CHAPTER III

Capital Imports and National Development

Ever since the fourth lecture of Sir Roy Harrod's *Towards a Dynamic Economics* economists have been discussing the relationship of long-term capital movements and economic growth in terms of simplified mathematical models.¹ It is becoming increasingly apparent, however, that both the nature of growth envisaged in these models and the assumptions underlying these models are highly objectionable. Indeed, in Spanish America the use of such models can be very misleading. The problem of these countries is not so much 'growth', i.e. expansion of a given socio-economic system, as it is 'development', i.e. rapid and fundamental politico-socio-economic transformation. However interesting 'growth theory' may be as an abstract intellectual exercise, it is very doubtful that it can be applied in Spanish America without first introducing substantial amendments.

Moreover, when one is trying to apply theory in a specific context several further considerations arise. First, the economist working in the underdeveloped countries must distinguish between foreign capital and foreign capitalists. Next, he must distinguish between the effects of a general inflow of capital and the effects on the economy of capital embodied in specific sectors and industries. Finally, he must distinguish between the effects of capital imports on the level and rate of growth of income and the subsequent effects of profit and interest repatriation on the balance of payments. Thus it is quite possible that in some circumstances general capital imports may be desirable while direct private foreign investment may be undesirable. A country may be anxious to receive foreign capital; at the same time foreign entrepreneurs may be feared for the effects they might

have upon a country's capacity for change and transformation and upon the development of an indigenous entrepreneurial class.

In this chapter we propose to reconsider the role of foreign capitalists and foreign capital in the light both of theoretical reflection and the actual experience of some Spanish American countries. The traditional theory is first summarized and then modified by introducing a series of additional elements.

1 FOREIGN CAPITAL AND FOREIGN CAPITALISTS

It is usually argued that capital imports will accelerate a country's rate of growth. In the absence of foreign aid or private foreign investment a country's rate of growth \(q\) is determined by the proportion of its income that is saved (\(s\)) and the effectiveness of investment, or the incremental output-capital ratio (\(e\)): \(q = se\). Foreign capital is assumed to supplement domestic savings and leave unchanged the effectiveness of investment, so that the growth rate rises by the amount \('fe'\), where \('f'\) is net capital imports expressed as a proportion of national income. The rate of growth of national income then becomes \(q = se + fe\).²

Foreign capital is viewed as an addition to the physical resources of a developing economy and it is assumed that all of these additional resources are saved and invested. Thus, in the absence of capital imports the growth rate would equal only \('se'\), while foreign assistance permits the growth rate to rise to \((s+f)e\). Some authors go even further and argue that not only do capital imports raise the rate of investment by the full amount of the foreign assistance, they also lead to a higher rate of domestic savings \((s)\), since the marginal propensity to save is assumed to be higher than the average.³

In addition to raising the aggregate investment ratio, other economists have argued that foreign capital may also play an important role in transferring knowledge from the industrial to the primary producing countries. By serving as a transfer vehicle for technical knowledge and organizational ability, capital imports may help to raise the effectiveness of investment \((e)\). Just how strong may be the interdependence between \('f'\) and \('e'\) is open to considerable debate. First of all, the knowledge imported may not be appropriate for the

² A model of this type has been constructed by R. J. Ball. See 'Capital Imports and Economic Development: Paradoxy or Orthodoxy?', *Kyklos*, Vol. XV, Fasc. 3, 1962.
e a country's economic structure and by the process of investment. Foreign aid and the growth rate of national income are expressed as a percentage of national income.

Capital inputs are additional resources that can be put to capital formation. For technical assistance, the marginal productivity of capital is high, and foreign assistance is likely to alter the composition of investment in favor of large, lumpy, capital-intensive projects with long gestation periods, e.g., roads, dams, university buildings. This change in the composition of investment, far from raising the incremental output-capital expense, may be the crux of the debate.\(^3\)

ratio, is likely to lower it—and thereby reduce the rate of growth. The scatter diagram above of twelve Latin American countries (Argentina, Chile, Colombia, Ecuador, Paraguay, Peru, Venezuela, Mexico, El Salvador, Honduras, Guatemala and Nicaragua) indicates that the capital-output ratio varies positively with the amount of aid received (expressed as a proportion of GNP). The great exception is Argentina, which had a very high capital-output ratio and received little aid.

Precisely how foreign aid can lead to a rising capital-output ratio is well illustrated by Turkey’s experience. The United States began a large aid programme in Turkey shortly after the end of the Second World War. This programme concentrated initially on providing tractors so as to ‘modernize’ Turkish agriculture. Between 1948 and 1957 the number of tractors in the country rose from 1,756 to 44,144. About a third of these tractors were used in central Anatolia to clear and cultivate marginal land previously used for livestock and forestry. This mechanization programme had two major effects. First, overgrazing on the remaining pasture lands was accentuated, over-cultivation of the new lands was encouraged and erosion was accelerated. Second, ‘tractorization’ increased the number of unemployed. It has been estimated that each tractor created unemployment for eight people, and from 1950 to 1955 about 350,000 agricultural workers were forced to become migrants.

It was about this time that the second phase of the US aid programme—a massive road construction project—began to yield results: between 1950 and 1960 investment in highways rose by about 1,350 per cent. Having created technological unemployment and having done almost nothing to raise agricultural yields, the peasants simply used the new roads to leave the rural areas. The major effect of investing in tractors and roads was to increase the number of unemployed and expand the urban slums. Very little additional output was generated; the value of the aggregate capital-output ratio, of course, increased considerably.  

It is quite possible that foreign aid may have had similar consequences in Spanish America although the research necessary to test this hypothesis has not yet been completed.

Thus ‘f’ and ‘e’ may be associated—negatively. Similarly, ‘f’ and ‘s’ may be inversely associated. If this is so, the conclusions of the standard theory may be incorrect because the assumptions of that theory are wrong. That is, capital imports and domestic savings

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may not be independent of one another as the neo-Keynesian approach implies. Policies designed to increase the domestic savings ratio may be incompatible, especially in the short-run, with the continued flow of foreign capital. The interdependence may also run the other way: the continued flow of foreign capital may reduce the domestic savings ratio. Let us begin by considering this second alternative.

**Capital Imports and Domestic Savings**

If one plots on a scatter diagram the average rate of growth of gross national product over the years 1957–64 for the twelve Latin American countries referred to earlier, one finds that it is inversely related to the ratio of foreign aid to GNP. The association is rather loose, but the general tendency is clear: the greater is the capital inflow from abroad the lower is the rate of growth of the receiving country. There is absolutely no support for the orthodox view that foreign aid accelerates the rate of growth.

Why does aid frequently retard growth? One reason, suggested

![Graph showing rate of growth of GNP vs. foreign aid as a proportion of GNP](image)

Figure III:2

5 The diagram was first published in K. B. Griffin and J. L. Enos 'Foreign Assistance: Objectives and Consequences', *Economic Development and Cultural Change*, forthcoming.
above, is that foreign aid leads to a less desirable composition of investment and, hence, a higher capital-output ratio. Another, and more important, reason is that aid reduces the incentive to save.

The formal models usually assume that domestic savings depend upon GNP or, alternatively, upon national income per capita rather than upon total available resources. Thus, domestic savings are assumed either to be unaffected by capital imports or, if national income rises, to increase. In fact, one should expect the opposite to happen. A gift to an individual (say, from his uncle) or a gift to a nation (say, from Uncle Sam) is likely to be partially consumed and partially saved. That is, total investment should rise but not by the full amount of the aid. Indeed, as long as the cost of aid, e.g. the rate of interest on foreign loans, is less than ‘e’, it will ‘pay’ a country to borrow as much as possible and substitute foreign for domestic savings. Aid may not be available in unlimited supply, of course. But given a target rate of growth in the developing country, foreign aid will permit higher consumption and domestic savings will simply be a residual, i.e. the difference between required investment and whatever amount of foreign aid is available. Thus one would expect, on theoretical grounds, to find an inverse association between foreign aid and domestic savings.

Given a target rate of growth (\(\bar{q}\)) and an average savings ratio (\(s\)) that is insufficient to achieve the growth target, foreign assistance becomes essential. Unless, however, the marginal savings rate (\(\bar{s}\)) is greater than the average, a country will never be able to reduce its dependence on foreign aid without sacrificing the growth target. Foreign assistance can be successful in accelerating long-run growth only if it raises the marginal propensity to save. A necessary, although not sufficient, condition for ultimately achieving independence from foreign aid is that \(\bar{s} > \bar{q}/e > s\). Yet if our hypothesis that capital imports lead to lower domestic savings is correct, a country that relies upon foreign assistance to achieve growth may become permanently dependent and incapable of self-sustained growth.

It has become evident that foreign savings often tend to supplant rather than supplement (let alone increase) domestic savings. Speaking of Latin America, Professor Chenery notes that ‘... aid has been a substitute for savings, not an addition to investment. The savings


The inverse relationship between gross domestic savings and capital imports in general, i.e. aid plus private foreign investment, is very apparent in Figure III:3. This figure includes observations from fifteen Latin American nations in the period 1958–64: in addition to the nine Spanish American countries we have included evidence from six others (Mexico, Guatemala, Honduras, El Salvador, Costa Rica and Panama). As can be seen, there is a clear tendency for gross domestic savings (expressed as a proportion of gross product) to fall as foreign capital imports (again expressed as a proportion of gross product) rise.

Figure III:3

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product) rise. In other words, the more foreign capital a nation receives, the less it tends to save itself.

A study of a single Spanish American country, Colombia, over a period of thirteen years provides additional support for our hypothesis; there is a negative relationship between domestic savings, on the one hand, and foreign capital imports, on the other: and for every dollar of foreign aid received, domestic savings declined by about eighty-four cents. The inverse relationship is very apparent if one compares the average flow of savings in the period before capital imports became important with the rate of savings in the early years of the Alliance for Progress. As can be seen in the data below, not only were capital imports associated with a proportionate decline in domestic savings, but the fall in savings was greater than the rise in aid, so that the rate of capital accumulation also declined.

\[Table\ III:\ 1\]

\[DOMESTIC\ SAVINGS\ AND\ CAPITAL\ IMPORTS\ IN\ COLOMBA\]

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\begin{array}{lll}
\text{Average} & \text{1950–59} & \text{1960–63} \\
\text{Domestic savings as per cent of GDP} & 22.40 & 16.20 \\
\text{Capital imports as per cent of GDP} & -0.11 & 3.45 \\
\end{array}
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Thus the available statistical evidence suggests that foreign assistance certainly does not lead to a rise in domestic savings, and probably leads to a fall. Foreign assistance in Spanish America seems to have done more to increase the region’s dependence on foreigners than to accelerate economic development. Additional reasons for this tentative conclusion are provided in the sections that follow.

The Effects of Private Foreign Investment on Entrepreneurial Initiative

At least since the time of Mill economists have recognized that external capital played a major role in creating the so-called dual economies or foreign enclaves, i.e. ‘outlying agricultural or manu-

facturing establishments belonging to a larger community'.

Many economists, however, frequently have confused income generated within a geographical region, i.e. gross domestic product, with the national product. The two are not necessarily the same, and a strategy which maximizes the former does not necessarily maximize the latter. The injection of foreign capital may increase geographical output but it does not necessarily follow that the welfare of the indigenous citizenry is thereby increased. Foreign domination of important economic sectors may introduce monopoly exploitation (in both the product and factor markets) and economic discrimination based on social or national origin. Social cohesion and mobility may be destroyed. Indigenous entrepreneurs may be discouraged. Foreign investors may leave domestic entrepreneurs on the margin of economic activity; they may preempt the most profitable opportunities and retard the development of an investing class. Should the presence of investors from economically advanced societies frustrate the growth of an indigenous entrepreneurial group, the chances for long-run development will be seriously prejudiced.

The Belgian sociologist, Roger Vekemans, expresses the problem this way: foreign investments 'subrayan la carencia de capacidades nativas. Como son productos del mas alto dinamismo tecnologico y economico del mundo actual, recuerdan, o bien la ineptitud y atraso del ambiente local o bien las vacilantes iniciativas locales anteriores que fueron minimizadas, anuladas o derrotadas por su sola presencia'.

Professor Hagen speculates that foreign intrusion into non-Western societies has been inversely associated with technical progress and growth. As an example he cites the four largest Asian nations—Indonesia, India, China and Japan. Indonesia and India, which were conquered, have had the longest and most intensive contact with the West. China, which was forced to submit to the establishment of a Western beachhead along the coast and to accept trade between the interior and the West, has had the next longest and most intensive contact, while since 1600 the rulers of Japan effectively prevented almost all contact with the West. Further, most Western capital, and over the longest period, has been invested in Indonesia and India.


12 'Quienes son los “Aliados para el Progreso?”', Mensaje, No. 117, March-April 1963, p. 94.
next most, over a shorter period but still a century or more, in China, but literally none in Japan until her economic modernization was well under way. But the order of entry on economic growth has been, first Japan; next seventy or eighty years later, China and India, with the growth in China . . . more vigorous than that in India; and, last of the four, Indonesia, which indeed shows no evidence of growth at present.\textsuperscript{13} Professor Hagen’s sample, of course, is very small, and furthermore, the causal relationship between foreign investment and economic stagnation is not clearly indicated. Nonetheless, his observation is highly suggestive and increases our confidence that the relationship observed between capital imports and development in Spanish America is not fortuitous.

\textit{Private Investment and Monopoly Power: the Chilean Case}

Chile has less than 13 per cent of the world copper market and about 25 per cent of world reserves. Thus Chile’s share of the market in no way corresponds to her share of world copper reserves. Furthermore, the average ore content of Chile’s reserves is higher than that of the United States or Canada, although not as high as that of Zambia or the Congo. Chile has an advantage over her African competitors, however, in that her transport facilities are better. These conditions have combined to make Chile an extremely low cost producer. Informed economists estimate that the cost of production in Chile is between 17 and 20 US cents a pound;\textsuperscript{14} marginal costs probably are somewhat higher. Copper prices recently have been averaging over 40 cents a pound. Nonetheless, copper production in Chile in 1966 was only slightly higher than the levels achieved in the early 1940s. It appears that American domination of the copper industry has prevented its expansion.

Moreover, not only has total production remained relatively stagnant until very recently, production of refined copper actually declined during the 17 years after 1947. In this same period the proportion of smelted copper subsequently refined fell from 69.2 per cent to 47.4 per cent. Chile’s share of world copper production declined from 19.1 per cent in 1947 to 12.7 per cent in 1966, but her share of refined copper fell by even more, indeed, by almost a half—from 10.5 per cent to 5.8 per cent.


\textsuperscript{14} See Chapter IV below; also see H. Castro, \textit{Las Fluctuaciones en el Mercado de Cobre y los Ingresos Tributarios en Chile: Soluciones Alternativas}, Thesis written for the University of Chile, p. 36.
At current prices the industry is experiencing strong competition from aluminium; some markets have been lost and many are threatened. On the other hand, the strong competition indicates that the long-run price elasticity of demand for copper must be quite high.

Thus it would appear that by substantially expanding copper production—and increasing the proportion refined—Chile could enjoy significant gains from her comparative advantage. Increased production might reduce copper prices, alleviate the pressure from aluminium, and greatly increase the quantity of copper demanded by the world market; high cost American mines might be eliminated and Chile might thereby increase her market share. Short-run instability in the copper market could be reduced by concentrating on long-run purchase agreements at fixed prices with the major buyers. Such purchase agreements perhaps could be arranged with the Socialist countries or the nationalized firms of mixed economies, and might also be arranged with the other members of the Latin American Free Trade Area, a potential market of some importance.

If the advantages of expansion are so obvious, why has production been restricted? We can mention at least three relevant factors.

First, the foreign-owned companies are afraid to lower long-run copper prices because it would eliminate the inefficient producers in the United States. The companies therefore are forced to walk a tightrope between oligopolistic pricing of copper and loss of markets from competition with aluminium.\(^\text{15}\) Chile will continue to suffer from this subtle form of domination as long as ownership of the

\(^{15}\) The Anaconda Company, one of the big producers in Chile, has hedged its risk by acquiring interests in aluminium as well.
companies and control over production decisions remain in foreign hands. Secondly, the effective tax rates in the industry were, until recently, unusually high, oscillating between 60 and 70 per cent of profits. In addition, the companies frequently have been burdened with penalty exchange rates. Thus it has not been very profitable to expand productive capacity. Third, wage rates of the miners in no way correspond to their opportunity costs. Wages and fringe benefits are estimated to be approximately four times higher in the copper mines than in other industrial activities. For obvious reasons, the copper workers are not very keen to change the management or organization of the industry. An unfortunate effect of foreign investment has been the creation of a privileged class of workers. This has reduced national cohesion and made the introduction of sweeping reforms for development more difficult. The use of exchange rate policy, high taxes and wage rates has helped to retard the expansion of the industry, but in general these measures could be justified as an attempt to ensure that some of the monopoly gains remain in the country. These largely negative and defensive measures should have been replaced long ago by positive policies for the development of the industry, but before this could be done either the Chilean mines had to be nationalized or the government had to obtain a majority stockholder interest in the subsidiary companies.

The latter solution entails a continuous outflow of profits but it will ensure continued access to technical knowledge and efficient management. Nationalization, however, could be done step by step or could be combined with a management contract and the transitional problems could thereby be reduced; featherbedding could be controlled and efficiency maintained. Ideally, the contract would be offered to the present management. Whether the American copper companies would accept such an agreement remains to be seen. Retaliation by the American government is unlikely, and at worst would involve little more than the suspension of grants and loans. Since Chile exports only 20 per cent of the copper of the Gran Minería (and only 10 per cent of the output of the pequeña minería) to the United States, the possible loss of the US market is only of marginal significance.

A third possible way of expanding the industry in Chile would be by establishing new, Chilean financed, mining enterprises. One difficulty with this approach is that capital costs are likely to be high due to economies of scale. Investments in copper would be only one of many possible uses of Chile's savings and, depending upon an evaluation of the project, conceivably might not be the best use of
The given investment resources. The other alternatives avoid this problem: expansion and compensation might be self-financing out of profits. In this case nationalization of the copper industry, either in whole or in part, would represent an addition to Chile's resources and need make no claim on the use of domestic capital.

The government of President Frei has decided to 'Chileanize' the industry. The major feature of this programme is the partial nationalization of one of the mining companies operating in the country. Specifically, the government has purchased 51 per cent of the Braden Corp., a subsidiary of Kennecott. Braden had previously stated that it would be willing to expand production by 100,000 metric tons, provided the government did not raise the profits tax above the 50 per cent level. This would have implied a reduction in Braden's profit rate from 26.9 per cent (the average over 1945-63) to 12.4 per cent. This proposal, however, was rejected by the previous government.

For purposes of compensation Braden was evaluated at $160 million, even though the book value of its assets after depreciation was only $66 million. The Chilean government not only has compensated Braden at an inflated rate, it must also contribute its share to the cost of the expansion programme. The estimated cost of the expansion programme itself suddenly and mysteriously has increased by $30 million, perhaps because Braden allowed its capital to deteriorate through lack of adequate maintenance. When all is said and done, the return to Braden's capital in the new joint venture will be about 24.1 per cent (only slightly lower than its historical average and nearly double the rate implicit in its earlier proposal) while the return on Chile's investment will be only about 8.5 per cent. Evidently, the government negotiated badly.

Public Capital Imports and the Development of an Entrepreneurial Class

Some students of Spanish America might argue that it is not foreign capital so much as it is foreign capitalists that may frustrate development. If it is difficult, although not impossible, to separate the private foreign capitalist from his capital, surely—it might be argued—one can import public capital and thereby avoid the ill effects of private foreign investment. Unfortunately, however, the ill effects of capital imports cannot always be avoided in this manner. The main

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16 See below for an indication of the volume of annual profit repatriation from Chile.

17 A detailed evaluation of the agreement is presented in the next chapter.
reason for this is that public aid is used quite consciously by the donor nations to encourage Spanish America to accept private foreign capital. Spanish America is offered a 'package' of public and private capital, and she is not allowed to choose one without the other.

The bias in favour of private enterprise sometimes is quite subtle. For instance, certain public lending institutions, such as the Export–Import Bank, may induce competition between national entities, especially non-private organizations, and foreign entrepreneurs for the same, limited, investment funds. These institutions favour private enterprise and thus private investment is encouraged at the expense of state capital formation. The composition of public and private investment usually is quite different: the former tend to concentrate on social overhead capital and, occasionally, on heavy industry, while the latter frequently engages in producing consumer goods and extracting primary materials. As in some cases the creation of an adequate infrastructure and basic industries may well have priority over the expansion of extractive industries or the production of consumer goods, the bias towards private enterprise may lead on occasion to a misallocation of investment resources.

In its eagerness to encourage private foreign initiative the World Bank goes so far as to insist that governments of underdeveloped countries open the bidding on public construction projects to foreign companies. The World Bank even bends over backwards to ensure that construction projects are attractive to foreign bidders. In Chile, for example, the Bank put pressure on the government to raise the minimum bid on road building projects to five million escudos. The average domestic contractor, due to his limited financial resources, was unable at that time to handle a contract much larger than 200,000 escudos. Thus native entrepreneurs were squeezed out of the large state construction projects and the development of a strong entrepreneurial class was frustrated.

One of the important tasks of public policy in Spanish America is to protect and strengthen the entrepreneurial class. Under certain circumstances the importation of public capital may weaken this class. This may occur, for example, if foreign loans are used to finance investment projects which have a low capital import content, such as construction of roads, schools, houses, and hospitals. To use external loans to finance this type of internal investment the foreign exchange must be converted into domestic currency. In most cases this means the government temporarily will have to permit addi-

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...tion imports. That is, in order to avoid inflation, tariffs, quotas and other controls will have to be reduced. Additional imports, due to the sudden change in policy, will impinge upon the profitability of nationally established import-substituting industries. Native entrepreneurs will be weakened and, in societies where saving and investment decisions are interdependent, private savings are likely to decline. That is, if profits and investment opportunities decline, private savings probably will fall as well. This process clearly occurred in Chile in the period after 1956. The policy of relying on foreign loans to finance investment resulted in a shift in the composition of investment from the private to the public sector, a reduction in private savings, a weakening of the entrepreneurial class and an encouragement to speculate in foreign exchange.

Attitudes to Future Capital Inflows

Having discussed the effects of past capital imports on the development of an entrepreneurial class, the level of savings, the capital-output ratio and the productive structure of the Spanish American economy, we must now consider what should be a country's policy with regard to possible future capital inflows. Two questions must be discussed: First, are future inflows desirable and, secondly, are they in fact likely to be realized? Contrary to what might be thought, it is not sufficient merely to assess the desirability of capital imports; it is also necessary, at the same time, to assess their practicability. For if it is found that capital inflows are desirable, a particular development strategy will have to be formulated to achieve that end. If, however, it is known a priori that the ends are unlikely to be achieved in practice, a second—different—strategy will have to be designed.

It is clear—but also trivial—that, everything else being equal, a reduction in profit leakages will ease the pressure on the balance of payments and, in this way, assist the development effort. One should not conclude from this, however, that the Spanish American countries should require foreign enterprises to reinvest all their profits in the region, for this would lead (i) to the de-nationalization of existing nationally owned industries, (ii) to a rapid rise in foreign owned enterprises relative to domestically owned firms, and (iii) to even larger profit repatriation at a later stage. Rather, Spanish America

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19 A superior alternative, or course, would be to raise domestic taxation, and consequently, government savings. For political reasons this course is seldom followed.

should favour long-term low interest rate loans instead of direct private investments, loans repayable in soft currency instead of in hard, and grants instead of loans. Even if the advocacy of such a programme were completely successful, however, it seems unlikely that capital imports by themselves—even if generously available—could provide a strong impetus to development.

Increasingly, it is realized that the development process requires a strong ideological foundation—whether this be nationalism, communism or Catholic socialism. As Professor McClelland, a Harvard psychologist, has stated, 'There is no real substitute for ideological fervour.'\textsuperscript{21} He concludes that 'ideological movements of all sorts are an important source of the emotional fervour needed to convert people to new norms. They are necessary and should be supported in whatever form is politically feasible or most congenial to the country concerned'.\textsuperscript{22} Foreign investment, however, is not the type of activity which generates and sustains an ideological fervour; this is something which only domestic efforts can produce. Large scale participation in an economy by foreigners, in fact, is likely to frustrate the growth of an entrepreneurial class, disrupt national cohesion, and delay the appearance of a development ideology. Thus it would seem unwise to rely on capital imports as a major stimulus to economic development.

In any event, capital imports by the poor and slowly growing countries of Spanish America are not likely to be large enough to generate sustained growth. First, foreign capital appears to be attracted to the wealthier of the underdeveloped countries. A study of the period 1952–58 indicates there was a $12.9 billion flow of funds to underdeveloped countries. Of this flow, 51 per cent was private—mainly invested in the major mineral exporters.\textsuperscript{23} On the basis of a sample of 29 underdeveloped countries, Pilvin states that 'the lower half of the underdeveloped populations received 8 per cent of the total net flow, while the lowest 70 per cent received but 15 per cent of the foreign funds. . . . The highest tenth of the underdeveloped populations alone obtained 58 per cent of total foreign funds: some three-eighths of the total flow were concentrated in the highest two per cent of the populations'.\textsuperscript{24}

Second, foreign investments and loans seem to have been attracted

\textsuperscript{21} The Achieving Society, p. 430.
\textsuperscript{22} Ibid., p. 339.
\textsuperscript{24} Ibid., p. 45; see also H. Myint, The Economics of the Developing Countries, p. 180.
more often to a country after growth has been initiated. That is, it is becoming increasingly clear that foreign capital historically has played a very small role in assisting a country to ‘take-off’. In the United Kingdom, France, Germany, Finlad, Japan, etc., capital imports played virtually no part in initiating development. Even in the much publicized cases of Canada, Australia, New Zealand, and the United States foreign capital and foreign capitalists did not initiate the economic expansion but only joined in long after the expansion was under way and when prospects had looked bright for quite a while.25

Celso Furtado mentions that ‘In the Sao Paulo district, for instance, the great expansion of the railways was begun with resources of domestic origin. Foreign capital for the public services came only at a later stage, when a vigorous process of development was already under way’.26 Thus it appears that it is the rich and growing countries that are recipients of private capital inflows. In Latin America, for example, the nine poorest countries (Bolivia, Ecuador, Paraguay, Dominican Republic, El Salvador, Guatemala, Haiti, Honduras and Nicaragua) represent approximately 13 per cent of the region’s population yet received in the period 1951–60 only about 6.4 per cent of total (net) capital inflows and 4.9 per cent of direct investments.27 In the Spanish-speaking countries of South America the four richest countries (Argentina, Venezuela, Chile and Uruguay) include 53 per cent of the area’s population yet they were the recipients of 86 per cent of the region’s direct foreign investments.28

Finally, the amount of aid the wealthy countries are willing to provide for development now seems to be declining. In 1961 the flow of assistance from the 15 DAC (Development Assistance Committee) countries was $8.73 thousand million; in 1964 it had declined to $8.66 thousand million. Meanwhile, debt servicing repayments from the underdeveloped countries, particularly from Spanish America, increased rapidly and the terms on which aid was granted, particularly the extent of tied aid,29 became less favourable. Between

27 UN, ECLA, External Financing in the Economic Development of Latin America, pp. 23, 146, April 6, 1963; (mimeo.). Also see T. W. Schultz, El Test Economico en America Latina, p. 25.
28 UN, ECLA, op. cit., p. 146.
29 A study by UNCTAD of tied aid in Chile indicates that imports financed by tied aid agreements cost at least 12.4 per cent more than the world price (see UNCTAD document TD/7/Supp. 8, November 21, 1967, p. 10).
1962 and 1966 the official flow of financial resources from the DAC countries to the underdeveloped countries declined from 0.72 per cent of their national income to 0.57 per cent. Hence, in view of these trends, a policy of relying on foreign assistance seems neither practicable nor desirable in Spanish America.

A Development Sequence

Rather than rely on capital imports it might be easier and much cheaper in the long-run to accelerate growth by following different domestic policies which as a by-product tend to discourage foreign investments, e.g. detailed government intervention in the economy, but which increase domestic savings. It is even possible to imagine a development sequence based on such a process.\(^30\)

Initially, in stage (1), the rate of growth of *per capita* output is negligible, the net savings rate is low—say 6 per cent—and capital imports are relatively high. At this stage foreign firms are likely to dominate important sectors of the economy—especially the foreign trade sector—and impede the emergence of an indigenous entrepreneurial class. The potential native investor is unable to compete on equal terms with his foreign counterpart; he lacks the experience and knowledge plus the tremendous financial and physical resources the latter can command. This inherent inequality frequently is reinforced by special incentives, tax preferences and investment guarantees favouring the foreign businessman. In other words, the economy is in a dependent status.

Such a situation is likely to be stable until it is disturbed by outside events (such as the importation of foreign political ideas) or the development of popular political movements. In this second stage economic and political uncertainty increase, popular leaders begin to acquire power and seriously discuss the need for ‘reform’. The increased uncertainty leads to a cessation of capital imports and, quite possibly, even to a slight decline of the already low domestic savings. Stage (2) is a transition period.

In stage (3) however, the ‘reforms’ actually are implemented and a series of policy measures are introduced which have the effect, among other things, of sharply increasing the domestic savings ratio

\(^{30}\) It must be emphasized that the ‘model’ which follows is not intended to predict the future; there is nothing inevitable about the sequence outlined: the ‘revolution’ may be a failure; foreign troops may invade the country, etc. The purpose of the model is to dramatize alternative policies facing Spanish American governments and to sketch in the possible implications of each. A diagram of the sequence is presented in K. B. Griffin and R. French-Davis, *El Capital Extranjero y el Desarrollo*, Revista de Economia, (Santiago), Vol. 83-4, 1964, p. 27.
and the level of domestically financed investment. Foreign capital, perhaps stung by a nationalization programme, stays away. Stage (3) is the period of the 'take-off': the rate of growth accelerates, national entrepreneurs become a dominant class, and the structure of the economy gradually becomes transformed into a modern industrial society. At some point during this stage foreign investors may recover their confidence and re-enter the economy, perhaps investing even more than in stage (1). The form and composition of this investment, however, is likely to differ significantly from the earlier period. Less emphasis will be placed on plantation crops, extractive industries or public utilities; more emphasis will be placed on light industry, consumer services, and intermediate producer goods.31 Foreign capital no longer will dominate the economy and foreign investors frequently will enter into partnership with national entrepreneurs. Thus in stage (4) the savings ratio has reached its new high level and foreign investment has returned to contribute to the growth process.

Looking at the sequence as a whole it is clear that over a certain crucial range there may be a conflict between policies designed to accelerate domestic savings and growth and those designed to increase foreign participation in the economy. The discontinuous movements in domestic savings and capital imports are likely to be sharper the more dramatic are the policy shifts between the pre- and post-reform periods. The extent of the 'reforms' in large part will depend upon the intensity of the desire to accelerate economic and social development. Thus the more anxious a country to develop rapidly the less will it be able to rely on capital imports.

The Development Sequence in Mexico

Such a sequence seems to have occurred in Mexico. During the presidency of Lázaro Cárdenas, 1934–40, the long-dormant revolution of 1910 was revived by a series of reforms which increased educational opportunities, gave organized labour a stronger voice, altered land tenure institutions, and changed the political structure of the country. As a climax to these social and economic reforms the government nationalized the railroads and the petroleum industry in 1937–38. Protesting the expropriations, the 'imperialist' countries

31 This change in the composition of foreign capital from export-based extractive industries to manufacturing industries can be highly significant. The investors in the former have nothing to gain by development and everything to lose—and hence favour the status quo—because it minimizes risk and uncertainty. Progress for investors in the latter, however, generally depends upon the overall rate of growth of the economy, and hence the interests of foreign capital and national development conflict less sharply.
responded with an international boycott. Far from preventing the Mexican 'take-off', the boycott accelerated development by forcing the Mexicans to create an efficient entrepreneurial class. Between 1939 and 1950 the average ratio of net savings to Gross National Product was 11.2 per cent.

During the period 1935–38 there was a pronounced outflow of capital from Mexico. The book value of US direct investments in Mexico declined sharply from $683 million in 1929 to $316 million in 1946; they rose rapidly in the next decade, however, and by 1956 they had nearly regained the previous peak. Clearly the policies of the Cárdenas era did not permanently reduce the attractiveness of Mexico to foreign investors and they undoubtedly increased the speed of development. As Professor Higgins has indicated, 'Once the Mexican economy began to move and new opportunities for profitable investment appeared, foreign capital flowed into the country, accelerating the rate of economic expansion'. ‘Between 1939 and 1944 (foreign) investments plus reinvested earnings averaged only $10 million annually while in the years 1949–54 the annual average increased to $22 million, or about 130 per cent higher than the yearly average in the preceding period.’ Thus, on the basis of the available evidence, Mexico entered stage (3) in the late 1930s and began stage (4) around 1945. The lag of nearly ten years between stages (3) and (4) probably was due in large part to the intervention of World War II, although the inexperience of foreign businessmen in adjusting to social revolutions also may have been a factor.

Capital Imports and the Alliance for Progress
An optimist might imagine that the stylized sequence presented above has been operating recently in Spanish America. The symptoms

34 Economic Development, p. 69.
35 IBRD, The Economic Development of Mexico, p. 137. The figures cited in the quotation exclude the 'characteristically erratic movements of inter-company accounts'.
36 One of the difficulties of testing the historical existence of the suggested stylized sequence is that frequently adequate data on an economy do not appear until stage (3). It almost appears that while the politicians were organizing a social revolution, the economists were deciding to organize a National Statistical Service!
indicate, if interpreted optimistically, that the region is in stage (2): political agitation has increased, 'reforms' are being discussed but not implemented, and foreign aid has declined.

There was also a decline of private foreign investment in the early 1960s. This can be attributed to the fear and uncertainty created in the minds of businessmen by the Bolivian and Cuban revolutions. The uncertainty was increased, and the decline in investment probably accentuated, by violence in Venezuela and Colombia in the early years of the decade and by the reformist pronouncements of the Alliance for Progress. In other words, both the initial reduction of private foreign investment and the creation of the Alliance for Progress were a reaction to social revolution within the hemisphere.

The tragedy of the Alliance is that the attempt by the US government to accommodate itself to Spanish American realities reinforced the fears of foreign businessmen without substantially changing the economic prospects for the region. In its early years the Alliance loudly called for tax, educational and agrarian reforms. It pointedly refrained from mentioning, however, the need to reform the (foreign owned) raw material industries. Nonetheless, the US State Department, at least temporarily, appeared to have become somewhat less afraid of the word 'revolution' and implied frequently that most Spanish American nations needed more progressive and popular governments. Unfortunately, talk of reform produced very little beneficial activity within the Spanish American republics but resulted in, or at least was accompanied by, an initial fall in private capital inflows.

It was at this point that US policy was reversed. President Johnson's Administration became much less interested in encouraging modest reforms and much more concerned with maintaining 'stability'. This shift of emphasis was made explicit by the Resolution of the US House of Representatives of September 20, 1965 which endorsed the unilateral use of force by the United States or by any other Western Hemisphere country to prevent a communist takeover. The governments of five of our Spanish American countries objected to this Resolution; Paraguay, Bolivia, Argentina and Ecuador did not. These events were accompanied by a general swing to the 'right' in Latin America—no doubt stimulated by US military intervention in the Dominican Republic and the right-wing

37 Indeed, the American government was delighted when Chile's Christian Democrats won the last presidential election under the slogan 'Revolución con Libertad'.
military *coup d'état* in Brazil—and this led to the revival of private capital inflows, as can be seen in Table III:3.

*Table III:3*

US PRIVATE DIRECT INVESTMENT IN FIVE SPANISH AMERICAN COUNTRIES  
(book value in millions of dollars)

<table>
<thead>
<tr>
<th></th>
<th>1963</th>
<th>1966</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>829</td>
<td>1031</td>
</tr>
<tr>
<td>Chile</td>
<td>768</td>
<td>844</td>
</tr>
<tr>
<td>Colombia</td>
<td>465</td>
<td>576</td>
</tr>
<tr>
<td>Peru</td>
<td>448</td>
<td>518</td>
</tr>
<tr>
<td>Venezuela</td>
<td>2808</td>
<td>2678</td>
</tr>
<tr>
<td>Total</td>
<td>5318</td>
<td>5647</td>
</tr>
</tbody>
</table>

*Source: Agency for International Development, Statistics and Reports Division.*

It is perhaps ironic that the privileged groups in Spanish America have approved of the Alliance because they believe it will not work, i.e. there will be no fundamental social and political changes, while the Marxists have always opposed the Alliance because they are afraid it will work, i.e. that it will perpetuate and reinforce governing minorities. Both groups, of course, have been correct.

American businessmen, opposed to ‘reform’, ‘revolution’ and ‘socialism’ and fearful of nationalization programmes withdrew their capital from the region and insisted, successfully, that the US should use its aid programmes to foster their views of economic organization. In the words of one recent report, the ‘encouragement of private enterprise, local and foreign, must become the main thrust of the Alliance’. The United States ‘should concentrate its economic aid program in countries that show the greatest inclination to adopt measures to improve the investment climate, and withhold it from others until satisfactory performance has been demonstrated’.\(^3^8\)

Thus it has become evident that continued capital inflows are likely to be contingent upon the maintenance of a particular form of economic organization, ‘free enterprise capitalism’. This particular economic system has been singularly unsuccessful in the past in solving Spanish America’s development problem. Yet these countries now may be forced to choose either foreign capital and foreign

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\(^3^8\) The Rockefeller Minority Opinion, part of the report from the Commerce Committee for the Alliance for Progress. The Minority Opinion was later endorsed by the Chairman of the Committee.
CAPITAL IMPORTS AND NATIONAL DEVELOPMENT

...capitalism or economic planning based entirely on domestic savings. Neither alternative is entirely satisfactory, but if forced to choose between them there is much to be said for electing the latter.

This is particularly true in view of the fact that foreign aid has not been forthcoming in the amounts promised and, indeed, has declined slightly. The original programme for the Alliance for Progress as negotiated at Punta del Este in 1961 envisaged an inflow of capital into Latin America of $20,000 million over 10 years. Most of this was to be provided in the form of foreign aid, i.e. aid grants and loans. Food for Peace commodities, loans from the Export-Import Bank, Peace Corps volunteers and assistance from the Social Progress Fund of the Inter-American Development Bank. A mid-term evaluation of the programme, however, indicated that in the first five years of the Alliance, US government aid commitments were only $4.9 billion, and disbursements were considerably less. Presumably it was for this reason that President Johnson announced in 1965 that the Alliance would be extended beyond the original ten years.

The evolution of Alliance for Progress aid in Spanish America can be seen at a glance in the table below. We have compared aid disbursements in 1962 (the year following the signing of the Charter at

Table III: 4

<p>| AID DISBURSEMENTS UNDER THE ALLIANCE FOR PROGRESS |</p>
<table>
<thead>
<tr>
<th>(millions, US dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>Argentina</td>
</tr>
<tr>
<td>Bolivia</td>
</tr>
<tr>
<td>Chile</td>
</tr>
<tr>
<td>Colombia</td>
</tr>
<tr>
<td>Ecuador</td>
</tr>
<tr>
<td>Paraguay</td>
</tr>
<tr>
<td>Peru</td>
</tr>
<tr>
<td>Uruguay</td>
</tr>
<tr>
<td>Venezuela</td>
</tr>
<tr>
<td>TOTAL</td>
</tr>
</tbody>
</table>

Source: Informe de los Estados Unidos de America al Consejo Interamericano Economico y Social, April 1967, Table 6.

Punta del Este) with disbursements five years later, in 1966. Over this period aid disbursements declined in five out of the nine countries, namely, in Argentina, Bolivia, Chile, Uruguay and Venezuela; they rose in Colombia, Ecuador, Paraguay and Peru. For the group as a whole, total disbursements fell by about six per cent. In per capita terms, of course, the decline was much sharper.

Even these figures, bad as they are, fail to indicate how ineffective has been the Alliance for Progress and other programmes of external assistance. In the first place, the net inflow of foreign capital is low and falling because an increasing proportion of the gross external receipts is being used to finance amortization and interest payments. In 1961, for instance, Chile received a gross inflow of $94.3 million from AID, IBRD, IDA, the X–M Bank and the Inter-American Development Bank; the net flow, however, was only $71.9 million. By 1967 the gross inflow from the same sources had risen slightly to $101.6 million, but the net inflow had declined by nearly a half to $39.4 million.40

Secondly, contrary to its original purpose, the Alliance no longer is using aid as an incentive to undertake structural reforms. Let me illustrate this with another example from Chile. In the first two years of the Alliance, AID used the promise of a loan of $35 million as an incentive to get the ultra-conservative régime of President Alessandri to pass a land reform law. This pressure was partially successful and resulted in the 1962 Agrarian Reform Law, although no serious attempt was made to implement the law. Subsequently, during the new reformist régime of President Frei, AID 'became silent on agrarian reform either as an indicator of Chile's self-help measures or as a condition for further US assistance'.41

The alternative of relying on foreign capital thus offers little hope for rapid development. The target of the Alliance for Progress was to achieve a minimum rate of growth of per capita income of 2.5 per cent a year. Yet in only two years since 1961, viz., 1964 and 1965, has the minimum target been achieved. Last year, 1967, the per capita rate of growth was only 1.5 per cent. The Alliance is obviously failing. In an attempt to prevent this, a meeting of most of the heads of state of the western hemisphere nations was held at Punta del Este, Uruguay, in 1967. At this 'summit' conference an action programme was formulated, the principal goals of which were the

40 V. Tokman, 'El Financiamiento Externo, Su Componente de Ayuda y los Efectos Sobre la Formacion de Ahorros y la Capacidad de Pagos: El Caso Chileno'. mimeo., August 1968, Table 2.
beginning of a Latin American Common Market in 1970 and its ‘substantial operation’ by 1985; promotion of multilateral development projects; modernization of agriculture; expansion of education and medical facilities; and the ‘elimination of unnecessary military expenditures’.

The results have not been encouraging. Military expenditure has increased; the impetus to regional integration has diminished; food production has continued to lag seriously behind the growth of population, particularly in Chile, Colombia and Peru. Education has not received the attention it deserves, with the notable exception of Venezuela, where nearly 13 per cent of the national budget is spent in this sector. Exports have remained stagnant: in 1967 export receipts increased only 2.7 per cent, i.e. no faster than the population. Finally, the contribution of foreign aid has been slight: in 1966 grants and loans to Latin America net of amortization and interest payments were $800 million, compared with $2.3 thousand million in Africa and $3.5 thousand million in Asia and the Middle East; debt servicing accounted for 75 per cent of the gross capital inflow.

Few economists are prepared to argue that capital imports are wholly bad. Some are prepared to argue, for the reasons given in this chapter, that domestic investment is better, and policies which encourage one may discourage the other. That is, the domestic propensity to save is not ‘given’; it is a variable. The standard models discussed at the beginning of the chapter usually assume the savings ratio is constant and, in so far as it varied, it varied independently of capital imports or, in a special case, rose as a result of them. Particularly in the short-run, however, policy decisions which have the effect of increasing domestic savings may have the opposite effect on capital imports. But if the policy changes are successful and, in fact, do accelerate growth, capital imports probably will not be influenced much in the long-run. One should conclude therefore that governments of Spanish America should encourage foreign capital imports only after all other policies have been determined. Capital imports at best are only a marginal element in the growth process; the main burden of development will have to be carried by native decision makers using domestic resources. Hence domestic policies should be established first and foreign capital can adjust to them; countries should not adjust their domestic policies to the dictates of foreign capital.

42 See Chapter VI below for a discussion of regional integration.
2 FOREIGN CAPITAL AND THE BALANCE OF PAYMENTS

Conventional theory would have us believe that a country receiving external capital would enjoy a substantial import surplus on current account. Only later, when repatriated profits and interest charges on past investments exceed the new capital inflow, would an export surplus be necessary to finance these leakages. Yet the Burmese economist, H. Myint, has shown that more often than not there were repatriated profits 'when there is no evidence of a previous inflow of capital in the form of import surpluses'. How can this be? Two extreme possibilities may be cited.

First, foreign control of an enterprise may be obtained with domestic capital. That is, there may never have been a capital inflow; funds may have been raised in the capital market of the host country, e.g. through domestic banks.

That is what appears to have happened to the Chilean nitrate industry in the nineteenth century. The government decided to nationalize the holdings in 1881 and the way was left open to foreign enterprise and speculation. John T. North acquired control of the industry with loans granted by the Bank of Valparaiso. This institution and 'other Chilean lenders supplied 6,000,000 pesos to North and his associates to buy up the nitrate certificates and the railroads of Tarapacá'.

In cases such as the above the underdeveloped economies obtain all the disadvantages of foreign economic domination without receiving a compensating advantage of a net capital inflow. The repatriated profits, in fact, are nothing more than a type of capital flight. Foreigners provide only organizational ability; the domestic economy provides capital and all other inputs, yet the profits of the firms are sent abroad just as if they represented a return on foreign capital. Organizational ability, of course, is worth something, but it


45 A. Pinto, Chile, Un Caso de Desarrollo Frustrado, p. 55, quoting F. Encina. Translated by the author. The copper industry also is somewhat ironical. Chilean copper did not come under foreign control until around 1900. At that time the private Chilean owners sold the mines and refineries to foreign interests. This occurred, incidentally, during a period of rising copper prices associated with the world-wide expansion of the electricity industry. The Braden Copper Co. was established in 1904 with a capital of $4 million. In 1964 the Chilean Government proposed to buy back half of Braden for about $82 million. See M. Lazo D'Arcangeli, La Exportacion Chileno de Cobre durante el Periodo 1810–1910, University of Chile thesis, 1964.
is doubtful whether it is worth a continuous outflow of profits; a high salary should be sufficient.

On the basis of a questionnaire circulated by the University of Oregon, it was determined that of the seventy-two companies reporting on their ‘sources of financing of foreign affiliates’, in 1959, thirty-three companies replied they borrow ‘all or all possible’ in the host country. 46 Between 1957 and 1959, ‘host country funds’ represented 17.5 per cent of all sources of funds for US direct investment in Latin America. Over the same period the host country provided 25.8 per cent of the funds for all US direct investment overseas. 47 Not all of the host country funds, of course, were raised through the banking system; some were equities and thus did not entail any subsequent capital outflow. Nonetheless the presumption exists that in many cases foreigners have gained control of domestic resources—and exported the subsequent profits—without first having imported capital.

Even if the original foreign investment can be attributed to a capital import and the receiving country consequently experienced an import surplus, it does not follow necessarily that subsequent increases in foreign investment will have similar balance of payments effects. If the increased foreign investment is due to, say, reinvestment out of profits or to a change of residence of a native capitalist, foreign control of domestic resources will increase without any additional importations of capital. In such cases it is not at all clear that the foreign contribution to the ‘recipient’ nation is sufficiently large to justify permanent repatriation of profits.

The second possible explanation for the absence of an import surplus is that foreign investors may demand an extraordinarily high rate of return on their investments. From the point of view of the capitalists, foreign investment is an unusually risky activity which requires a high rate of amortization. Thus foreign capital may be turned over very rapidly in sectors which yield extraordinarily high profits. These high profits, in turn, may be due in large part to monopolistic manipulation of costs and prices, or they may be due to a natural monopoly, i.e. a lack of close and cheap substitutes.

The substantial leakages of interest payments, dividends, and profit repatriation—not to mention the repatriations of principal—greatly reduce the impact of foreign investment on the host economy and directly accentuate the problem of the balance of payments. Further-

more foreign firms are likely to have a propensity to import far above the national average. This, too, reduces the 'multiplier effects' of foreign capital on the productive structure of the economy and further aggravates the payments difficulties. Little impetus is likely to be given to domestic suppliers. Managers, technicians, equipment, and many other inputs are imported. In some cases, even the labour force was imported, as occurred for example with the importation of East Indians to work the sugar plantations in what was then British Guiana.48

We noted above that the net contribution of foreign aid to the capital resources of Spanish America is rather small. Evidence is also being accumulated, gradually, which shows that the profit leakage from foreign private investment is remarkably large. It is rare indeed that new investment in the underdeveloped countries exceeds repatriated profits. There has been a consistent net capital outflow from the low-income, capital-poor countries to the high-income, capital-abundant countries. Data from the US Department of Commerce, for example, indicate that over the half decade 1956–60 United States businessmen invested slightly over four and a half thousand million dollars in the underdeveloped countries, yet during the same period over seven thousand million dollars of profits were repatriated. Thus on private account there was an outflow of capital net of investment of almost $2.7 thousand million in five years.

In Latin America, if anywhere in the underdeveloped world, one would expect capital inflows to exceed repatriated capital. The United States has had a long and profitable association with the Spanish American Republics. North American businesses have developed extensive contacts in the region, have experience in working with Spanish American institutions and laws, and in practice have encountered remarkably little hostility to foreign investment. Expropriations have been infrequent and eventually have been followed by compensation in all cases except the Cuban. Yet here, too, we see that over the twelve year period 1950 through 1961 the region as a whole repatriated more capital than it received. This may be seen in Table III:5.49

The net inflow of $1829 million on public account was not nearly sufficient to compensate for the $3910 million outflow of capital on private account. The Latin American region was a source of capital

49 The data in Table III:5 refer specifically to Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela. These countries comprise nearly 90 per cent of the population and income of the entire Latin American region.
import far weaker effects' economy and it is likely that the labour export of the British aid to the European is also profit leakage. Indeed, it is likely that the capital outflow from high-income, European countries to Latin America in the 1950s exceeded the inflow of capital from Latin America during the same period. In the rest of the world, one of the main sources of capital was the United States. The relationship between capital inflow and investment is not clear. However, it seems that excesses have continued to the present day in practice in Latin America. This may have been the case in 1961. Yet here, too, the period from 1951 to 1961 the inflow has been positive. This may reflect the relative success of private investment. The inflow of private capital is still not nearly as high as that of capital on loan. It is not the inflow of capital that is important, but the use of capital.

<table>
<thead>
<tr>
<th></th>
<th>1950–61</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Net new direct US investment:</td>
<td>US$2965m</td>
<td>US$247m</td>
</tr>
<tr>
<td>(2) Profit and interest remittance on (1):</td>
<td>6875</td>
<td>573</td>
</tr>
<tr>
<td>(3) Net movement of private capital:</td>
<td>-3910</td>
<td>-326</td>
</tr>
<tr>
<td>(4) Total US aid:</td>
<td>3384</td>
<td>282</td>
</tr>
<tr>
<td>(5) Official US debt repayments:</td>
<td>1151</td>
<td>96</td>
</tr>
<tr>
<td>(6) Interest on debt to US Government:</td>
<td>404</td>
<td>34</td>
</tr>
<tr>
<td>(7) Net movement of public capital:</td>
<td>1829</td>
<td>152</td>
</tr>
<tr>
<td>(8) Net movement of all capital:</td>
<td>-2081</td>
<td>-174</td>
</tr>
</tbody>
</table>

Source: US Department of Commerce and Agency for International Development.

to the United States throughout the period. It is interesting to note that the Alliance for Progress expects private investors to play an important role in developing Latin America. The target of $300 million a year on private account has been set. It is not clear whether this $300 million is supposed to be a net contribution of capital, i.e. net of profit and interest remittances, or only gross. In either case the target is unrealistically high and it is very doubtful that it will be achieved. Direct investment averaged only $247 million a year in the period covered by Table III: 5, and in eight of the twelve years private direct investment was less than $200 million. In the first five years of the Alliance for Progress the inflow of new private capital into Latin America has been about $200 million a year—excluding Venezuela, where the inflow was negative.

Another way to consider the balance of payments effects of foreign capital is to express the service payments (interest, amortization and profit repatriation) on long-term capital imports (both public and private) as a percentage of export earnings (both visible and invisible). According to ECLA's data, between 1951–55 and 1961–65 service payments on foreign capital rose from 3-2 to 30-0 per cent in Argentina, from 20-0 to 44-5 per cent in Chile, from 7-5 to 29-4 per cent in Colombia, from 9-5 to 19-0 per cent in Peru, and from 4-4 to about 10 per cent in Uruguay. In other words, payments to foreign capital in Spanish America are rising considerably faster than exports.

A critic might argue that it is not legitimate to lump all the underdeveloped countries into one group, or even to look at Latin America.
or Spanish America as a whole. Differences between countries are important. Those countries which have abundant resources for development and which show no intention of nationalizing foreign enterprises will be net recipients of foreign capital; countries which are hostile to foreign investment will experience large-scale capital repatriation. Once again we find that this generalization probably is incorrect. Let us take Chile as an example: (a) from 1958 until September 1964 a conservative coalition was in power; (b) the country is politically stable and democratic; there is no revolutionary tradition; (c) there are tremendous resources to be developed. In addition to the copper reserve mentioned earlier, the country has great potential in exports of wine and of iron ore; she has unexploited forest resources and could become an important producer of

\[ \text{Table III:6} \]

\text{CHILE: CAPITAL FLOWS ON FOREIGN PRIVATE ACCOUNT} ('000 US dollars)

<table>
<thead>
<tr>
<th>Year</th>
<th>(1) Net Private Foreign Invest.</th>
<th>(2) Repatriated Profits (a)</th>
<th>(3) Net Private Capital Flow: (1)-(2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1944</td>
<td>-3,612</td>
<td>19,755</td>
<td>-23,367</td>
</tr>
<tr>
<td>1945</td>
<td>-9,158</td>
<td>15,381</td>
<td>-24,539</td>
</tr>
<tr>
<td>1946</td>
<td>-3,039</td>
<td>26,025</td>
<td>-29,064</td>
</tr>
<tr>
<td>1947</td>
<td>-3,243</td>
<td>44,500</td>
<td>-47,743</td>
</tr>
<tr>
<td>1948</td>
<td>12,180</td>
<td>56,339</td>
<td>-44,159</td>
</tr>
<tr>
<td>1949</td>
<td>29,607</td>
<td>30,167</td>
<td>-560</td>
</tr>
<tr>
<td>1950</td>
<td>20,492</td>
<td>35,024</td>
<td>-14,532</td>
</tr>
<tr>
<td>1951</td>
<td>38,497</td>
<td>48,233</td>
<td>-9,736</td>
</tr>
<tr>
<td>1952</td>
<td>39,509</td>
<td>46,793</td>
<td>-7,284</td>
</tr>
<tr>
<td>1953</td>
<td>14,977</td>
<td>25,075</td>
<td>-10,098</td>
</tr>
<tr>
<td>1954</td>
<td>-3,946</td>
<td>29,972</td>
<td>-33,918</td>
</tr>
<tr>
<td>1955</td>
<td>2,534</td>
<td>63,753</td>
<td>-61,219</td>
</tr>
<tr>
<td>1956</td>
<td>12,892</td>
<td>81,807</td>
<td>-68,915</td>
</tr>
<tr>
<td>1957</td>
<td>43,019</td>
<td>38,817</td>
<td>+4,202</td>
</tr>
<tr>
<td>1958</td>
<td>55,362</td>
<td>32,530</td>
<td>+22,832</td>
</tr>
</tbody>
</table>

Total: 246,071 594,169 -348,098
Average: 16,405 39,611 -23,207

\text{Source:} Calculations based on data published by the Banco Central de Chile \textit{Balanza de Pagos} 1958. (a) includes figures only for the \textit{gran minería del cobre}, \textit{gran minería del hierro} and \textit{salitre y yodo}. The Table ends in 1958 because methodological changes at the Central Bank after that date make further comparisons difficult.
Countries are scarce; her bountiful fishing grounds have not been fully developed. In spite of these investment opportunities Chile has suffered a large outflow of capital on foreign private account. This is shown in Table III:6.

Net investment was negative in five of the fifteen years covered by the Table. Repatriated profits exceeded new investment in thirteen of the fifteen years. Over the entire period there was a net outflow from Chile of $348 million or a yearly average outflow of $23 million. Profit leakages, however, have not necessarily frustrated development. In so far as foreign investment creates wealth and provides a flow of goods and services which otherwise would not have been provided capital imports are a contribution to the economy and profit repatriation per se is not objectionable. This surplus over costs becomes of interest mainly for its effects on the balance of payments and as an indication of the potential benefits of expropriation. But beyond a certain point we must agree with Mr W. Rosenberg when he argues, 'The heavier the interest burden on foreign investment, the greater is the likelihood of a country having to borrow to meet that interest burden. Once embarked on this slippery slope, the action of compound interest starts to work, and foreign investment tends to become a growing burden which is no longer compensated by the advantage of increased availability of real resources. . . . Thus while on the surface foreign investment may stimulate a country's development in certain fields, looking at it over a period of years, excessive foreign investment leads to a reduction of growth.'

It is important, however, that the direct effects of foreign investment and foreign aid on growth and the secondary effects of profit repatriation and debt servicing on the balance of payments should be separated. This does not imply that the state of the balance of payments has no influence on growth and development. On the contrary, a persistent payments difficulty can easily frustrate economic development—particularly if the measures adopted to control the balance of payments result in a lowering of the level of income and investment. This has occurred frequently in Spanish America and is the topic of Chapter V.

Summary
The orthodox conclusion that capital imports will accelerate economic development is not always valid. Under certain circumstances

foreign capital, whether public or private, may fragment the economy, introduce monopoly elements into the society, discourage the development of a native entrepreneurial class, lower the domestic savings ratio, raise the capital-output ratio and cause subsequent balance of payments problems. This last problem can be avoided in part if foreign enterprises reinvest a substantial proportion of their profits in the host economy, but this, in turn, only causes further difficulties, *viz.* growing foreign control of the economy and de-nationalization of local industry. In Central America this process already has advanced very far. Foreign investment has penetrated not only into large industries but into small and medium industries as well. This phenomenon has been associated with the acquisition by foreigners of established firms managed for many years by local businessmen. In effect, private foreign investment has converted small local entrepreneurs into rentiers and thereby retarded the development of an indigenous capitalist class.\(^{51}\)

The national interest may not be compatible with a large inflow of foreign capital. The encouragement of a development ideology and the introduction of widespread social and economic reforms necessary to raise the domestic savings ratio may be extremely difficult in countries where capital imports provide a large part of the finance for growth. Thus, over a certain range, policies designed to encourage capital imports may be in conflict with policies designed to raise domestic savings and alter the *status quo*. When such a conflict occurs, the case for concentrating on domestic savings is strong, for if the policy changes are successful in raising the savings and growth rates, capital imports are unlikely to be adversely affected in the long-run.