECTIVES AND ORGANIZATION by the National Bureau of Economic Research (1959). In an earlier footnote I have already mentioned another source of

research needs, viz., Douglas Faruq's article, "Some Frontiers of Empirical Research in Economic Development." Both these sources ably illuminate the need for greater research, study, and understanding of what I consider to be the most vexing and momentous problems of our time.
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