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## Development Assistance

# Social Structures in Economic Development

by Professor Mark Z. Fabrycy, New York

**T**he purpose of this paper is to discuss the basic aspects of the development process and their relationship with the foreign policies of the industrialized countries. It will be shown that there are constraints in the development process which impose limitations on the choice and effectiveness of foreign policies adopted by the industrialized nations.

### **Prerequisites to Development**

Before development can be initiated certain basic requirements must be fulfilled. The first prerequisite is the existence of a secure and stable nation. External and internal security, equitable laws fairly administered, and unifying links of common cultural, political and economic interests, are all important. If disruptive forces endanger the unity of a nation and threaten war and destruction, one must expect that the propensity of the public to save and invest in productive capacity will be drastically reduced. Thus the use of foreign aid for construction of national "sport palaces" or for luxury cars for national administrators may be sometimes justifiable as, for example, when the prestige of the national government has to be increased in relation to the prestige of tribal or regional chiefs. Similarly, aid may have to be used sometimes to pacify dissident social groups threatening revolution if this will provide sufficient time to initiate development and diminish the gap between expectations and income. Assuming, of course, that the main cause of friction is an economic one and not religious, cultural, or racial.

Secondly, sufficient public investment must be made to create the necessary social overhead capital: public buildings and services, education, transportation and communications network, and power. In addition, some experimental and extension services as well as help in local financing are required.

Thirdly, institutions, social and political attitudes, and economic propensities must be such that the relatively large amounts of saving and investment

necessary for economic development will be provided. In general, the people's attitudes must be favourable towards work as against leisure, for saving as against consumption, for technological improvements as against traditional methods, and for expansion of productive capacity as against accumulation of conspicuous wealth such as gold, land, etc. Similarly, sufficient geographic, as well as economic and social mobility must exist to allow the necessary changes to take place.

And finally, there must be preference for work in industrially productive fields as against work in administrative or cultural areas.

It would seem that the attitudes and propensities described in the last two of the above points are the main factors determining whether sufficiently rapid development can take place under a system of private enterprise. At the very least this system requires that the propertied and managerial groups have adequate preference for investment as against consumption, for innovation as against tradition, and for industrial and commercial endeavour as against cultural, political, military, or governmental work.

### **Current Obstacles to Development**

These can be outlined briefly. Firstly, where national ties are very weak, tribal or regional unrest may bring about instability and a lack of internal security which may make investment and growth impossible. Alternatively, civil unrest may be caused by a dissatisfaction with the existing system or the ruling elite. This would also usually lead to a decline in capital formation and a further deterioration of the existing conditions.

Secondly, a very high rate of population growth may easily dissipate even a very large investment effort.

Thirdly, the existing institutional structure may provide insufficient incentives for saving, investment, and innovation. The system of land tenure provides

little incentive to the tenant farmer to make improvements to the farm as usually this will only result in an increase in the rent he has to pay. Similarly, large patriarchal families may make it unprofitable for their energetic members to work harder and to innovate since the fruits of their labour will be distributed among their large families with little gain accruing to themselves. As to innovation, it will often be angrily rejected by the heads of the families as nothing but a threat to their authority as planners and organizers of all work<sup>1</sup>.

Fourthly, the values of the propertied and managerial groups may be oriented to consumption rather than production. The social status of a man may depend on how large is his estate and not on how much it produces. Or the attitudes of this group may be such that the institution of inheritance will not act as a powerful incentive to work, save, and invest as it has done in such countries as, for instance, the United States. Instead, the possibility of leaving one's estate to one's children may not stimulate harder work and saving on the part of the parents and may eliminate all incentive to work on the part of the children. In fact, the pseudo-aristocratic attitudes of the elite may attach the highest status to not working at all, the second highest to cultural, administrative, or military work, and relegate manufacturing and commerce to work suitable only for the "lower classes". This set of values is likely to result in virtually all savings of the productive sector of the economy being wasted in conspicuous consumption, military service in unnecessarily large armies, and cultural activities which, however valuable to those few who can afford them, will not promote economic development of a poor country<sup>2</sup>.

#### **Policies of Industrial Countries**

Undoubtedly humane considerations play some role in relations between industrialized, high income nations and primary producing, relatively poorer countries. But the extent of such considerations is very limited: outright gifts are usually small and granted on an emergency basis; and, following a catastrophic drought, the United States did help India but was not prepared to help China. Hence humane considerations seem to play only a very small role. Main goals of the industrialized nations appear to be based on their own long-run interests: to help in creating or accelerating economic development of primary producers within an economic and political framework similar to that of the donor country in order to increase the external and internal security of the donor's system and to increase future trading opportunities.

We could say that development could occur along three routes: private enterprise, central planning, or some combination of the two methods. In those

countries, however, where development did not occur we could assume that the existing institutions, propensities, and attitudes were such that development under any system could not have occurred or that the existing system stood in such a contradiction to the prevailing attitudes that development was impossible.

Secondly, we could also, it seems, safely assume that development is desired by the poor majority more than the preservation of their present values since no country actually wishes to stay undeveloped and no developed country seems to desire to go back.

Lastly, development itself, where not spontaneous, must involve great changes in attitudes and further changes have to take place as development proceeds. Peaceful, rural communities with their secure, well-established ways are replaced by a continually changing, restless and rootless society where a search for new and better ways and a geographic, economic and social mobility are all valued characteristics of the new world. Thus where development is not spontaneous, few of the old values are likely to survive. We can say that development does not occur where short-run preferences of the society are in conflict with their long-run development interests. While the majority may well realize what their long-run interests are, they may be unable to break away, on their own, from the present system of institutions, attitudes, and propensities. Partly this may be because they cannot or do not know how to change this system, partly through inertia, and partly because their present energies may be dissipated in dealing with the immediate problems. Thus where the short-run preferences and existing institutions cannot produce development, and this occurs not because the preferences are in conflict with the institutions but mainly because both are not suited to development, the impetus must be provided from abroad.

#### **Effects of Present Policies**

These appear to be rather uneven and, on balance, not very encouraging. Clearly, in a number of cases foreign assistance has successfully initiated or accelerated development in private enterprise as well as in centrally planned economies. Few would argue, however, that the success in those cases was not mainly due to the fact that suitable institutions, attitudes, and propensities already existed in the recipient countries and thus the inflow of foreign aid was only a secondary factor. Regrettably, in many other cases where these attitudes and propensities did not exist, providing foreign assistance failed to initiate development. Foreign aid can compensate for inadequate propensity to save. But in the face of low propensity to invest foreign funds will either be used for consumption or, where foreign aid is in the form of capital goods, may simply be offset by reducing domestic saving and investment. Providing funds does not automatically produce investment.

<sup>1</sup> C. Wolf, Jr., *Institutions and Economic Development*, American Economic Review, May 1955.

<sup>2</sup> B. F. Hoselitz, *Noneconomic Factors in Economic Development*, American Economic Review, May 1957.

On the other hand, both in private enterprise and in centrally planned economies available funds, whether provided by voluntary or forced saving, from domestic or from foreign sources, have often been dissipated in the course of internal or external conflicts. Very large funds, undoubtedly saved at a great sacrifice, have been used up in the present ideological conflict in China thus reducing very considerably their rate of capital accumulation and economic growth. The same is true of external tensions and conflicts which obviously can absorb very large resources.

### **A Vicious Circle**

In a number of private enterprise economies unproductive economic propensities coupled with antiquated attitudes and institutional structures not only can frustrate development even in the presence of large foreign assistance, but can actually cause substantial losses both to themselves and to the donor countries. In those unfortunate cases the propertied and managerial groups, in sharp contrast to businessmen and farmers in developed countries, are more interested in conspicuous consumption than in expanding and improving their productive facilities. Under these conditions all increases in funds available for investment are likely to be dissipated in consumption. Since the output of the economy will probably increase here more slowly than the population, the per capita income of a very large majority of the population will slowly decline despite the assistance received from abroad.

Due to the revolution of expectations, however, the dissatisfaction of large sectors of the population is very likely to lead to widespread unrest. The established propertied and managerial groups may try to respond by building up the police and armed forces thus redirecting more resources away from capital formation and into economically unproductive channels. In addition, the existing tension will reduce the propensity to invest and will result in a flight of domestic capital abroad. This will reduce the rate of growth further while the local government will probably begin clamouring for greater foreign aid to support its expanded military establishment. A vicious circle can easily establish itself with mounted pressure being offset by stronger and stronger military constraint. The increasing strength of the military created by this pressure may eventually result in a military coup and new "firm" controls. These may often only serve to sharpen the conflict and ultimately bring about a violent revolt and a rejection of the existing system together with its foreign supporters.

The role assigned the military in the above example is not, of course, inevitable. A coup d'état by the military may serve as a vehicle of development when it replaces a corrupt and inept regime with a more efficient hierarchy which is genuinely interested in removing the obstacles, creating the necessary attitudes, and promoting development in general. The

crucial point here is the intention of the military take-over: is it to suppress dissatisfaction for the benefit of the privileged but inept few, or to remove its causes for the benefit of the entire nation? And, secondly, can the new regime release or create the attitudes necessary for economic development?

A very important part of this process is related to the fact that in these conflicts both sides may honestly act with the best of intentions—but, once their attitudes are given, it is very likely that the final result concerning development is fully determined. Thus the problem seems to lie essentially in people's attitudes and not in the large number of other factors usually put forward.

### **Assistance through Private Investment**

The form of foreign assistance which is most advantageous to the recipient countries is free gifts. It is not easy, however, to obtain public approval for them in the donor countries and, from a purely selfish point of view, donor countries may wonder how long their generosity will be remembered. In general, it would appear that unconditional gifts are granted mainly in case of emergency.

At the other end of the range is private investment. This is more expensive to the recipient country than government loans or gifts but has an important ad-

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vantage in that it brings with it advanced technology. How important this last factor is depends mainly on whether foreign investment will form an „enclave“ largely isolated from the local economy, or will interact closely with it. And, secondly, whether it will help in the industrialization (or steps leading to it) of the developing country sufficiently to make the venture profitable to that country in the long-run. If the above two factors are favourable, then private investment seems to be advantageous both to the developing and to the industrial countries. It would be useful, however, to note here that some attempt by the governments of both sides should be made to make it more profitable for foreign investment to flow into projects which would tend to pass advanced technology and training to local labour and which would assist in the industrialization of the host country.

On the other hand, we cannot overlook the fact that foreign investment tends to create powerful vested interests. In the smaller developing nations large foreign investors will naturally seek to create political climate favourable to their long-run objectives and are likely to exert considerable influence. Where suitable attitudes exist for development along private enterprise lines, this influence may undoubtedly become an important factor in promoting growth. It is not likely, however, that, in those countries where popular attitudes favour central planning, foreign investors would refrain from trying to counter such tendencies. Strong conflicts may easily arise here to the detriment of both parties. What is more important, foreign investors, when threatened, may find it worthwhile to seek support from their own governments. Consider a case of an investor who decides to finance a foreign project where he must expect a full expropriation in 10 years. Naturally the rate of profit in the intervening years would have to be adjusted to compensate fully for the final loss of all invested capital. It is unlikely, however, that after 10 years, even if the expected rate of profit had been realized, the investor will quietly accept expropriation. In all probability he will strongly urge his own government to intervene and himself take any steps open to him to prevent expropriation.

#### **Long-run Loans**

The third method involves long-run loans granted by governments of industrial nations. These are usually cheaper to the developing country than private investment and can carry with them considerable technological assistance especially in the public sector. In the private sector, however, it would seem to be more difficult to transfer as large amounts of technical information as those carried by private investments. This could be probably overcome by close cooperation between private corporations, loan granting agencies, and the recipient countries. More recent experience led to suggestions that development loans should be granted by international agencies rather than directly by the individual donors. This

arrangement has the advantage that it is cheaper to the donor country mainly because the recipient nation will usually be unwilling to default and thus antagonize an agency which is likely to be one of the very few sources of large future loans. It is not at all clear, however, that the donor nations would be willing to use such an international agency to channel most of their development loans since this policy, however valuable on other grounds, would deprive the donors of much of their influence on the developing countries.

Lastly, capital exports probably reduce the rate of technological advance in the domestic economy. Thus the usefulness of foreign private or public investment, from a national point of view, should be considered only after the probable reduction in the rate of technological advance has been taken into account. Without suggesting that there is a clear and definite causality, historical evidence shows that, in the past, continued large foreign investments of Great Britain and France may have been associated with some slowing-down of technological advance in those countries, with growing rigidity of the economy and protectionism, and finally with substantial losses of foreign investments through partial or total expropriation. While the evidence is far from conclusive, the possibility that it may be relevant must not be overlooked.

#### **Stress on Social Structures and Attitudes**

The above discussion supports several conclusions. Firstly, channelling of foreign assistance through international lending agencies should be safer to the lenders and thus cheaper to the developing countries. It would seem, however, that, given the existing attitudes of the public, the lending countries would desire to retain control over the general political orientation and to maintain some presence in the borrowing countries. Secondly, it does not seem likely that outright gifts will acquire any greater importance than they have now, i.e., mainly as emergency measures. Thirdly, the role of private investment within general, publicly sponsored development plans should be emphasized due to its ability to carry very valuable technical and entrepreneurial knowledge. On the other hand, the value of entirely uncoordinated private investment is much less certain owing to the possibility of its forming isolated enclaves without promoting growth and owing to the danger of interventions. It would seem that much closer cooperation between private investors and public (including international) lending agencies would be of great value to all involved.

The main thesis of this paper, however, is that the entire stress of development assistance has been often misdirected. As shown earlier, it is the attitudes and institutions that are the essential factors of economic development. Thus the stress should be put on a suitable background of social structures and attitudes rather than on the industrial application of capital

inflows. If suitable attitudes and institutions do not exist, pumping capital into an underdeveloped country is not likely to benefit either the donor or the majority of the population in the developing country. Under very unfavourable conditions, it may, in fact, lead to an aggravation of tensions not only within the developing country, but also between the great powers.

### Changes in Social Structures

There is no doubt that foreign assistance will bring greatest returns in those cases where suitable institutions and attitudes already exist. In addition to attitudes which are "basic" to all development, such as, e.g., high propensity to save and invest for the nation as a whole, it is useful to discern "specific" attitudes which would support development either along private enterprise or along centrally planned lines (such as high private but low public propensity to invest, or vice versa). Along much of the range between the two extremes a given mix of specific attitudes would probably leave considerable leeway for adjustments between a capitalistic and a centrally planned economy. But it is doubtful if a given system could be imposed and maintained in the long-run in the face of antagonistic specific attitudes. Thus it would seem that, for instance, an industrialized, private enterprise nation should give first preference in its foreign assistance to those developing countries which already have basic attitudes and institutions favourable to growth and, in addition, have specific attitudes which, at least in the main, favour development along the private enterprise lines. In these cases it would be reasonable to concentrate most attention on industrial application of capital imports and technical assistance rather than on attempts to change attitudes.

Next, attention would be turned to countries where neither the basic nor specific attitudes clearly favour development in general or along any particular path of development. It is in these cases that most difficulties were encountered in the past and it is here that our thesis would lead to a considerable reorientation of effort away from industrial projects and into activities which would create the requisite attitudes and institutions. The following methods could be used for that purpose:

- ☐ A sustained campaign in support of the desired institutions and attitudes carried out by the mass communication media.
- ☐ Official support of the new attitudes by the government and the main political parties.
- ☐ Support of the churches.
- ☐ Support of local organizations such as chambers of commerce, cooperatives, farmers associations, etc.
- ☐ Fiscal changes favouring investment as against consumption, mobility and adaptability as against rigidity, etc.
- ☐ Redesign of educational curricula to eliminate undesirable attitudes and substitute the new ones.

Education was left for the last point not because it is less important than the others. On the contrary, eventually it will probably have a stronger effect than the other factors even though this effect must be delayed until the new generation is educated and acquires sufficient influence in the society. But what is important here is to realize that simply expanding the existing educational system may not only fail to improve conditions but may actually be harmful. If the present educational system simply serves to perpetuate the existing values, then expanding such a system will spread even more widely undesirable, pseudo-aristocratic attitudes.

### Need for Foreign Assistance

Now it could be suggested that if the measures listed were, in fact, practicable, there would be no need for foreign assistance—the country would be perfectly capable of developing on its own. This, however, does not necessarily follow. Firstly, though quite willing to take the necessary steps, the authorities in the underdeveloped country may not have the knowledge and skill required for a development program. Secondly, some tension may already exist between the ruling elite and the majority of the people. It may then be impossible to create internally funds needed for development since any attempts to force a higher saving rate could result in a revolt and throw the nation into deeper poverty and unrest. Funds from abroad would have to be obtained but a sufficient proportion of these funds should be immediately directed towards creating attitudes which support development. Thirdly, the ruling groups may be unwilling to give up their privileges and their power but may be sufficiently enlightened to realize that they must either give up some of them and initiate development or lose them all in a violent conflict. The changes the ruling elite may be willing to make may be quite inadequate but the prestige of the industrialized power and the leverage of the aid offered may be sufficient to persuade the governing groups to accept the necessary changes. This should not be attempted, however, if conditions have been allowed to deteriorate too much. If the pressures within the developing country are close to the point of violent eruption, it is probably far better for the industrialized nation not to get associated in the eyes of the people with a failing regime whatever its political persuasion.

The methods suggested above constitute an exercise in what could be called power economics in the sense that actions by one country will force through changes in another for the sake of an economic goal. As mentioned before, the problem can be viewed as a conflict between short-run preferences which are blocking a nation's development and its long-run interests which strongly favour economic development and industrialization. It is the assistance of the industrial nations that should be designed to break the deadlock and launch the country on a successful path to development.