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SOME CONCEPTUAL ASPECTS OF INTERNATIONAL ECONOMIC DEVELOPMENT OF UNDERDEVELOPED TERRITORIES

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I. INTRODUCTION

MANY attempts have been made to define an "underdeveloped" country, region or community. All the definitions known to me leave much to be desired. The difficulty consists in the fact that while development is not necessarily a measurable it is always an evolutionary process; while the forms or symbols under which it is subsumed frequently remain, or appear to remain, the same, the "realities" to which they correspond are altered.

Indeed, to speak of development, or lack of it, at all, is to assume that the society to which the term is applied is proceeding, or is failing to proceed, in a certain direction—towards a preconceived foreseeable goal or end, the attainment, or partial attainment, of which will indicate a more desirable state of affairs than that now being experienced, or than that which the society experienced in the past. In other words, to speak of the process of development is to assume, or imply, consciously or unconsciously, certain standards or criteria of such development.

Whether a society is regarded as economically developed or underdeveloped will depend, therefore, on the specific criteria of development applied by the observer, and the position occupied by him. They will vary according to whether the observers are within or outside the society; whether they are or are not also actors in it; whether they comprise the whole, a large, or a small part of it; whether they apply criteria based on their own experience, or criteria borrowed from others; whether such criteria are based on the past, or rest on utopian conceptions of the unrevealed future; whether they appeal to the reason or judgment, or the whims or appetites of their fellow men; whether to the "lessons of history" or, like the prophets of old, to transcendental values and the word of God.

As Schumpeter wrote about capitalism, it is well to remember that the fate of a particular society "is not a question of the merits or demerits

we may individually see in it. Our judgment about these is a matter of personal or groupwise preference that depends on interests and ideals largely determined by our personal or groupwise location in the social organism. What we mean when we say that we are for or against capitalism" [or as I here suggest "for or against" a particular stage of economic development] "is that we like or dislike a certain civilization or scheme of life. . . . But civilizations are incommensurable. Even if we agreed to neglect those cultural aspects, which are what really matters to us, and to make the 'desirability' of retaining or eliminating capitalism turn on some purely economic criterion—such as comparative productive efficiency—we should never agree about the result. For even if those extra-economic and largely extra-rational preferences did not prevent us from admitting that any criterion could ever tell against the alternative we have chosen to espouse—which they no doubt would in most cases—we should immediately challenge a criterion that did. No amount of honest intention to place oneself on the standpoint of the public welfare or of the nation's interest avails against that. For the point is precisely that these words carry different meanings for different minds. The only thing we can do in something like a scientific frame of mind is therefore to try to visualize, irrespective of our wishes, the actual situations which may be expected to emerge and the relative power of the groups which will be in a position to assert their interests and ideals in handling those situations."*

But let us not forget that history is the record of social action not of passive observation. Indeed, the belief (which I do not share)** that development is merely a "rational" process of social choice and hence that it is above all a question of social *will*, and determinate action based thereon, lies at the root of the outlook of the modern Western World. The history of social development—development as social history—is the story of the ambivalent role of man in search of freedom to choose the ends of action and of conscious or unconscious desires to impose those ends on others, or have them imposed upon himself—either for what he believes consciously or unconsciously to be for his sake or for theirs; either out of conviction that he *knows* or has had revealed to him what is good for them, or as a rationalisation for what he rightly or wrongly conceives to be good for himself.

* Joseph A. Schumpeter, "Capitalism in the Post War World" in *Postwar Economic Problems*, edited by Seymour E. Harris, McGraw-Hill Book Company, Inc., 1943, p. 113. Quoted with permission of the publisher.

** I am not here concerned with either the validity or the philosophical implications of that belief.

II. "INCOME AGGREGATES" AS CRITERIA OF INVESTMENT AND DEVELOPMENT

It is of importance to probe behind the symbolisms in which the criteria of development we consciously, or unconsciously, apply are clothed.

It is clearly not possible within the compass of this essay to examine the many different criteria of development which have been suggested, or of the large number (many of them contradictory in themselves),* that have been made use of by national and international agencies. What I shall attempt here has a more modest aim. It is to examine some conceptual and praxiological aspects of *investment*, and particularly foreign investment, as a means of furthering the development of "underdeveloped societies." Underlying nearly all current discussions of this problem are two assumptions: (a) that international policy should be directed to raising the income per capita of the inhabitants of underdeveloped societies, and (b) that one of the main pre-requisites for doing this is to stimulate investment from abroad in them.

* For a critical analysis of current criteria of development I would refer the reader to Professor Jacob Viner's "Lectures on the Theory of International Trade," given at the Fundaçâo Getúlio Vargas, National University of Brazil, Rio de Janeiro, July-August, 1950 and Published in Portuguese Translation in *Revista Brasileira De Economia*, Ano 5, Número 2, June 1951. I would draw particular attention to the following challenging statement in Lecture VI. "Let us suppose, for instance," writes Professor Viner, "that a country which has embarked on a program of economic development engages in periodic stock-taking of its progress, and finds not only that aggregate wealth, aggregate income, total population, total production, are all increasing, but that per capita wealth, income, production, are also all increasing. All of these are favorable indices, but even in combination do they suffice to show that there has been 'economic progress,' an increase in economic 'welfare,' rather than retrogression?

"Suppose that someone should argue that the one great economic evil is the prevalence of a great mass of crushing poverty and that it is a paradox to claim that a country is achieving economic progress as long as the absolute extent of such poverty prevailing in that country has not lessened or has even increased? Such a country, nevertheless, might be able to meet all the tests of economic development which I have just enumerated. If population has undergone substantial increase, the numbers of those living at the margin of subsistence or below, illiterate, diseased, undernourished, may have grown steadily consistently with a rise in the average income of the population as a whole. . . .

" . . . Were I to insist, however, that the reduction of mass poverty be made a crucial test of the realization of economic development, I would be separating myself from the whole body of literature in this field. In all the literature on economic development I have seen, I have not found a single instance where statistical data in terms of aggregates and of averages have not been treated as providing adequate tests of the degree of achievement of economic development. I know, moreover, of no country which regards itself as underdeveloped which provides itself with the statistical data necessary for the discovery of whether or not growth in aggregate national wealth and in per capita income are associated with decrease in the absolute or even relative extent to which crushing poverty prevails."

These assumptions may or may not be correct. But this is not a matter with which I am immediately concerned. What I am concerned with is the basic implication that low or high "incomes" per capita or low or high aggregate "incomes" do in fact provide *criteria* for investment policy in relation to "underdeveloped territories" at all. I believe it is significant that the current literature on the relation between aggregate "income" and investment makes use of terms like gross or net national "income" per head *as if* the word "income" in such expressions has a similar connotation as a guide for investment decisions as it has, or had, in a money-exchange economy for a private entrepreneur or promoter. In other words, it uses aggregate "income" as an accounting symbol and as a rationale for economic policy. There is yet another use of the word "income" in this context which implies that changes in aggregate "income" can be regarded as indicating, and indeed as "causing," changes in "welfare" in the same direction. This, as I hope to show, is not only logically fallacious but further undermines the usefulness of such concepts as aggregate "income" as criteria of investment policy.

It is I believe basic to the problems considered in this essay to realise that the "income" criterion of investment applied by a private entrepreneur has little in common with the use of national, regional, or other collective income aggregates as criteria of investment and social action. In using the term entrepreneurial investment I mean the placing of capital at risk in order to obtain a net monetary return or, more exactly, a net increase in the value of the capital which increase can be converted into money. The rationale of private or "business" investment, i.e. the investment of money made by the entrepreneur or a "legal" entity acting as such (and independent within the field of action for which it has been set up), is made with the sole object of deriving an income or profit from that investment in an accounting sense. Such income, or profit, or monetary return, consists in the net *increase* in the value of the capital and is nothing other than this in so far as the entrepreneur is concerned. In fact strictly speaking there is no such thing as a *flow* of income from an investment of capital. The income arises from the increase in the *value* of the assets and their disposal (in whole or part) from time to time. A profit and loss account covers a period between the dates of two Balance Sheets and is only a detailed reconstruction of how the capital accounts changed within the period of time so chosen.

Capital and Income are—as Irving Fisher stressed long ago—logically exclusive terms; when income is received by the investor he must decrease his capital to an equal extent. Income thus represents a "decrease" of the capital value attained at that time—an exchange

of that portion of the capital, which is "detached" from it, for money or for a money equivalent.

All this is of course well-known. Yet the fallacy persists* that the word "income" can be used to express something other than a "return" to capital, i.e. something other than an accounting relation, and can "measure" the services, satisfactions, or pleasures yielded by a good (e.g. a piano, or a piece of bread). This is what Irving Fisher tried, I believe fallaciously, to "account" for as "psychic income"; which I have argued cannot be so recorded in accounting terms at all.**

Similarly the concept of an "increase" in "income" as yielding, and as "causing" an increase in "welfare" (in the sense of a subjective counterpart to the "recorded" income), is also logically untenable. To identify, or seek for, a functional relationship between "income" and total welfare is as logically fallacious as to identify the points scored in playing a game with the "value" of the game to the player. It is not a change in the National Dividend, or measurable net money income, which causes a change in "welfare." It is a change in what is by habit, custom or belief, regarded by the society as constituting welfare, which determines the nature, and frequently the amount, of the national dividend itself. It is the ultimate (conscious or unconscious) purposes for which the "events" we call "income" are desired that determine the nature and extent of the forms in which "income" will be incorporated. We cannot therefore compare "income" aggregates for different societies, or even "evaluate" income in them, without taking into account the social purposes and "value" system which govern the production of income. A society which glorifies war will have a different "system or concept of welfare"—a different "scale of values" and hence different concepts of what is "income"—from one which desires peace.

The belief that income aggregates, for societies greatly differing in their structure and ideologies, can be compared, and that breakdowns of these statistical abstractions, such as, for example, net "income," "con-

* See my "Psychic and Accounting Concepts of Income and Welfare." *Oxford Economic Papers*. February 1952. See also my "Concepts of Income and Welfare in Advanced and Underdeveloped Societies—With Special Reference to Intercomparability of National Income Aggregates" which was submitted to the 1951 meeting of the International Association for Research in Income and Wealth and is to be published in its proceedings.

** Thus to say that an investor who invests capital in buying house "A" rather than house "B" although both houses cost the same, have the same market value, and yield the same net money income, is obtaining an additional "income" because he has what he thinks is a better view from "A" than from "B" is not a correct use of the word "income." Such "subjective" income is not "income" in an accounting sense. Whatever its importance it has no relevance to the pure act of private investment for which the basic criterion is the achievement of a net increase in the value of the capital which increase can if desired be "detached," i.e. exchanged for money.

sumption," "saving" and "investment" per head are useful for comparative purposes rests on a peculiar assumption. It is assumed that if we can "measure," in money terms, the goods and services which make up the "income" of these collectivities or individuals, we can infer also the private values or criteria, the inner stream of consciousness, the satisfaction or "utility"—in short, what Irving Fisher called the psychic income—which these individuals, *irrespective of the society to which they belong*, enjoy. It is implied therefore that international comparisons of income are meaningful precisely because such comparisons refer to an abstract entity—to "income" dissociated from the specific social context in which it is embedded. It is therefore further implied that the basic criterion and objective of development is the increase in, and, indeed, the maximisation of, "aggregate" national or "collective" net money "income"; it being assumed, *ex hypothesi*, that this statistical abstraction will indicate a "real" increase in welfare, and provide both a measure of, and the target for "progress." Indeed, the uncritical use of such statistical aggregates has gone so far that it is frequently even implied that a country, a society or even a continent with a "high" net money income per head can "afford" to "give" some of this "income" to a society with a "low" per capita income in order to redress the balance; as if all that this would imply would be the mere transfer of such "income"—much as a person transfers "income" from one bank account to another.

But the use of the word "income" in this abstract sense either as a collective aggregate, or as an individual entity, is unwarranted. The term "income" is a purely accounting term, and can only express an accounting relation. We cannot compare the accounting relations or ratios recorded in one society with those relating to accounting symbols in another, with a different social and economic framework, and a different system of economic and social values. We cannot, therefore, assume that what appears to be "income" in one society can be compared with "income" recorded in another. The "income" which we can "grasp" (because it is publicly recorded in exchange transactions on the market) is an accounting relation and not an abstract psychic entity. It follows that what will be so recorded in the two different societies will (assuming that both do indeed have an overall system of market valuation, which, of course, is by no means necessarily the case) differ in its significance according to the nature and ideals of the society itself.

The purpose of the foregoing necessarily condensed argument has been to expose the fallacy that an increase (or decrease) in "national" or "collective" measures, such as aggregates of "money income," implies an increase (or decrease) in some counterpart entity—e.g. in "wel-

fare" etc. Such aggregates cannot be a "correct" criteria of investment decisions. For what is involved in a change in income *is* (by definition) a change in the "welfare" pattern itself. It is what societies regard or desire "income" to be, and the forms in which they produce or receive it (whether in guns or butter, temples or trinkets, work, leisure or indolence) that *ipso facto* constitutes the "welfare" or "ill-fare" they have chosen. The argument that "income" is one thing, but that "welfare" is another (a counterpart to it), rests on a common category mistake based on fallacious reasoning. From the point of view of the development of underdeveloped societies it is a particularly serious fallacy. It leads to the dangerous belief that the purpose of investment is to increase "aggregate income"; whereas the real problem is to discover *what "income" is to consist in*: what changes in social demand, in social institutions, habits and beliefs should, and can be, induced to make the investment effective for such new purposes; and which of them will be socially tolerable and economically perpetuating.

There is a further serious shortcoming in the use of these "income" aggregates *as if* they were automatic and trustworthy criteria of development and investment policy: These aggregates are only statistical estimates of events which lie wholly in the past; they are abstractions which cannot serve as a guide to future action. They are therefore not adequate criteria of *calculation*. To say for example that more investment is required to increase the "aggregate income" of a society is like saying that we must spend more money in order "to cure disease." "To cure disease" is a laudable slogan not a specific objective; it cannot fulfill the requirements of a criterion of action. It is not a possible criterion of action because it does not tell us what "disease" consists in. Moreover it does not tell us which of the many alleged or real diseases shall (or shall not) be cured, and at what cost, e.g. whether *at the expense* of better housing (which might prevent some "disease"); or at the expense of old-age pensions which might keep old people alive longer; or at the expense of food subsidies to reduce the infantile death rate; or at the expense of "defence" to safeguard the whole population against its neighbours; or at the expense of agricultural research to protect its food supply against the ravages of insect-born pests. To argue that capital investment is required in an underdeveloped country to increase the "aggregate incomes" of the population is to postulate a similarly impracticable criterion of action. To use the word "income" to describe abstract collective aggregates is to overlook the fact that in a society in which "income" is increasing the goods and services which compose that "income" must be changing. But how are we to "measure," and compare, the aggregate incomes in two societies when the pattern of

behaviour and wants *are* changing and are *made* to change? What are the changes we are to select and foster? How are we to "know" or "judge" whether individuals previously living as, let us say, subsistence "peasants" in a non-market economy have had an increase in "income" when they are transplanted into an urban or industrial environment, in which their recorded money "incomes" appear to be higher, but we know nothing of the extent of the other non-measurable types of "income" which they have lost in the society from which they have been removed or which the process of change has destroyed?

As Professor Mises has so well expressed the matter: "The impracticability of measurement is not due to the lack of technical methods for the establishment of measure. It is due to the absence of constant relations. If it were only caused by technical insufficiency, at least an approximate estimation would be possible in some cases. But the main fact is that there are no constant relations. Economics is not, as ignorant positivists repeat again and again, backward because it is not 'quantitative.' It is not quantitative and does not measure because there are no constants. Statistical figures referring to economic events are historical data. They tell us what happened in a nonrepeatable historical case. Physical events can be interpreted on the ground of our knowledge concerning constant relations established by experiments. Historical events are not open to such an interpretation."*

The point is that if we *assume* that there is *agreement* on what additional "incomes" are to be produced and in what form; if we assume further that the type, nature and extent of "investment" which will produce them is known in advance; if we assume there will be no changes of any kind in the future which can obviate this knowledge; if we assume that the future additional incomes (i.e. the future growth of capital) are an automatic consequence of the additional capital investment, and that it is known precisely how much of the additional income can be detached from capital so as not to impair the "original" value of the latter; if we assume, finally, that the idea of *aggregate national* capital and its increase in "value" is a meaningful concept at all, then indeed the use of increases or decreases in aggregate incomes as a criterion of development is justified—but then, I submit, our knowledge is so perfectly attuned to the infinite future that the problem has been assumed away.

To those who would care to make these assumptions somewhat haphazardly I would only suggest that a study of the range of possible conflicts as to the purpose of "investment," the direction that "in-

* Ludwig von Mises, *Human Action—A Treatise on Economics*, Yale University Press. 1949. p. 56. Quoted with permission of the publisher.

creases in aggregate incomes" should take, and of the "uncertainties" which in the real world encompass the growth of capital (and therefore of income) might prove salutary. They are illustrated currently by events in Iran, or historically by the attitude of President Kruger to the "uitlanders" who wanted to "develop" gold-mining in the Transvaal, or by the experience of the Overseas Food Corporation, set up by the British Government, in choosing to "develop" ground-nut [peanut] cultivation in an unsuitable area in Tanganyika chosen partly in order to obviate the need to move elsewhere Africans who were engaged in "subsistence" production on what would have been the better land for the project.

But I must return to the main point of this analysis. It is designed to show that where there are contradictory objectives of policy, where the ends of action or goals of endeavour are not, at least symbolically, assumed to be relatively clear cut—at any rate for the actor on the social scene—there can be no specific calculation at all. Vague and necessarily conflicting objectives such as are conveniently obscured by statistical aggregates of the type we have been discussing cannot be used as criteria of "calculation"—except by an authoritarian state which sets its own goals of action irrespective of the costs thereof to the human agents through which they are pursued.

III. THE CRITERION OF PRIVATE INVESTMENT

The criterion of private investment as an economic activity is, and continues to be (in so far as it is not affected by changes in legal and fiscal institutions and practices), the "marginal efficiency" of the capital in the basic sense, and in that sense only, that the "efficiency" is expressed as "income" which is recorded in accounting transactions. Such income accrues through changes expressed in the "market" valuation of the capital assets at risk. It is not "income" in any imaginary subjective or collective sense, which goes unrecorded and is alleged to "exist" only in the "minds" of the actors.

In the historic nineteenth century development of the "world-economy," in which Britain played the role of "The World's Banker," the basic characteristic of the domestic and foreign investment situation consisted in the fact *that as far as the investor was concerned he was, and in the exercise of his function was supposed to be,* concerned only with the problem of so choosing the direction of his investment, and so embarking his capital, as to obtain the relatively highest net income therefrom over comparable periods of time and in comparable circumstances. This objective was the fly-wheel of investment activity. That it was so