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THE INTERNATIONAL FLOW OF PRIVATE CAPITAL 1946-1952

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FOREWORD

In resolution 622 C (VII) of 21 December 1952 the General Assembly, referring to the importance of stimulating the international flow of private capital for the economic development of under-developed countries, to action taken to stimulate the flow of such capital and to the fact that, despite efforts made, the capital flow was not yet adequate to cover the needs of these countries, requested the Secretary-General:

> "To include in an early future world economic report an analysis of the international flow of private capital, including the volume and direction of that flow as well as the types and the fields of application of such investment and any reasons for the continued inadequacy of such investment in under-developed countries, so as to facilitate the efforts of the Economic and Social Council in its formulation of constructive proposals."

Following a decision by the Economic and Social Council on 30 November 1953, according to which the world economic situation (and hence the *World Economic Report, 1952-53*) would be dealt with at the eighteenth session of the Council, the General Assembly in resolution 724 C (VIII) of 7 December 1953 requested the Council to examine at its seventeenth session the study prepared pursuant to General Assembly resolution 622 C (VII). Since the study will thus not be considered by the Council at the same session as the *World Economic Report,* it is being issued as a separate document.

The study was prepared in the International Financial and Commercial Relations Section of the Division of Economic Stability and Development of the Department of Economic Affairs.

EXPLANATION OF SYMBOLS

Three dots (. . .), when used in tables, indicate that information is not available.

A dash (—), when used in tables, indicates that the amount is nil or negligible.

"Billion" indicates a thousand million.

"$" or "dollars" indicate United States dollars, unless otherwise stated.

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CHAPTER 1

THE STATISTICAL EVIDENCE

The global picture

This study deals with the international movement of private capital since the end of the war. Private capital includes amounts placed by private investors, whether as loans or equity investment and, in the case of loans, whether the borrower is a private enterprise or a government. Both new investments made and the return flow of old investments to the capital exporting country are considered here.[1] Since the study is principally concerned with capital employed in production, attention is focused on long-term investment. It may be observed, however, that the available statistical information does not always permit of the segregation of long-term and short-term capital, or of public and private capital. Further, the granting of mercantile credits of several years' duration and in many countries the immobilization by exchange control of foreign banking deposits and similar liabilities have in many cases tended to blur the distinction between long-term and short-term investments. (Traditionally, investments with a maturity of over twelve months are counted as long-term.) The shift in national ownership of property that results from emigration is not considered a movement of capital and has accordingly been disregarded.

Though the statistical information on balance of payments has greatly increased during recent years, it does not permit of presenting a very simple and clear record of private capital movements during the period under review. Reinvestment by foreign-owned or foreign-controlled companies of undistributed earnings is a principal source of additions to existing investment, and though reinvestment normally does not enter into international payments, it is recognized that, in a complete account of the foreign transactions of a given country, the amounts involved should be included as a "current" item (that is, capital yield received or paid) and be offset in the capital account as an addition to outstanding investments.[2] Figures for reinvestment are not always available, however, and when they are, they may in some cases be understatements, in particular because recorded profits are sometimes reduced through depletion or depreciation allowances that permit an actual increase in the capital invested to appear as normal replace-

[1] It follows that a government's repayment of a loan raised in a foreign capital market is considered a movement of private capital. According to the terminology used in the balance of payments statements computed for the International Monetary Fund, such a capital transaction is "official" in the repaying country but "private" in the receiving country.

[2] This principle has been accepted by the International Monetary Fund in its *Balance of Payments Manual* but is not always applied in the balance of payments accounts prepared by individual countries.

ment.[3] There are also indications that in several countries applying exchange control there has been a clandestine export of capital that is by no means negligible and frequently, through indirect channels, has helped to sustain long-term investment.

At the same time, the relationship between the movement of capital of different kinds, particularly between public and private funds, has become more involved. Inter-governmental loans and grants have increased greatly in importance; in many cases they have reduced the need of the receiving countries to raise capital in foreign markets and in some cases have undoubtedly rendered it possible for them to invest private capital abroad. The receipt of such funds has enabled several countries in western Europe in turn to extend large governmental credits and grants to politically affiliated territories overseas and has facilitated their private investments in such territories. Lending by governments has succeeded the floating of loans in leading capital markets. Also, an international agency, the International Bank for Reconstruction and Development, has become a major lender to under-developed countries. The movement of private long-term capital accordingly has not played the same role in the balance of payments as it used to do, for instance, during the early inter-war period.[4]

As in the 1930's, when there was a tendency to liquidate outstanding international investments, a number of under-developed countries during the post-war period have repaid debts previously raised in foreign markets or have acquired foreign-held equity investments in greater amounts than they have absorbed private investment funds from abroad. Nevertheless, there has been, on balance, a net movement of such funds from a number of highly developed countries, particularly the United States and a few countries of western Europe.

The United States was the largest exporter of private capital during the period under review and also the country for which the most complete statistics are available. During the seven years 1946-1952, the United States

[3] Thus, "almost all forms of resource extraction are allowed a depletion deduction by the United States . . . the depletion deduction is a percentage of the gross income from the property varying from 5 per cent to 27.5 per cent but cannot exceed 50 per cent of taxable income". (*United States Income Taxation of Private United States Investment in Latin America,* United Nations publication 1953.XVI.1, page 36.) In the case of the United Kingdom, the "initial" depreciation allowances have been of special importance during the post-war period. After an increase in April 1949, these allowances amounted during three years to 40 per cent for capital expenditure on plant, machinery, mines and oil wells, and to 20 per cent on the construction of new industrial buildings. In 1953, the allowance for plant and machinery, and for new industrial buildings, was lower—20 and 10 per cent, respectively.

[4] During the inter-war period the principal inter-governmental movements of funds were payments of reparations and on account of inter-allied debts. Both types practically came to an end in the early 1930's. In the 1920's there was a complicated relationship between certain of these payments and private capital movements. Thus, it may be said that German imports of private capital from 1924 helped to enable Germany to pay reparations. Reparations paid by Germany to France were one of the factors causing the heavy French surplus on current account in the 1920's; this surplus, which accrued to French exporters, was largely placed on short term abroad, particularly in the United Kingdom and the United States, and contributed to the ability of the capital markets in these countries to absorb loans for the account of other countries.

had a surplus on account of goods and services,[5] including reinvested profits,[6] of $43.4 billion. The great bulk of this balance is accounted for by United States government loans and grants, amounting to $8.9 billion and $26.9 billion, respectively, and by an outflow of short-term capital (chiefly in the form of liquidation of foreign short-term assets and gold holdings) totalling $4.0 billion. On the other hand, there has been a heavy offsetting unrecorded inward movement of private foreign short-term capital seeking refuge in the United States; the residual of "errors and omissions" in the United States official balance of payments account is usually attributed largely to this inflow. During the years 1946-1952 this residual amounted to $4.3 billion. The balance of the items mentioned corresponds to a net surplus of $7.9 billion which would thus represent the net outflow of long-term private investment funds.

In the case of the United Kingdom, the information available as to new private long-term investments abroad is less precise. According to annual statements computed by the Bank of England, the nominal value of "oversea investments of United Kingdom residents through the medium of securities quoted on, unofficially dealt in or otherwise known to the London Stock Exchange" declined during the years 1946-1951 by £432 million,[7] and the decline would have been greater had not the depreciation of sterling in 1949 caused an appreciation of the book value of the investments by £84 million. The official balance of payments statement indicates a net outflow of private capital during the period 1946-1952 of £966 million (representing the balance of a deficit on account of transactions in goods and services, including private donations, of £438 million and a credit on account of official financing transactions—such as United States and Canadian grants and loans, changes in sterling balances and in gold and dollar reserves—of £1,404 million). Part of this capital outflow of about £1 billion, however, represented short-term funds; thus, commercial credits guaranteed by the Export Credits Guarantee Department amounted to £300 million. The balance on account of long-term private capital for investment purposes is not recorded.[8]

However, the figures relating to the change in the nominal value of the investments as well as to balance of payments transactions tend to overstate the inflow, or understate the outflow, of private investment capital since they do not reflect additions to investments in the form of reinvestment of

[5] Throughout this study, "private donations," chiefly immigrants' remittances, have been included with goods and services.

[6] In the official balance of payments statement for the United States, as published by the Department of Commerce, the profits reinvested by foreign branches of United States enterprises are included both as an income from investments and as a capital outflow; on the other hand, reinvestments by subsidiaries abroad are excluded. In the figures set out above, reinvestments by subsidiaries have been included; the amount involved is $3.6 billion. Similarly, reinvestments by foreign enterprises in the United States, amounting to $0.9 billion, have been included as a capital inflow.

[7] The nominal value of the securities sold is recorded at £444 million and the cash received at £310 million.

[8] There was an outflow of capital on account of new capital issues floated in London for oversea account of £284 million, but this was more than offset by a capital inflow resulting from the sale and redemption of investment outside the sterling area (£458 million, including £164 million on account of the sale of Argentine railway securities).

undistributed profits. Such profits, after deductions of those of foreign companies in the United Kingdom, may have amounted to about £700 million during the period 1946-1952. It seems likely, therefore, that there was during the period a considerable net outflow from the United Kingdom on account of private long-term capital.

In continental Europe, Switzerland retained its position as an exporter of private capital, derived not only from domestic savings but also from foreign funds seeking refuge from countries with less stable currencies or applying exchange control. Capital issues floated in the Swiss capital market from the end of the war to the middle of 1953 amounted to $170 million; loans granted by Swiss banks, mostly to foreign governments, equalled about $200 million; and Swiss purchases of United States securities during the period 1947-1951 amounted to $70 million.

In France a net inflow of long-term capital from countries outside the franc area, largely representing liquidation of French long-term investments abroad, is recorded in the balance of payments at $330 million during the six years 1946-1951. This figure, however, is misleading since it does not take into account capital transfers to the franc area, reinvestment of earnings by French enterprises overseas (particularly in the franc area) and capital exports escaping the exchange control. The increase in investments by private enterprises in French oversea territories recorded during the period 1947-1952 reached a sum equivalent to over $950 million.[9] From this figure would have to be deducted investments by enterprises not owned in France; further, there may have been some withdrawal of French private investments in Indochina. Everything considered, there may have been a private outflow of long-term capital during the whole period 1946-1952 approaching $1 billion. The ability of France to finance this capital export depended on an inflow of governmental loans and grants, particularly from the United States, of several billion dollars. The inflow of official funds to support the balance of payments has been on the decline, however, while the outflow of private capital to French oversea territories increased steadily in the course of the period 1947-1952.

Belgium's situation as a capital exporter is in some respects similar to that of France. Belgian reliance on United States aid has, however, been much smaller than that of France; the principal benefit derived by Belgium from such aid has been indirect, through the facilitation of triangular settlement of international payments. The Belgian payments position has been favourable, and Belgian surpluses with the European Payments Union have indirectly helped France, the United Kingdom and other countries to finance investment at home and abroad. During the early post-war years there was a heavy but declining liquidation of Belgian long-term investments abroad. Judging from the official balance of payments accounts, the capital inflow on this account totalled over $600 million during the four

[9] *Cinquième rapport de la Commission des investissements.* In this study the equivalent in dollars of amounts expressed in certain other currencies is computed only in order to facilitate comparisons. Since official exchange rates are employed, the dollar figures derived from the conversion may involve some overstatement.

years 1946-1949, a figure which does not take into account the reinvestment of profits by Belgian enterprises abroad. Since 1949, the accounts show an outward movement of private long-term capital. The principal outflow has been oriented towards the Congo. New private investments in the Belgian Congo during the period 1945-1949 have been estimated at $300 million,[10] and during the four years 1948-1951 at about $400 million, mostly raised in Belgium or obtained through reinvestment of profits by Belgian companies in the Congo.[11] Over the entire period 1946-1952 the export of private long-term capital from Belgium may have been well in excess of the withdrawals.

The traditional position of the Netherlands as an exporter of private capital was undermined by losses suffered during the war and government outlays to support the economy of Indonesia and Surinam during the early post-war years.[12] The external payments position during these years was sustained by grants and credits from the United States and other sources, deficits with the European Payments Union (until the middle of 1951) and the compulsory sale of private assets, mostly foreign currency holdings. The voluntary movement of private long-term capital during the period 1946-1951, as officially recorded, resulted in a net inflow of funds exceeding $40 million. This figure, however, does not take into account the undoubtedly considerable amounts reinvested by Netherlands companies abroad.

Sweden largely discontinued its role as a supplier of private investment capital abroad during the post-war period. Portugal has undoubtedly added to its holdings in Mozambique and Angola but appears on balance to have reduced its private oversea investments. The same seems true of western European countries other than those mentioned.

On the basis of the above short review, it appears that during the seven post-war years considered there was a net outflow of private long-term capital from the industrialized countries known as capital exporters, and referred to above, of some $11 billion (or an average of $1.5 billion annually). In estimating this figure, little account could be taken of concealed capital exports in various forms. The actual capital export may therefore be well above the amount just indicated. The great bulk of the capital came from the United States; and a considerable portion of it was absorbed by economically developed countries, such as Australia and Canada.

The amount mentioned represents the balance of inward and outward movements. The figure for the United States capital exports ($7.9 billion) is the balance of a recorded increase in foreign investments in the United States of $1.3 billion (including reinvested earnings) and an outflow of United States capital for investment abroad of $9.2 billion. Even countries which in recent years have, on balance, been capital importers have invested

[10] Organisation for European Economic Co-operation (OEEC), *Intra-European Investments* (Paris, September 1951), page 14.

[11] *Cf.* Organisation for European Economic Co-operation, *Europe—the Way Ahead* (Paris, December 1952), page 240.

[12] The "net financing of Indonesia and oversea parts of the realm" during the period 1946-1951 amounted to 1,464 million florins ($517 million).

abroad—mention may be made, for instance, of investments by Canada, Germany and Italy in Latin America, of Argentina in other Latin American countries and of Denmark in central Africa. Broad movements affecting the composition of the outstanding investments have also occurred. In general, outstanding government loans floated in international capital markets before the war have been reduced gradually through repayment under loan contracts and repurchases in the market; similarly, there has been a tendency to liquidate international investments of loan or equity capital in railways and, to some extent, in other public utilities. On the other hand, private foreign investment in extractive industries and, to some extent, in manufacturing has been on the increase.

The additions to outstanding private business investments appear recently to have been financed through the reinvestment of undistributed profits by as much as three-fourths or more. A considerable share of the capital has been absorbed by countries which have achieved a substantial degree of industrial development and are at the same time richly endowed with natural resources. Canada records a net inflow of Can. $1,129 million on account of foreign direct investment [13] during the period 1946-1952, not including reinvestment by branches and subsidiaries that, judging from partial information available,[14] was in excess of the figure just mentioned; the movement of Canadian direct investments abroad and of Canadian and foreign securities resulted in a net inflow of Can. $355 million. The balance of payments of the Union of South Africa suggests that during the same period that country absorbed the equivalent of about $1.6 billion of private long-term and short-term capital, not including reinvestment. Australia records an inflow, during the six fiscal years ending 30 June 1952, of capital for foreign direct investment equivalent to about $700 million, consisting to a large extent of undistributed income of branches and subsidiaries of oversea companies; other recorded movements of private long-term capital, including redemption and repurchase of Australian government bonds held abroad resulted in an outflow of about $400 million. However, the two figures mentioned do not include a heavy unrecorded net inflow of private capital reflected in a residual, "errors and omissions", in the balance of payments of close to $1,200 million.

Usually less prominent as capital importers but in receipt of substantial amounts of investment funds are a number of countries, particularly in Latin America, which are much less advanced industrially but are rich in natural resources. To this group belong, for instance, Brazil, Chile, Colombia, Mexico and Peru. A special case is presented by areas with abundant petroleum resources—countries such as Venezuela, Saudi Arabia and Iraq have absorbed very large amounts of private capital during the postwar period. Finally, Belgium, France and the United Kingdom have made

[13] Foreign "direct investment" or "entrepreneurial investment" represents investment in enterprises (usually branches or subsidiaries) which are controlled by enterprises in the capital exporting country. Investments in securities (usually bonds) held predominantly by investors not exercising managerial control are termed "portfolio investment".

[14] Subsidiaries of United States companies reinvested $1,039 million during the six years 1946-1951.

heavy investments for the development of the rich natural resources of their dependent territories in Africa.

Unlike the areas referred to, many of the world's over-populated regions with relatively undeveloped manufacturing industry record a net outflow of private long-term capital during the period under review. This is true, for instance, of Ceylon, India, Indonesia and Egypt. Part of this outflow represents normal amortization of outstanding government bonds; but there has also been a liquidation of equity investment, facilitated in some cases by the withdrawal of sterling balances and the realization of other assets. The recorded outflow of private long-term capital may, to a smaller or greater extent, have been counterbalanced by accretions to the foreign investments in these countries on account of unrecorded reinvestment of profits. Nevertheless, the contrast between these countries and those with more plentiful natural resources is striking. It appears that private foreign capital tends to be attracted to such resources rather than to abundant manpower.

This and other tendencies of importance in a consideration of the contribution that foreign private investment may make to the development of countries with limited capital resources are described in a brief analysis of readily available information concerning recent changes in the private foreign investments of the principal creditor nations. Attention is paid to the geographical distribution of the capital flow from these countries, the type of investments (that is, loans versus equity investment or portfolio versus direct investment) and the fields in which they are applied.

The general trend

The flow of private investment capital was not of equal volume throughout the period under review. In general, no large export of such capital occurred during 1946 and in several countries the volume of capital exports or imports tended to increase in the course of the period. This tendency is illustrated by table 1. It will be observed that the figures for different countries in this table are not comparable.

New direct United States investments abroad rose in 1947 to a level which has since then been maintained with only minor fluctuations. Outstanding portfolio investments abroad declined in 1946 but have since risen, particularly because of large purchases of Canadian securities since 1950. Aggregate exports of private long-term capital have therefore shown a tendency to increase during the period. The first series shown for the United Kingdom reflects the relative ease of the capital market during 1947-1949, following the receipt of the United States loan in 1946. It seems probable, however, that the outflow of private capital at the time largely represented short-term funds; the trend of long-term capital exports may be more accurately reflected in the capital issues for oversea account which have tended to rise over the entire period considered. French private capital investments in the French oversea territories—principally in North Africa—appear not to have reached substantial proportions until 1949 but from that year they have been large and rising. Swiss capital issues for foreign

Table 1. Trend of Outward Capital Movements, 1946–1952

Country, item and unit	*1946*	*1947*	*1948*	*1949*	*1950*	*1951*	*1952*
United States (millions of dollars):							
Direct investment abroad [a]	183	724	684	786	621	603	830
Reinvestment by subsidiaries	303	387	581	436	475	752	876
Portfolio investment abroad	−124	86	64	10	466	360	143
United Kingdom (millions of pounds sterling):							
Private long-term and short-term capital (net) [b]	−128	299	145	212	82	261	103
New capital issues for oversea account	17	33	38	42	52	50	52
Switzerland (millions of Swiss francs):							
Capital issues for foreign account	—	55	50	54	212	50	247
France (billions of French francs):							
Private investment in oversea territories [c]	...	0.2	0.4	52	69	96	106
Belgium (billions of Belgian francs):							
Net flow of private long-term capital [b]	− 11.2	− 10.8	− 4.5	− 0.8	5.0	1.4	2.1

Source: International Monetary Fund, *Balance of Payments Yearbook;* United States: Department of Commerce, *Direct Private Foreign Investments of the United States, Census of 1950* (Washington, D.C., 1953) and *Survey of Current Business*, December 1953; United Kingdom: Central Statistical Office, *Monthly Digest of Statistics;* France: *Cinquième rapport de la Commission des investissements.*

Minus sign (−) indicates inward capital movement. The series given, chosen to show the general trend of the movements of private capital in the course of the period, are not comparable with one another.

[a] Excluding reinvestment by subsidiaries.

[b] Excluding reinvested profits.

[c] Including investment owned locally or made by countries other than France.

account have shown a tendency to increase during the latter part of the period considered. In Belgium, some liquidation of foreign investments occurred during the early post-war years, but for 1950 and 1951 a net outflow of private capital is recorded even if account is not taken of the substantial reinvestment of profits by Belgian enterprises abroad. Acceleration in the growth of Belgian investments in the Congo is reflected, for instance, in the steady increase in the number of enterprises established there, from 13 in 1947 to 279 in 1952.

It appears from the figures shown that European private capital exports, hampered during the early post-war years by the necessity of using available funds for domestic rehabilitation and reconstruction, have only gradually become a factor of importance.

It was estimated above that during the period under review the average net outflow of private capital from the capital exporting countries for investment purposes exceeded $1.5 billion annually. During the last few years, however, the annual outflow may well have exceeded $2 billion. To some extent, the increase has been due to the recovery from war-time exhaustion, particularly in western Europe.

The outflow of private capital from western Europe tended to rise with the increase in production during the first post-war years and was supported by United States government loans and grants for rehabilitation purposes. The decline in United States government contributions may tend to limit the capital that can be placed abroad. On the other hand, the drain upon the resources of western Europe for the accumulation of normal stocks of goods has come to an end. Similarly, the large short-term and medium-term export credits granted by European countries, though possibly still on the increase, will sooner or later reach a stage when they become revolving, thus releasing funds which may be invested on long term abroad.

Comparison with the 1920's

It was pointed out above that the net annual outflow of private long-term capital from the industrialized countries known as capital exporters has tended to increase in the course of the post-war period and may have exceeded $2 billion during the last few years. This compares favourably with the 1930's when the principal capital exporting countries were liquidating their external assets and few under-developed countries were able to attract foreign capital. On the other hand, during the mid-1920's the capital exporting countries recorded a net capital outflow of some $2 billion annually.[15] This sum is not comparable with that for the last few years, however, for two reasons. It excludes a portion of the reinvestment of undistributed

[15] See, for instance, *Capital Movements During the Inter-war Period* (United Nations publication 1949.II.D.2), page 17. The figure includes capital of all types; the recorded net outflow of long-term capital may have been slightly less. Inter-governmental capital movements (chiefly payments among the capital-exporting countries on account of inter-allied debts) cancelled out among the countries concerned, taken as a group. On the other hand, Germany absorbed a large proportion of the capital issues for foreign account.

profits—though such reinvestment was less important at that time, in part because a larger portion of the capital outflow represented purchase of foreign government bonds. Secondly, in view of the considerable increase in the dollar prices of goods since the 1920's, it may be said that in real terms private capital exports in recent years correspond to only about half of those in the 1920's. Since populations have increased in both capital importing and capital exporting countries, the decline in the capital movement per capita has been still greater.

The pages which follow review post-war private investments as reflected in information for the chief capital exporting countries.

United States investments

On the basis of available official information, United States private capital invested abroad at the end of 1952 amounted to about $21 billion, of which $14.5 billion represented direct investments,[16] computed at book value, and $6.5 billion, portfolio investments at their market value. During the seven years 1946-1952, the recorded gross outflow of private investment capital was $9.2 billion, of which sum direct investment accounted for $8.2 billion and portfolio investment for $1 billion. These figures reflect the drastic change in the capital market since the decade following the First World War, when portfolio and direct investments appear to have been expanding at approximately the same rate. In the mid-1920's capital exports resulting from the flotation of new capital issues in the United States—chiefly in the form of dollar bonds of foreign governments, though also including some corporate issues which would now be counted as direct investment—amounted to about $1 billion annually.

United States portfolio investments are reduced each year by repayment, and increased by new securities floated for foreign account. For the period 1946-1951, amortization amounted to $1.2 billion and new securities floated to $1.5 billion. In addition, transactions in outstanding foreign securities and bank loans and other long-term capital resulted in a net increase in holdings of $0.6 billion. The regional distribution of the net increase resulting from all these transactions ($0.9 billion) is shown on page 11, in millions of United States dollars.

[16] Direct investments include investments in branches abroad of United States companies and in foreign corporations if the holding by one United States company or person amounts to 25 per cent or more of the voting stock; in some cases other criteria are used. If a foreign enterprise is defined as a direct investment, all private United States holdings of securities of that company are considered part of the direct investment; hence the figures for such investments may include some investments which are not "controlling" but of the portfolio type.

	Portfolio investment, 1946–1951 [a] Outflow of capital	Inflow of capital
Canada	493	—
Latin American republics	—	278
Western Europe	241 [b]	—
Western European dependencies	—	9
Other countries	19	—
International institutions	432	—
TOTAL	1,185	287
BALANCE	898	

Source: United States Department of Commerce, *Balance of Payments of the United States. 1949–1951.*

[a] The figures relate to movements affecting United States portfolio investments abroad and thus do not include changes in foreign portfolio investments in the United States.

[b] Including $200 million that represents a special loan transaction not indicative of conditions in the capital market.

The figure for "international institutions" reflects private subscription to bonds floated for the account of the International Bank for Reconstruction and Development; it may be assumed that the amounts involved have been or will be utilized by the Bank's lending for development purposes. It is characteristic of prevailing conditions that the remaining net outflow of funds for portfolio investment was absorbed chiefly by Canada. Underdeveloped countries, particularly in Latin America, were reducing their privately-held long-term debt to the United States during the period. The par value of new capital issues floated in the United States during the years 1946-1951 for the account of foreign governments and the Bank was as follows, in millions of United States dollars:

Belgium	16
Canada	456
Israel	50
Netherlands	12
Norway	6
International Bank for Reconstruction and Development	385
TOTAL	925

The Canadian issues were principally for provincial and municipal governments. Canadian corporate issues in the United States were also large; in the main, they represented direct investments by United States parent companies. No information is available concerning United States participation in a large number of minor issues of Canadian mining companies.

Of the capital outflow of $8.2 billion for direct investment, only about $1.9 billion appears to have represented "fresh" capital while some $2.6 billion represented the reinvestment of profits by branches of United States enterprises [17] and $3.7 billion similar reinvestment by the foreign subsidiaries of such enterprises. Again, of the $1.9 billion of fresh capital invested, a considerable proportion undoubtedly was the counterpart of machinery

[17] Estimated on the assumption that about 55 per cent of the branch profits was retained abroad (*cf.* United States Department of Commerce, *Survey of Current Business,* October 1951, page 8).

and equipment imported into the country of investment by the enterprises concerned. Hence, a relatively small proportion of the total addition to United States direct investments abroad was transferred through foreign exchange markets.

Tables 2 and 3 show the movement of United States direct investment capital during the period 1946-1951 by regions and by industries. The book value of investments outstanding at the end of 1951, computed in accordance with the census of United States direct investment abroad in 1950, after addition of the recorded capital outflow during 1951, has been entered in the last column of both tables. Of the capital outstanding at the end of 1951, approximately half appears to have been invested during the six preceding years. To some extent, however, such a comparison tends to overstate the relative importance of post-war additions to the investments. If the capital movement (including reinvestment of profits) had been the only factor influencing the value of outstanding investments, that value would have been appreciably higher than recorded, for a sum of $1.7 billion was written off between 1943 and 1951 on account of war losses, currency devaluations and other factors. Moreover, physical assets represented by post-war investments have generally been booked at higher values than those of investments made when prices were lower.

Canada and western Europe together absorbed 40 per cent of the total capital outflow; of the less developed regions, Latin America received almost as much (38 per cent).

Among the principal industrial groups, petroleum extraction and related activities (refining, transportation, distribution) accounted for no less than 45 per cent of the capital outflow and manufacturing for 32 per cent. Manu-

Table 2. United States: Direct Investments, by Region

(Millions of United States dollars)

Region	*Capital outflow, 1946–1951*			*Capital outstanding, end of 1951*
	Capital flow [a]	*Reinvestment of subsidiaries*	*Total*	
Canada	783	1,039	1,822	4,078
Latin America	1,629	864	2,493	5,174
Western Europe [b]	297	503	800	1,890
Western European dependencies	170	131	301	438
Other European countries	22	29	51	49 [c]
Other regions	781	287	1,068	1,498
TOTAL	3,682	2,853	6,535	13,127

Source: United States Department of Commerce, *Balance of Payments of the United States, 1949–1951* (Washington, D. C., 1952); *Survey of Current Business*, September 1952; *Direct Private Foreign Investments of the United States, Census of 1950.* Investments in eastern Europe and China are excluded.

[a] Including reinvestment by branches.

[b] Countries in the Organisation for European Economic Co-operation (OEEC), including Greece and Turkey.

[c] Including Spain, 31; Finland, 9; Liechtenstein, 1.2; and Yugoslavia, 0.5.

facturing, in contrast with other industries, derived the great bulk of the new capital from the reinvestment of profits of subsidiaries. Most of the manufacturing enterprises abroad are organized as subsidiaries.

Table 3. United States: Direct Investments, by Industry

(Millions of United States dollars)

Industry	*Capital outflow, 1946–1951*			*Capital outstanding, end of 1951*
	Capital flow [a]	*Reinvestment of subsidiaries*	*Total*	
Public utilities	– 70	51	–19	1,417
Agriculture	82	87	169	629
Petroleum [b]	2,313	644	2,957	3,780
Mining and smelting	260	139	399	1,305
Manufacturing [c]	456	1,619	2,075	4,336
Trade	283	275	558	907
Miscellaneous	358	38	396	753
TOTAL	3,682	2,853	6,535	13,127

Source: See table 2.

[a] Including reinvestment by branches.

[b] Including refining, transportation and distribution of petroleum and petroleum products.

[c] Excluding petroleum refining and metal smelting.

Mining and plantation agriculture, in which, until the mid-1940's, more private capital had been invested than in petroleum, absorbed only 9 per cent of the capital outflow; in relation to outstanding capital as well, investment in these industries lagged.[18] There was, on balance, a small withdrawal of capital invested in public utilities, resulting from liquidations not fully offset by new investment. Between 1943 and 1950—the years of the last two censuses of United States direct investments abroad—the share of utilities in the total of such outstanding investments fell from 18 to 12 per cent.

As table 4 shows, post-war investments in the petroleum industry, though naturally largest where petroleum is extracted (Canada, Venezuela and the Persian Gulf area), are spread among all the groups shown since they include enterprises engaged in refining and distribution.

The figures for manufacturing investments in the same table show that the capital outflow has not taken place principally to countries which lag behind in manufacturing. Canada and Europe together account for over 70 per cent of the post-war investments in this field. In Canada, the pulp and paper industries, which have traditionally been the principal object of United States investment, have received only a fraction of United States post-war capital. One reason for the heavy United States investment in a wide range of Canadian manufacturing industries is the system of tariff preferences which has rendered it profitable to manufacture in Canada for export to other Commonwealth countries. The same factor has contributed to the expansion of manufacturing investments in the United Kingdom. When

[18] As to the lag in mining investments, see page 34.

Table 4. United States: Outflow of Capital for Direct Investment, by Industry and Region, 1946–1951
(Millions of United States dollars)

Industry	*Canada*	*Latin American republics*	*Western Europe*	*Western European dependencies*	*Other countries*	*Total*
Public utilities.....	– 41	1	—	—	21	–19
Agriculture.......	6	148	—	–1	16	169
Petroleum [a].......	559	1,194	214	268	722	2,957
Mining and smelting	207	157	2	3	30	399
Manufacturing [b]...	878	587	423	12	175	2,075
Trade [c]...........	96	261	88	16	97	558
Miscellaneous.....	117	145	73	3	58	396
TOTAL	1,822	2,493	800	301	1,119	6,535

Source: See table 2. Including reinvested earnings of subsidiaries as well as branches. Minus signs indicate net inflow of capital.

[a] Including refining, transportation and distribution of petroleum and petroleum products. Under this heading also appears to be included the bulk of the sale of ships (chiefly tankers) to foreign flag operators controlled in the United States, recorded as follows, in millions of dollars: to Panama, 285; to other Latin American republics, 41; to Liberia, 75; and to other countries, 8.

[b] Not including petroleum refining and metal smelting.

[c] Not including petroleum distribution.

the enterprises concerned do not work for export, a substantial market is usually required for efficient production of the type of large-scale manufacturing in which foreign-controlled enterprises are engaged; this, again, has tended to attract manufacturing investments to industrialized countries.

Nevertheless, the Latin American republics attracted close to $600 million of United States capital for investment in manufacturing during the years 1946-1951. The investments, though absorbed chiefly by a few countries, were widely distributed among enterprises engaged in the production of food, chemicals, rubber, electric machinery, motor vehicles and similar products.

United States manufacturing investment in the last geographical group shown in the table, "other countries", increased by $175 million during the period shown. The bulk of this sum appears to have been placed in Australia and the Union of South Africa.[19] Investments in the manufacturing industries of the typical under-developed countries in this group were therefore relatively small.

Table 5 gives figures for total outstanding United States direct investments in 1943 and at the end of 1950 (the dates of the two last censuses taken), by countries, the object being to show to what extent individual under-developed countries have been receivers of investment capital. Attention is called to the fact that the changes in outstanding capital do not reflect

[19] From 1943 to the end of 1950, United States manufacturing investments in Australia are reported to have increased from $48 million to $98 million, and in the Union of South Africa from $11 million to $44 million.

Table 5. United States: Direct Investments, by Country, 1943 and 1950
(Millions of United States dollars)

Country	*May 1943*	*End of 1950*	*Increase, or decrease (−)*
United Kingdom	519	847	328
Continental western Europe	1,267	873	−394
Canada	2,378	3,579	1,201
Australia	114	201	87
New Zealand	14	25	11
Union of South Africa [a]	50	140	90
Argentina	380	356	−24
Brazil	233	644	411
Chile	328	540	212
Cuba	526	642	116
Mexico	286	415	129
Panama	110	348	238
Venezuela	373	993	620
Other Latin American republics	485	797	312
India and Pakistan	41	46 [b]	5
Philippines	95	149	54
Indonesia	... [c]	58	...
Egypt	17	39	22
Israel	6	15	9
Liberia	18	82	64
United Kingdom dependencies [d]	93	297	204
Other European dependencies in Africa	17	43	26
Other countries	212 [e]	659	447 [e]
TOTAL	7,562 [f]	11,788	4,226

Source: United States Department of Commerce, *Direct Private Foreign Investments of the United States, Census of 1950.* The following statement is made concerning the figures for 1950: "The coverage is believed to be virtually complete, at least as far as major investors are concerned. Probably the only significant omissions are relatively small business enterprises, especially in Canada and Mexico, owned by individuals; the omission of even a large number of such enterprises would not seriously affect the dollar totals."

[a] Including South West Africa.

[b] Including India, 38 and Pakistan, 8.

[c] Indonesia is included with "other countries".

[d] Areas other than those in the Western Hemisphere and in Africa account for 30 in 1943 and 190 in 1950, the increase being due largely to petroleum investments in the Middle East.

[e] The increase is due largely to petroleum investments in Saudi Arabia.

[f] Not including eastern Europe (259) and China (41), for which figures relating to 1950 are not available.

capital movements alone but also changes in book values due to other factors. War losses are likely to account for the bulk of the reduction in investments in western Europe. Investments in Argentina fell off between the two years on account of the liquidation of public utility holdings and other factors. The proportionately large increase in investments in Panama, as well as that in Liberia, is due to the incorporation in these countries of shipping companies which have only a limited connexion with the local economy. Petroleum accounts in large part for the considerable increase in investments in Venezuela, United Kingdom dependencies and some countries not specified in the table. The investments in India and Pakistan were small and increased little during the period. On the whole, United States direct investments in under-developed countries outside Latin America have been confined largely to the petroleum industry and to countries such as the Philippines having close relations with the United States.

The income from United States direct investments abroad, after taxes payable to foreign governments, has in the past few years been about $2 billion annually (of which about half was not distributed but reinvested). In 1950 such income amounted to $1.8 billion, or about 15 per cent of the total book value of the outstanding capital of $11.8 billion.[20] For various reasons, however, comparison between income and book value during any recent year overstates the profitability of the investment. Thus, the fixed assets which, if finance and insurance are disregarded, represent on the average about 40 per cent of total investment, are usually booked at original cost and not at replacement value, which is considerably higher in view of the increase in prices during recent years; other accounting practices as well have tended to keep book values at a very low level. Also, the overhead costs of the parent corporation on account of their branches and subsidiaries abroad are not always charged to the latter.

The profitability of foreign direct investment in several branches of industry has been sustained by the general prosperity of the last few years. In particular, this applies to the petroleum industry, which has profited from exceptionally high world requirements of petroleum products, and to manufacturing, which has been supported by an unprecedented demand for consumer goods as well as capital goods in many countries. In some under-developed countries high rates of return in manufacturing reflect the protection afforded by import restrictions and the high profits generally prevalent under inflationary conditions. Given the high yield of business investments in recent years within the United States, capital would hardly have been attracted from that country by foreign ventures unless profits had been high. It is worthy of note that in the only industrial group not showing a net outflow of United States capital during the period under review, namely public utilities, earnings were very low—in 1950, 4.3 per cent of the book value of investments. The reasons for this are considered below.

United Kingdom investments

Details concerning the movement of United Kingdom oversea investments may be derived from reports published periodically by the Bank of England. As mentioned above, the figures in question relate to investments of United Kingdom residents through the medium of securities quoted on or known to the London Stock Exchange. They thus do not include various investments in "private ventures". They refer to "nominal" values and do

[20] The corresponding income from areas other than Canada and western Europe was $1.1 billion, about 17 per cent of a book value of outstanding capital of $6.5 billion.

not reflect additions to invested capital through the reinvestment of undistributed profits, nor the increase since the 1930's in prices and hence in the value of physical assets. Investments in companies operating both in the United Kingdom and abroad are omitted; this excludes "many important commercial companies", all insurance companies and all shipping companies. These limitations greatly influence the computation; in particular, the omission of information on the reinvestment of profits may account for the fact that the figures show a reduction in total investment outstanding over the period 1946-1951.[21] In spite of their incompleteness, however, the figures reflect some of the tendencies encountered during the period.

Table 6. United Kingdom: Oversea Investments, 1946–1951

(Nominal values, in millions of pounds sterling)

Note: The reinvestment of undistributed profits is not included, and the figures are also incomplete in certain other respects (see text).

Item	*Outstanding at the end of*		*Increase, or decrease (−)*
	1945	*1951*	
Government and municipal loans	903.7	768.8	−134.9
Companies registered in the United Kingdom:			
Share capital	756.2	568.6	−187.6
Loan capital	265.6	88.6	−177.0
TOTAL	1,021.8	657.2	−364.6
Companies registered abroad:			
Share capital	312.5	388.0	75.5
Loan capital	179.1	171.1	− 8.0
TOTAL	491.6	559.1	67.5
TOTAL INVESTMENTS	2,417.1	1,985.1	−432.0

Source: Bank of England, *United Kingdom Oversea Investments, 1938 to 1948* and subsequent issues. Account should be taken of the fact that the holdings were revalued in connexion with the devaluation of sterling in 1949; without this revaluation the decline in total investments would have been £516 million instead of £432 million. The difference of £84 million is distributed as follows: United States domestic securities, £34 million; Canadian domestic securities, £12 million; dollar securities of other countries and other currency securities, £38 million.

The movement of investments according to the groups recorded is shown in table 6. Investments in government and municipal loans, according to this table, fell off by 15 per cent during the six years covered and business investments—a term which may be used to represent the remaining investments—dropped 20 per cent.[22] However, while the former percentage

[21] Figures for the end of 1952 are not available.

[22] The term "direct investments" is generally not used in United Kingdom statistics. The amount of private investment that does not involve control of the enterprises concerned may well occupy a larger proportion of business investments abroad than is true of such investments originating in the United States. Investments in "companies registered in the United Kingdom" correspond broadly to United States investments in foreign branches of United States enterprises, and investments in "companies registered abroad", to United States investments in the foreign subsidiaries of United States companies.

undoubtedly represents a fall in the holdings of oversea government bonds, the latter fails to take account of additions to business investments through the reinvestment of profits. Of the recorded decline of £365 million in the share and loan capital of companies registered in the United Kingdom, 93 per cent is accounted for by the liquidation of oversea railway properties; the increase in the capital of companies registered abroad relates principally to investments in petroleum production and gold mines.

As table 7 shows, the reduction in outstanding private investments in government and municipal loans is due to repayment of debt by some Commonwealth countries (Australia, Canada and New Zealand)[23] and by Latin American countries (principally Argentina and Brazil). The debt repayment of the former countries obscures a strong tendency to confine new capital issues for oversea public authorities to Commonwealth countries. This tendency is illustrated by the following figures for such issues (not including refunding and conversion issues), computed at the price of issue, in millions of pounds sterling:

	1946	*1947*	*1948*	*1949*	*1950*	*1951*	*1952*
Commonwealth countries..	—	8.9	8.2	21.2	28.2	27.7	33.1
Other countries..........	—	—	—	1.2	—	5.4	—

Source: United Kingdom Central Statistical Office, *Monthly Digest of Statistics*, July 1953.

Over the period shown, only 5 per cent of the issues were absorbed by non-Commonwealth countries. Judging from table 7, British central Africa and the Union of South Africa were the principal Commonwealth borrowers.

Table 8 shows to what extent business investments were made in companies operating in Commonwealth countries and elsewhere. Some of the enterprises concerned cannot be classified according to country of operation; the amounts involved are entered as unclassified investments.

It will be observed that the nominal capital of the companies operating in Commonwealth countries remained practically stable during the period. A large increase in investments in the Union of South Africa was more than offset by the liquidation of holdings in Canada and British central Africa. The decline recorded for the latter territory is due largely to the acquisition in 1947 by the Government of Southern Rhodesia of the Rhodesia Railways. A loan was raised in London to finance the purchase—a fact which explains part of the increase in United Kingdom holdings of government loans of British central Africa, as shown in table 7.

Recorded business investments outside the Commonwealth fell off by as much as £310 million, or 40 per cent. The great bulk of the decline relates to the acquisition in 1948 by the Argentine Government of British-owned railways in that country. The sale of railway properties and other British-owned public utilities to the governments of other Latin American countries, particularly Brazil and Uruguay, account for part of the remaining decline. On the other hand, investments in the United States rose by 37 per cent.

[23] Repayment of India's government debt had taken place before 1945.

Table 7. United Kingdom: Government and Municipal Loans, 1946–1951
(Nominal values, in millions of pounds sterling)

Area	Outstanding at the end of 1945	Outstanding at the end of 1951	Increase, or decrease (–)
Commonwealth countries:			
Australia	374.0	300.8	– 73.2
New Zealand	96.3	52.4	– 43.9
Canada	40.1	14.1	– 26.0
Union of South Africa	20.9	33.0	12.1
British central Africa	11.7	59.2	47.5
Other areas	53.4	49.1	– 4.3
TOTAL	596.4	508.6	– 87.8
Other areas:			
Europe [a]	132.0	135.1	3.1
Latin America	99.1	42.7	– 56.4
China	33.3	33.3	—
Japan	40.6	40.7	0.1
Other countries [b]	2.3	8.4	6.1
TOTAL	307.3	260.2	– 47.1
ALL COUNTRIES	903.7	768.8	–134.9

Source: See table 6.
[a] Including Ireland in both the years shown.
[b] Including Burma in both the years shown.

The nominal value of investments in most of the listed countries in south and south-east Asia, both inside and outside the Commonwealth, has declined. In particular this is true of India, Pakistan, Burma and Indonesia. The investments in Malaya show a small increase, probably representative of only a fraction of the actual addition to investments that has taken place, largely through the reinvestment of profits. It will be observed that the Colombo Plan, covering the period 1951-1956, assumes a considerable flow of private capital for development of the area in addition to the sums expected to become available through official financing (withdrawal of sterling balances, inter-governmental transfers and loans from the International Bank for Reconstruction and Development).[24]

Table 9 gives available information relating to investments, by groups of activity and by countries in which the companies are registered.[25] The principal change—the heavy liquidation of the railway investments of British companies operating in Latin America—has been referred to already. The tendency towards decline in other public utilities is tempered by an increase in investments in the United States, owing largely, however, to the revaluation of dollar investments after the depreciation of sterling in 1949. The most important group shown, "industry, commerce, etc.", shows

[24] See pages 30 and 31.
[25] Information as to the distribution of investments in various industries by countries of operation is not available.

Table 8. United Kingdom: Distribution of Oversea Business Investments by Region, 1945 and 1951

(Nominal values, in millions of pounds sterling)

Country of operation	Outstanding at the end of 1945	Outstanding at the end of 1951	Increase, or decrease (–)
Commonwealth countries:			
Australia	55.5	61.5	6.0
New Zealand	10.2	11.4	1.2
Canada	167.5	142.0	– 25.5
Union of South Africa	90.1	128.7	38.6
British central Africa	58.0	37.2	– 20.8
Other British Africa	53.4	54.7	1.3
Ceylon	21.4	22.6	1.2
India and Pakistan	77.1	66.4 [a]	– 10.7
Malaya	62.0	64.4	2.4
British West Indies	13.1	20.1	7.0
Other areas	5.2	2.4	– 2.8
TOTAL	613.5	611.4	– 2.1
Other countries:			
European countries [b]	72.1	64.2	– 7.9
United States	88.0	120.6	32.6 [c]
Egypt	3.3	9.3	6.0
Argentina	297.8	35.7	–262.1
Brazil	67.9	30.6	– 37.3
Chile	30.4	20.2	– 10.2
Peru	23.0	22.0	– 1.0
Uruguay	17.5	1.3	– 16.2
Rest of South America	27.1	26.6	– 0.5
Cuba	26.0	24.0	– 2.0
Mexico	43.1	36.2	– 6.9
Central America	4.0	4.3	0.3
Burma	15.7	10.0	– 5.7
China	3.2	2.3	– 0.9
Indonesia	22.6	20.3	– 2.3
Japan	5.1	5.3	0.2
Other countries	22.7	24.6	1.9
TOTAL	769.5	457.5	–312.0
Unclassified investments	130.4 [d]	147.4	17.0
WORLD TOTAL	1,513.4	1,216.3	–297.1

Source: See table 6. The figures refer to the total of share and loan capital.

[a] Including Pakistan, 8.7.

[b] Including Ireland in both the years shown.

[c] Increase due to the revaluation of holdings following the depreciation of sterling in 1949.

[d] Including Iran, 33.8; the corresponding figure for 1951 is not available.

Table 9. United Kingdom: Outstanding Oversea Business Investments, by Industry Group and Country of Registration, 1945 and 1951

(Nominal values, in millions of pounds sterling)

Industry group	*United Kingdom*		*United States*		*Other countries*	
	1945	*1951*	*1945*	*1951*	*1945*	*1951*
Railways	405.7	65.1	15.7	15.2	141.0	131.3
Other public utilities	83.3	71.1	19.8	32.5	63.6	56.3
Finance	123.1	107.7	6.2	4.0	39.3	37.0
Industry, commerce, etc.	404.5	408.6	45.1	66.8	158.9	205.2
Plantations	117.3	118.5	...	...	0.1	—
Gold mining	37.3	30.5	...	...	39.5	59.3
Other mining [a]	67.8	66.7	...	...	17.6	20.0
Petroleum	109.0	117.0	...	...	13.9	35.1
Other industries	73.0	75.9	...	...	87.8	90.8
Unclassified	5.2	4.6	—	—	1.8	11.0
TOTAL	1,021.8	657.2	86.8	118.4	404.8	440.7

Source: See table 6. The figures refer to amounts outstanding at the end of the years indicated.

[a] Iron and coal production is included with "other industries".

an increase which is due principally to gold mining and petroleum. The increase in both these fields is accounted for by companies registered in "other countries". To some extent the shift from companies registered in the United Kingdom to those registered elsewhere may be attributed to the more favourable position of the latter from the point of view of taxation.

Investments in manufacturing are not shown separately, but it is obvious from the figures given that they represent only a minor share (less than a fifth) of the total, and that there cannot have been a large increase in the nominal capital of the manufacturing companies during the period considered. Moreover, there is reason to believe that a large proportion of the manufacturing is located in economically developed countries, such as Australia, Canada, the Union of South Africa and the United States, and that part of British-controlled manufacturing in under-developed countries consists of processing primary products for export rather than producing for the local market.

As was mentioned above, the quoted Bank of England figures for business investments do not include additions to outstanding amounts through the reinvestment of profits; it was suggested that if account were taken of these reinvestments, there would have been a net outflow of private long-term capital from the United Kingdom. Over the whole period 1946-1952, the interest and dividends paid on account of United Kingdom investments in companies operating abroad amounted to about £735 million, of which almost two-thirds was paid by companies registered in the United

Kingdom;[26] in addition the latter companies paid an estimated £500-600 million in taxes in the United Kingdom. If the ratio of undistributed to distributed profits were the same for British business investments abroad as for all British-registered companies, operating at home as well as overseas,[27] reinvestment overseas, after allowance for profits transferred to the United Kingdom for investment there and for other factors, would be perhaps £850 million.[28]

So far as can be judged from available information, manufacturing has absorbed more than its share of reinvested profits—a tendency which was observed also in the case of the foreign investments of the United States. Relatively large amounts appear to have been reinvested in industrially developed countries in which British capital has entered into manufacturing, particularly in Australia, the Union of South Africa and the United States. Thus, according to the official balance of payments statements for Australia, unremitted profits of foreign branches and undistributed income of subsidiaries of foreign companies in Australia during the seven years 1946-1952 totalled £A106 million, of which £A35 million accrued to the dollar area. Branches and subsidiaries of United Kingdom companies may have accounted for about nine-tenths of the remaining £A71 million (equal to £57 million sterling).

Large amounts of undistributed profits have, however, been reinvested in extractive industries, particularly petroleum production. Investment overseas by British petroleum companies for the expansion of productive capacity and for pipelines during the three years 1947, 1948 and 1949 alone amounted to about £120 million.[29] Judging from information available for one such company and its subsidiaries, the corresponding figure for the period 1946-1951 is likely to have exceeded £200 million—a figure which may be compared with the increase in the nominal share and loan capital of British oversea petroleum investment, as recorded by the Bank of England, of £39 million.

Swiss investments

Swiss capital exports have been sustained by foreign funds as well as domestic savings. Foreign capital flotations were resumed in 1947. During

[26] Measured as a percentage of the nominal capital outstanding, the remitted income has recently been higher than before the war, owing in part to the fact that a large proportion of the less profitable investments were disposed of during and immediately after the war. The largest returns are recorded for mining and petroleum and the lowest (as in the case of the United States) for public utilities.

[27] During the period 1946-1952, the annual average of undistributed income after taxation of these companies represented 136 per cent of the income distributed in the form of dividends and interest.

[28] This figure does not take into account additions to the value of the investments that have been financed, not by book profits, but by writing down the book value of physical assets at a more rapid rate than actual depreciation. On the other hand, some part of the undistributed profits may not have been reinvested but kept on deposit abroad.

[29] *Cf. Economic Survey for 1951*, Cmd 7649, pages 50 and 51. The total capital expenditure was recorded at £240 million, of which about half was required for the maintenance of production and the remainder for expansion.

1947-1952 the public bought sixteen issues totalling 667 million Swiss francs ($155 million), distributed as follows (in millions of Swiss francs):

Belgium	250
Other western European countries	60
Union of South Africa	135
Belgian Congo	120
International Bank for Reconstruction and Development	100
Peru	2
TOTAL	667

The amount raised by Belgium was largely for government-owned public utilities. The Belgian Government also guaranteed the Congo loans. The Government of the Union of South Africa obtained 60 million Swiss francs of the 135 million going to that country; an investment trust and one other private enterprise accounted for the remaining 75 million.

Foreign capital issues tended to rise in the course of the period. This trend partly reflected the growing accumulation of capital and the scarcity of suitable domestic investment objects. The effective yield of Belgian Congo bonds, for instance, in 1953 fell below 4 per cent, but even this relatively low rate was attractive compared with domestic yields of 2.5 per cent or less.

Besides foreign loans floated in the market, there were large bank loans, extended mostly to European governments. These loans sometimes served special purposes, such as to increase Swiss exports, to guarantee supplies of certain import goods at favourable prices or to relieve the Swiss surplus position in the European Payments Union.

Swiss direct investments, though not statistically verifiable, are known to have been active and to have flowed through industrial holding companies and investment trusts. The convertibility of the Swiss franc naturally facilitated the choice of investment.

French investments

In the absence of other statistical information as to the nature of French investments abroad, reference may be made to the distribution of the market value on the Paris Stock Exchange of shares of companies operating in French oversea territories. The totals at the end of the years 1945 and 1949 are as follows:

	Billions of French francs		*Equivalent in millions of United States dollars*	
	1945	*1949*	*1945*	*1949*
Indochina	23.4	25.0	196	72
North Africa	23.8	67.3	199	193
Elsewhere	25.6	56.1	215	161

Source: Ministère de la France d'Outre-Mer, *La monnaie et le crédit dans les Territoires d'outre-mer, 1950*, tables 50 and 52.

The shares by no means represent aggregate French investment in the territories and the figures afford only some indication of tendencies affecting the investments. The decline in the computed dollar value should not be taken as an indication of capital withdrawal (except possibly to some extent in Indochina), but of the failure of the franc value of the securities in question to rise in proportion to the depreciation of the French franc. While the exchange value of the dollar in terms of French francs at the end of 1949 was 292 per cent of that at the end of 1945, the corresponding indices of share quotations were 122 per cent for companies in Indochina, 158 per cent for those in North Africa and, on the average, less than 150 per cent for those in other French territories.

The franc value of Indochina shares rose so little because of the smaller area of rubber plantations. The franc value of other such shares rose during the period by over half. Political conditions in Indochina have hampered economic development and occasioned some capital withdrawals.

The percentage distribution of the total value by groups of industries was as follows:

	1945	*1949*
Public utilities	4.0	3.4
Agriculture	22.5	10.9
Mining and other extractive industries	29.7	36.5
Manufacturing	13.8	14.5
Trade	15.3	16.9
Banking	8.5	10.7
Miscellaneous	6.2	7.1
TOTAL	100.0	100.0

The heavy decline in the share of agriculture, owing to the smaller area under rubber in Indochina, has naturally tended to raise the percentages for the other groups. Nevertheless, the share of public utilities, which was remarkably small in both the years shown and even in 1938 was only 5.3 per cent, declined, in agreement with tendencies observed elsewhere. The share of manufacturing did not increase greatly during the four years covered but was substantially higher than in 1938 (8.8 per cent). Most of the territories were still in early stages of industrial growth. Almost all the manufacturing establishments covered by the statistics were engaged in the production of cement and the processing of foodstuffs.

BELGIAN INVESTMENTS

Available information concerning corporations operating mainly outside Belgium throws some light on investments in the Belgian Congo. The combined share and reserve capital of such corporations, registered in Belgium or the Congo, was as follows in 1947 and 1952:

	Millions of Belgian francs		*Equivalent in millions of United States dollars*	
	1947	*1952*	*1947*	*1952*
Corporations operating mainly in:				
Belgian Congo	9,617	27,694	219	554
Elsewhere	5,184	6,415 [a]	118	128 [a]

Source: Annuaire Statistique de la Belgique et du Congo Belge. This is also the principal source for other figures given in the remainder of the section.

[a] 1951; the figure for 1952 is not available.

While these figures, as those shown for France, are far from comprehensive, they clearly indicate that Belgian business investments abroad were oriented principally towards the Congo.

The net profits earned by the corporations operating in the Belgian Congo during the six years 1947-1952 totalled 20.7 billion Belgian francs ($430 million). The profits increased rapidly in the course of the period; thus, of the amount just mentioned, 6.7 billion francs was earned in 1952 alone. Of the net profit, 12 billion francs ($250 million) was distributed to shareholders while the bulk of the remaining 8.7 billion ($180 million) was probably added to share capital and reserves. The reinvestment of undistributed profits was thus considerable, but it is not possible on the basis of the figures quoted to indicate its share in the expansion of the capital of the companies.

The recorded distribution by industry of the aggregate share and reserve capital of the corporations was as follows, in billions of Belgian francs, in 1947 and 1951 (1952 figures are not available):

	1947	*1951*
Transportation	3.29	3.59
Agriculture	0.97	2.64
Mining and manufacturing	3.76	11.72[a]
Trade	0.45	1.22
Finance	0.37	1.61
Miscellaneous	0.78	0.87
TOTAL	9.62	21.65

[a] Mining 7.02; manufacturing 4.7.

Transportation—the only public utility represented—accounted for a third of the capital in 1947 but for only 17 per cent in 1951. This rapid decline in relative importance was possible because of investment in public utilities by public funds. Thus, Belgian budgetary allocations for investment in one public enterprise alone (*Office des Transports Coloniaux*) amounted to 9 billion francs during the period 1949-1952. The capital of corporations engaged in agriculture increased during the period from 10 to 12 per cent of the total and that in mining and manufacturing from 39 to 54 per cent. Part of the last-mentioned expansion was accounted for by the *Union Minière du Haut-Katanga*, which, by the end of 1952, had a total share and reserve capital of $120 million and assets with a book value of close to $300 million; its profits during the year equalled $60 million. Part of the company's assets consist of installations for the generation of electric energy used in metal production. Manufacturing, which was stimulated during the war by the discontinuation of imports from Europe, accounts for a considerable share of the capital and appears to have made more progress than in other African dependent territories. It is also more diversified; it includes, for instance, rapidly expanding textile production. Total manufacturing trebled in volume between 1939 and 1947, and doubled between 1947 and 1951.

Large investments by public authorities in utilities, and high prices of copper and other products of the Belgian Congo, have contributed to render investments there relatively profitable. Thus, net profits of corporations operating mainly in the Congo averaged 16.2 per cent of their combined share and reserve capital during the years 1947-1951, as against 7.2 per cent for corporations operating in Belgium.

Canadian investments

On balance, Canada has imported private investment capital during the post-war period. Foreign private investments in Canada are reported to have risen from the end of 1945 to the end of 1951 by Can. $2,397 million and Canadian private investments abroad by only Can. $428 million. The last-mentioned sum is the balance of a net liquidation of portfolio investments of Can. $12 million and an increase in direct investment of Can. $440 million. All the figures quoted represent book values and include additions resulting from the reinvestment of profits.

The regional distribution of Canadian private investments at the beginning and the end of the period was as follows (in millions of Canadian dollars):

	Outstanding at the end of 1945	*Outstanding at the end of* 1951	*Increase, or decrease (−)*
United Kingdom	54	74	20
Other Commonwealth countries	69	88	19
United States	455	906	451
Other countries	142	92	−50
TOTAL	720	1,160	440

Source: Canada, *The Canadian Balance of International Payments in the Post-War Years, 1946–1952* (Ottawa, 1953).

Canadian capital, according to these figures, went principally to the United States. It was absorbed chiefly by industrial and commercial enterprises, but a minor portion went into public utilities and mineral production. Little Canadian capital appears to have been invested in under-developed countries.

CHAPTER 2

NATURE OF THE FLOW OF CAPITAL

The main tendencies

The main tendencies which emerge from the preceding chapter may be summarized as follows:

(*a*) The floating in international capital markets of foreign government bonds, once so important in international financing, is now limited to special cases of loans between countries maintaining close commercial or political relations with each other.

(*b*) Similar floating of shares and debentures of business enterprises, and trade in outstanding securities, have also declined to minor importance, except when the transactions are related to so-called direct investments, involving managerial control through enterprises in the investing country. Such investments accordingly account for the great bulk of private long-term capital moving between countries.

(*c*) The growth of direct investments does not result principally from the transfer of fresh funds from the capital exporting countries, but from the reinvestment of a large proportion of the profits earned.

(*d*) Under-developed countries in Latin America derive most of their inflow of foreign private capital from the United States, and dependent territories from their respective metropolitan countries in western Europe. (This does not apply to investments in the petroleum industry.) Relatively little capital is flowing to the independent countries in south-eastern Asia.

(*e*) There is no flow of private capital to countries with centrally planned economies in eastern Europe and Asia.

(*f*) New private foreign investments in public utilities have been more than offset by the liquidation of such investments, particularly in railway properties; the outstanding amount of such investment has accordingly tended to decline.

(*g*) The petroleum industry accounts for a large proportion of foreign direct investments in recent years.

(*h*) In other extractive industries, foreign direct investment has expanded, particularly in the dependent territories of western European countries.

(*i*) Most of the foreign direct investment in manufacturing has been made, not in under-developed, but in economically advanced countries.

Nevertheless, certain Latin American countries have received considerable amounts of United States capital for investment in manufacturing.

Some of these tendencies are further analysed below.

Direct versus portfolio investment

The public flotation of foreign government bonds in the leading capital markets, in the 1920's perhaps the most important international investment activity, has since then been on a small scale and is now confined to special cases of limited importance. The London market is still open to countries in the Commonwealth, but in spite of small flotations for their account, the gradual liquidation of earlier loans has tended to reduce the sterling debt of the Commonwealth as well as of other areas. Some Swiss loans for foreign account have also been floated—partly, it appears, with the aid of capital seeking refuge from weak currencies.

A similar reduction has taken place in the flotation of foreign business securities for public subscription. International business investments of the portfolio type are still being made in some countries; to this category belong, for instance, the purchases of shares of United States enterprises by European funds attracted to New York, or of Canadian shares by the United States public. The orientation and nature of the capital movements involved indicate that individual investors are anxious to avoid losses resulting from monetary or other economic policies pursued by the countries of investment but do not shun business risks proper. The net outflow of capital of this kind to under-developed countries appears to be small.

While portfolio investments have thus shrunk, the capital outflow since the war has been reflected largely in entrepreneurial or direct investments. The investors are corporations, are relatively few in number, and the investments are in the form of branches or subsidiaries under managerial control of the parent firm. Such investments, particularly in under-developed countries, are not a new phenomenon; what is new is their growth in relative importance and in absolute terms. One—but not the only—reason for this development is the difficulty which an individual experiences in attempting to appraise the effect of government policies and other institutional factors upon holdings of foreign securities.

Public utilities

A break with the past is the reduced role of private capital exports for investment in railways and public utilities in general. As to railways, which in the second half of the nineteenth century formed one of the principal objects for international investment (chiefly by British capital), the decline is of long standing. The completion of principal railway lines and other factors have greatly reduced the need for railway construction. At the same time there has been a tendency for governments to acquire public utilities, particularly railways, from foreign investors. United Kingdom investors, who during the First World War had sold off the bulk of their railway investments in the United States, liquidated additional investments of this type during the 1930's, particularly in India, where the railways were taken over by the Government. Since the war the liquidation of British railway properties, particularly in Argentina but also in other Latin American countries and elsewhere, has continued. The debtor countries have financed the purchases by means of sterling claims accumulated during the war or the early post-war years. (In Southern Rhodesia, a purchase was financed by a loan raised in London.) As a general rule British railway investments, particularly in Latin America, have in recent decades ceased to be remunerative.

In most countries, whether industrialized or not, the need for the expansion of public utilities other than railways has continued unabated. During the early decades of the present century, foreign investments were made, for instance in the generation and distribution of electric energy, by enterprises not only of British but also of United States and other origin. For reasons which will be discussed in a subsequent page, this industry has of late failed to attract much foreign private capital. Its expansion, however, is acknowledged as a prerequisite for economic development in general, and it demands heavy capital investment as well as large imports of foreign equipment by most under-developed countries.[1]

Many public utilities cannot easily be remunerative enterprises and have always been financed and maintained by public authorities. This is true, for instance, of highways and streets, and usually of water and sewer systems, port facilities and the like. For the financing of such utilities before the 1930's, governments in under-developed countries frequently had recourse to loans in international capital markets. With the virtual collapse of these markets, governments have frequently found the financing of public utilities difficult, the more so because they frequently also wished to engage in expanding the generation of electricity, telephone systems and similar utilities which had previously to a large extent been taken care of by foreign-owned enterprises.

Expansion programmes have been carried out by a number of foreign utility enterprises, particularly in Latin America. The capital required has been principally derived, however, from accumulated reserves or other "internal" funds of the enterprises concerned and to a smaller extent from the local sale of securities in the countries of operation; but it appears that the enterprises are becoming increasingly dependent on loans by the Export-Import Bank (an agency of the United States Government) and the Inter-

[1] The following quotation from a statement at a meeting on 9 September 1953, by the president of the International Bank for Reconstruction and Development, bears this out: "Even if, over the next ten years, the present low per capita consumption [of electricity] in the less developed countries [excluding the Union of Soviet Socialist Republics and China] were to be no more than doubled, an investment of as much as $10 billion would probably be needed, of which more than half would have to be spent on imports" (International Bank for Reconstruction and Development, *Summary Proceedings*, Eighth Annual Meeting (Washington, D.C., 1953), page 8).

national Bank for Reconstruction and Development.[2] Much "official" international financing in recent years has served the expansion of public utilities of various kinds, both privately and publicly owned. Though the present study is concerned primarily with private investments, brief reference may be made to the official financing of public utilities.

The International Bank for Reconstruction and Development had, to the middle of 1953, granted loans amounting to $1,560 million. Of this amount $497 million represented "reconstruction loans", granted to European countries principally during the first few years of the Bank's activity. Of the remaining $1,063 million, 63 per cent represented public utilities (38 per cent electric power, 14 per cent railways and 11 per cent other transportation and communications). As table 10 suggests, the loans for public utilities went chiefly to under-developed countries, particularly in Latin America. The Bank has had recourse to the capital market in order to finance part of its lending transactions; thus, by the autumn of 1953 it had issued bonds with a value of $653.5 million, of which $575 million was in United States dollars and the remainder in Swiss francs, pounds sterling and Canadian dollars.

Similarly, the Export-Import Bank has granted large credits to under-developed countries for the expansion of public utilities (though increased mineral production and the liquidation of mercantile debt have been the purpose of many of the credits). Thus, loans have been extended to Brazil for railway equipment and electric power development, to Chile for highway construction, to Ecuador for water supply systems and highways, to Mexico for the rehabilitation of railways and for highways, canals and electric power. In Asia, the Philippines and Indonesia, among other countries, have received credits for similar purposes.

Countries which during the war accumulated large claims on the United Kingdom ("sterling balances") have been able to finance public expenditure for development purposes in part by the liquidation of such claims. This is true in particular of a number of countries of southern and south-eastern Asia participating in the Colombo Plan.[3] The total expenditure by public

[2] An example is afforded by American and Foreign Power Company, Inc., a major company operating in Latin America and controlled in the United States. Its capital outlay during the period 1946-1952 totalled $214 million; the planned outlay during the period 1953-1956 is $221 million. It is estimated that reliance upon "internal" resources of the company will fall from three-fourths of the capital outlay in the former period to a little over half in the latter, and upon loans from the Export-Import Bank will increase from 6 to 33 per cent. The remainder largely represents local sales of securities in the country of operation. While the use of retained earnings, it is stated, "has been essential under the circumstances, it has reduced the return available to [American and] Foreign Power's own security holders and made equity financing for [the company] impossible in the United States" (see American and Foreign Power Company, Inc., *The Foreign Power System,* New York, September 1953). Other foreign utility companies in Latin America, particularly in Brazil and Mexico, have depended on loans by the International Bank for Reconstruction and Development. It will be observed that private investment financed by bank loans (including loans by the Export-Import Bank and the International Bank for Reconstruction and Development) are not included in the amounts shown as United States direct investments in chapter 1 of this study.

[3] *Cf. The Colombo Plan for Co-operative Economic Development in South and South-East Asia,* Cmd 8080 (London, 1950).

Table 10. Loans granted by the International Bank for Reconstruction and Development to 30 June 1953, by Purpose and Area

(Millions of United States dollars)

Purpose	*Latin America*	*Asia and Middle East*	*Africa*	*Australasia*	*Europe*	*Total*
Reconstruction loans....	—	—	—	—	497	497
Public utilities..........	339	102	92	69	70	672
Electric power........	253	28	58	30	35	404
Railways............	37	63	31	16	3	150
Other transportation and communications.	49	11	3	23	32	118
Agriculture and forestry..	17	51	—	54	28	150
Mining equipment.......	—	—	—	7	16	23
Manufacturing.........	—	32	—	20	74	126
General development....	1	2	40	—	49	92
TOTAL	357	187	132	150	734	1,560

Source: International Bank for Reconstruction and Development, *Eighth Annual Report, 1952–1953,* page 15. The figures represent the original principal amount less cancellations and refundings.

authorities as envisaged under the plan by the Commonwealth countries in the area [4] during six years beginning with the fiscal year 1951-52 amounts to £1,868 million, of which agriculture (including multi-purpose projects combining irrigation, flood control and the production of hydroelectric power) accounts for 32 per cent, transport and communications for 34 per cent, fuel and power for 6 per cent, manufacturing and mining (except coal) for 10 per cent and "social capital" (education, health, etc.) for 18 per cent. The cost of capital goods to be imported for the programme was estimated at £411 million, but a total inflow of foreign capital of £1,084 million was considered necessary in order to permit the financing of the domestic expenditure. Of the last-mentioned sum, it was planned to obtain £246 million through the withdrawal of sterling balances. While private oversea capital was counted upon to fill part of the gap of over £800 million, it was expected that funds would also be forthcoming from the International Bank for Reconstruction and Development and from oversea governments.

As an indication of the manner in which official or public investment is related to private in dependent territories, including various Trust Territories, under modern conditions, a few figures may be quoted from a study of the Organisation for European Economic Co-operation for oversea terri-

[4] India, Pakistan, Ceylon and four British territories (the Federation of Malaya, Singapore, North Borneo and Sarawak).

tories in Africa south of the Sahara.[5] Anticipated aggregate investment in these territories from all sources during the ten years 1946-1955 is close to $8,000 million, of which public investment represents $5,000 million and private $3,000 million. During the first five years 1946-1950, the public capital actually invested was $1,300 million and private capital $700-800 million. For some 87 per cent of the anticipated public investment during the ten-year period, the following distribution is available:

	Millions of United States dollars		*Per cent*
Non-revenue-earning investment:			
Education	250		
Public health	450		
Scientific research, administrative services, etc	370	1,070	25
Basic equipment:			
Transport and communications, "nearly"	2,000		
Water control	400		
Electric power	400	2,800	64
Productive sector		500	11
TOTAL		4,370	100

Though the term "investment" is used in the quoted study to include outlays usually not classified as such (schools, hospitals, administration and so on), the figures stress the magnitude of the public expenditure which would accompany a private investment below $3,000 million. Public investment in what is generally included under the term "public utilities" (shown above as "basic equipment") would alone be approximately as large as private investment. Finally, a large amount of public investment is anticipated in the "productive sector", particularly in certain activities which the authorities wish to promote but which are not earning revenue or in which profits will not be forthcoming for many years. Private investments would thus be confined to activities involving "normal commercial risks". This does not mean that private capital enters only into the productive sector (chiefly extractive industries and manufacturing). Mention is made, for instance, of extensions to electricity systems in the Congo, carried out by Belgian mining companies simultaneously with the publicly supervised programme for developing power resources. Other parts of the world—in particular, Latin America—also afford examples of foreign companies engaged in extractive industries that generate electric energy for their own needs and, in addition, distribute such energy to the public.

Of the public investment of $5,000 million in the African territories south of the Sahara, it was estimated that three-quarters would be derived from the territories themselves and their metropolitan countries and one-quarter from other countries. No exact division is made between funds raised locally and amounts supplied as loans and grants from the metropolitan countries. For private investments, the territories would naturally be

[5] *Investments in Overseas Territories in Africa, South of the Sahara* (1951).

dependent to a very large degree on enterprises owned in the respective metropolitan countries.

The study quoted points out that public investments, which are chiefly in public utilities of various kinds, do not compete with private investments in the territories. "Despite the broad scope of the public plans and the fact that they cover all types of activity, it is no part of their aim to eliminate private enterprise. The improvements in basic equipment brought about by the public authorities, should, on the contrary, lighten the task of private enterprise by providing the conditions essential for its success."

Extractive industries

The petroleum industry has in recent years been the chief extractive industry attracting foreign capital. The principal investments in petroleum extraction proper have been made in Venezuela, various countries in the Persian Gulf area and, of late, in Canada. Relatively few known petroleum deposits are located in dependent territories. The deposits in British protectorates in the Persion Gulf area are worked not only by British but also by French, Netherlands and United States enterprises. The extracting enterprises are usually engaged also in exploration of deposits, refining, transportation and distribution of petroleum and petroleum products; they thus own plant, pipelines, tankers, storage facilities, etc. The combined investment in these activities [6] is thus widely spread and is not confined to countries in which petroleum deposits are being tapped. The petroleum industry accounts for 45 per cent of the post-war additions to United States direct investments abroad and for close to a third of the total book value of such investments. It accounts for the great bulk of the estimated post-war increase in the value of United Kingdom oversea investments; the additions to investments in this industry may not have been much smaller than receipts on account of the heavy liquidation of British railway properties in Latin America.

The increased demand for petroleum products and the location of petroleum deposits have greatly influenced the volume and the geographical distribution of private capital exports in post-war years. After the completion of several large petroleum investments about 1949 it was expected that the flow of new investments by the United States in this field would subside, and some decline actually occurred. Even in the following years, however, petroleum has continued to absorb much more capital, particularly from the United Kingdom, than any other branch of industry.

The post-war tendencies of private investment in extractive industries (including agriculture) other than petroleum production have not been uniform. United States direct investments in such industries have not kept pace with those in other branches of production. Thus, the post-war increase in the book value of United States investment in both agriculture

[6] Of United States direct investments in the petroleum industry at the end of 1950, it has been estimated that about half pertained to crude oil production and exploration and that the remainder was divided about evenly between refining operations and the distribution of crude and refined oil (including investments in tankers and pipelines).

(chiefly sugar and fruit production in Central America) and mining and smelting (chiefly in Canada and Latin America) is less than 20 per cent of that in the petroleum industry, and the total book value of outstanding investments in these fields at the end of 1951 was less than in 1929.

While relatively little private United States capital has entered into direct investment in the field of mining and smelting, the activity of the Export-Import Bank in financing the production abroad of essential raw materials in short supply in the United States has increased. Its authorized loans during the post-war period for the construction of facilities to produce strategic metals and minerals have approximated $400 million (not incuding loans for unspecified types of equipment); of this amount Brazil and the Union of South Africa have each received slightly over a quarter and Northern Rhodesia about 10 per cent. The loans were usually extended to private enterprises (but sometimes to governments); in several cases, the borrowers undertook to sell part of their output to some agency of the United States Government and to use the proceeds of the sale for the redemption of the loan.

Large new international investments in plantations and mining during the post-war period have been made in Africa by investors in the European metropolitan countries who do not find south-eastern Asia as attractive a field for investment as in the past. It has been in the interest of the governments of these countries to develop new sources of supply for products which would otherwise have to be paid for in hard currency. African production for export, which has thus been expanded to include a large number of agricultural and mineral products previously obtained to a greater extent from other regions, is disposed of largely in European markets. United States-controlled enterprises abroad engaged in agriculture and mining have to a great extent disposed of their output in the United States. In the case of the United States petroleum investment abroad, on the other hand, less than 25 per cent of the export income was derived in 1950 from sales to the United States, an indication of the special position occupied by petroleum among the extractive export industries financed by foreign capital. On the basis of a rough calculation covering twenty-one important primary products, it has been estimated that about 25 per cent of United States total imports during the period 1946-1950 were derived from United States-controlled companies abroad.[7]

Manufacturing

Many under-developed countries have considered that their economic growth has been unbalanced, lagging in the field of manufacturing while relatively heavy in primary production for export. The increase in United States post-war investments in manufacturing has aroused hopes that the time has come when private foreign capital would make a greater contribution than in the past towards all-round economic development.

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[7] United States Department of Commerce, *Survey of Current Business*, October 1951, page 12.

The somewhat limited statistical information available on the industrial distribution of private capital movements tends to understate investment in manufacturing. This is due to the fact that the computations are frequently made according to the chief activity of the enterprises concerned and that enterprises engaged in both the production and the processing of primary goods are usually classified as engaged in primary production. Thus, metal smelting is usually combined with mining, petroleum refining with petroleum production and sugar production with agriculture. Under-developed countries engaged in primary production for export are naturally anxious that the goods produced should be processed within their borders to the extent that this is economically possible. Lower freight charges frequently favour local processing, such as metal smelting and the extraction of oil from seeds. Where freight savings are relatively small, however, importing countries are likely to attract the processing industries in order to save foreign exchange or for other reasons. Much petroleum refining, for instance, is located in the consuming rather than the producing countries. In the case of many extractive industries, particularly those developed in Africa by the metropolitan countries, the tendency has been to expand processing.

The range of manufacturing industries of this kind in any country is naturally very limited. Generally, under-developed countries are more concerned about the growth of their industries manufacturing goods for domestic consumption. In such industries, foreign capital plays a less important role than in industries producing for export. Moreover, manufacturing for the domestic market is slow in developing and in its early stages appears confined largely to goods the import of which is uneconomical because of the high cost of transportation or the risk of spoilage. To this group belong the manufacturing enterprises most frequently referred to in reports dealing with economic conditions in, for instance, many African dependent territories—cement plants, breweries and other factories for the processing of local foodstuffs. There is little to indicate that foreign investments in such manufacturing enterprises have increased much more rapidly in recent years than foreign investments in general. As was pointed out above, the share of manufacturing in the capital of French and Belgian enterprises in Africa appears to have been relatively stable during the post-war period.

Manufacturing of consumption or capital goods of types normally imported belongs to a more advanced stage of development. Both United Kingdom and United States investments in this field have expanded greatly since the war. The great bulk of such investments has been attracted to highly developed countries. United Kingdom investments in manufacturing have expanded, in particular, in Australia, Canada, the Union of South Africa and the United States. The heavy increase in United States manufacturing investment, too, is accounted for chiefly by industrially developed countries—Canada and countries in western Europe. However, United States manufacturing investments in Latin America increased by close to $600 million in six years.

Whatever the contribution which foreign investments may make to the growth of manufacturing, there are reasons why under-developed countries have to rely for such manufacturing on domestic capital to a greater extent than, for instance, in their primary production for export. This matter is considered in the following chapter.

Other activities

The principal branches of activity not considered above are distribution and finance. Most of the investment involved is in enterprises selling products manufactured in the investing country and is thus more directly related to the manufacturing and export of that country than to production in the importing country. In some cases, however, such commercial activities have represented the nucleus from which subsequent investment in manufacturing for the domestic market has developed. Foreign-owned banks in under-developed countries otherwise lacking adequate banking facilities are of importance in particular for foreign investors. In countries which have reached a somewhat more advanced stage, foreign banking is sometimes hampered by government regulations and the same holds true of foreign insurance activities. In view of their services to the general public, banking and insurance are in some respects similar to public utilities, and the controls to which they are subjected are sometimes such as to favour domestic management. This may help to explain why foreign investment in these activities has not always kept pace with such investment in extractive industries and manufacturing.

CHAPTER 3

FACTORS LIMITING THE FLOW OF CAPITAL

Inadequacy of the capital flow

The flow of private capital for investment in under-developed countries, it was pointed out above, has been on a comparatively small scale in recent years. It should not be forgotten, however, that before the war such capital movement was subject to considerable fluctuation, that during the 1930's there was, on balance, hardly any flow of investment capital to the under-developed countries and that even the considerable flow of such capital during the mid-1920's and during a few years prior to the First World War, while clearly advancing the development of certain countries with plentiful natural resources, did not make the contribution to the economic growth of many other countries that would have been desirable.

However this may be, the adequacy of a given capital flow from the point of view of economic development does not depend on its amount alone, but on several factors, including in particular the form it takes and the fields of activity in which the capital is applied. It should not be assumed that capital which, because of prevailing conditions, does not flow between nations in one form or for one type of activity will be available for investment in another form or for other activities. A potential investor in foreign government bonds, for instance, is likely to prefer a stable to a higher but uncertain rate of return on his investment. If the conditions under which foreign bonds can be acquired do not appeal to him, he is unlikely to put his money into foreign equity investment, particularly since such investment at present is for various reasons largely direct, or controlling, implying that the investment decision does not rest with individual buyers of securities. Again, an enterprise will normally consider a direct foreign investment only within its own field of activity. In the circumstances, obstacles to the flow of private capital at particular points have tended to reduce that flow rather than divert it into new channels.

An increase in the production of goods in under-developed countries must at least be paralleled by, or even in certain cases preceded by, the establishment of public utilities of various kinds, particularly transportation and electric energy facilities that pave the way for industrialization, division of labour, marketing of industrial goods, etc. During the early stages of development such investment, including that in non-revenue-earning or non-self-liquidating investment (for instance, schools and hospitals), may greatly exceed the investment in physical production of goods, as was found above to be the case in the dependent African territories south of the Sahara. Until the 1930's public utilities in under-developed countries were to a large extent established by means of foreign capital, either in the form of government loans raised in foreign capital markets or of direct investment by foreign-controlled enterprises. In fact, the great bulk of the foreign capital that entered under-developed countries for development purposes [1] belonged to these two categories.

This analysis leaves little doubt as to the dilemma of under-developed countries with regard to the financing of development by foreign private capital. It is precisely public utilities, the most basic and traditionally the largest investment objective, that have been deprived of such capital through the drying up of the two sources from which it used to flow.

The virtual discontinuation of this flow of capital for public utilities is so significant that problems concerning financing other fields of development appear of secondary importance to many countries with undeveloped public utilities. There is in fact little indication that the foreign capital absorbed by such other fields has been lower in recent years than during any earlier period. It is true that, given the large extent to which private capital is absorbed by petroleum production and other extractive export industries and the tendency of capital for manufacturing to be attracted to countries which are industrially well advanced, the geographic and industrial distribution of the capital that has flowed has not necessarily been such as to promote economic expansion in the places and the manner that under-developed countries desire. It should be kept in mind, however, that capital inflow to extractive industries is likely to contribute indirectly to a country's ability to establish public utilities and to develop generally.

Nature of the limiting factors

Various circumstances tend to limit the international flow of private capital for the purpose of development, some of them by no means characteristic of the post-war period only. Three groups of factors may be considered.

First, there are a number of general conditions not subject to change over short periods. Differences between capital exporting and capital importing countries in outlook, traditions and social and political circumstances, distance, incomplete knowledge on the part of potential investors of conditions in capital importing countries, difficulties of absentee ownership and similar factors are in themselves sufficient to exclude foreign capital from entering into wide fields of activities. In other fields, shortages of various kinds in under-developed countries act as a barrier—shortages, for instance, of natural resources suitable for exploitation, of skilled labour, of transportation facilities, electric energy and other public utilities that frequently serve as a basis for developing the production of goods and a market capable of absorbing the goods produced.

Second, international tension and the risk of changes in political conditions inside under-developed countries, or in political relationships among countries, act as strong deterrents to capital exports, even if in particular

[1] In view of the purpose of this inquiry, account is not taken here of foreign loans raised for purposes other than economic development (e.g., for armament or consolidation of short-term liabilities).

cases these factors may contribute to such exports by reducing risks through a wider dispersal of capital assets.

Third, many of the economic and social policies pursued by individual countries are such as to affect capital movements. In some industrial countries, such policies have tended to render domestic investment increasingly attractive or to limit the savings available for investment abroad. In some under-developed countries with highly centralized government-planned economies the entrance of foreign private funds for investment purposes is in practice excluded. In others, foreign investments in particular fields are restricted or excluded; in others, again, the entry, application or profitability of foreign investment is regulated, generally with a view to adapting the use of the capital to national economic objectives or aspirations rather than to reducing the inflow. Various measures are applied, for instance, to divert foreign capital into particular channels; to conserve natural domestic resources; to enable the government to share in the gain derived from their exploitation, through taxation or otherwise; or to make foreign-controlled enterprises utilize or train domestic labour.[2] Even when measures of this kind are not formally discriminative, they frequently affect foreign investment more adversely than domestic. To an even greater extent this is true, by definition, of restrictions on international transfers of investment income and capital. In the principal European countries that used to invest abroad on a large scale, capital exports to non-affiliated countries are strictly regulated, and the same is true, in the great majority of under-developed countries, of the transfer abroad of interest, dividends and profits and of capital withdrawn by foreign investors.

It may be argued that exchange controls, established as a result of pressure on the balance on payments of the countries concerned, aim only at limiting outward transfers to what these countries can afford, in view of their external payments situation, and hence do not reduce the transfer that would be possible. In some cases, however, available resources of foreign exchange have undoubtedly been reserved for purposes other than the transfer of capital and capital yields. Also, the controls have tended to

[2] Such measures are described in some detail in various reports, including the following:

United Nations: *Survey of Policies Affecting Private Foreign Investment* (mimeographed), E/1614/Rev.1, 8 March 1950; *Foreign Investment Laws and Regulations of the Countries of Asia and the Far East* (1951.II.F.1); *Foreign Capital in Latin America*, study in preparation, consolidating and revising the series, *Economic and Legal Status of Foreign Investments in Selected Countries of Latin America* (mimeographed), E/CN.12/166 and Addenda 1-15, 12 April 1950 to 11 May 1951; *United States Income Taxation of Private United States Investment in Latin America* (1953.XVI.1).

Organisation for European Economic Co-operation: *Report on International Investment* (Paris, 1950); *Intra-European Investments* (Paris, 1951).

Pan-American Union: Series under the title, *Statement of Laws of . . . in Matters Affecting Business*, initiated by the Inter-American Development Commission and continued by the Pan-American Union of the Organization of American States, Washington, D.C. Studies relating to eighteen countries of Latin America were published during the period 1946-1951.

United States Department of Commerce: *Factors Limiting United States Investment Abroad*, part 1 (1953); *Investment in Venezuela* (1953); *Investment in Colombia* (1953); *Investment in India* (1953); International Reference Service, Series entitled, *Establishing a Business in. . . .*

prolong the disequilibrium which prompted their introduction; and a number of countries have used them not only as a support to the balance of payments but as a means of taxing or otherwise regulating foreign enterprises.

The regulatory measures referred to have frequently not aimed at discouraging foreign capital, but the possibility of changes in measures once introduced, and in some cases the fear of more radical interference such as nationalization of industries or expropriation of assets, have tended to create a climate for private investments that is less favourable than during earlier periods.

To a large extent, economic conditions and national policies that affect government borrowing in international markets and direct investment in the three principal industrial groups—public utilities, extractive industries for export and manufacturing for the domestic market—differ, and it is useful to consider each of these four types of capital export separately. However, questions related to exchange control and international economic disequilibrium call for special consideration.

Private loans to governments

Expenditure by governments in under-developed countries has tended to grow, in particular because of the increased need for public facilities such as schools and hospitals, and because of the urge for government development of revenue-earning public utilities such as the generation and distribution of electric energy. Most such governments would undoubtedly be prepared to raise loans in foreign capital markets in order to finance investment for such purposes, so much the more since the burden of their external debt service has greatly declined since the 1920's as a result of amortization, debt adjustment and the rise in export prices. However, in spite of a substantial fall in the yield of domestic bonds in several capital exporting countries since the 1920's, foreign loans can in general not be floated on conditions acceptable to borrowers.[3] The margin between the yield of domestic and foreign bonds in the 1920's reflected only the appreciated risk of the respective borrower's inability to fulfil the loan contract, not the unforeseen collapse of international trade about 1930 and the resulting transfer difficulties affecting the great majority of countries. Continued international disequilibrium, coupled with the maintenance of exchange control in almost all capital importing and in several capital exporting countries, acts as a formidable barrier to the floating of international loans except to countries with which the lending country maintains close monetary or commercial relations.

If the obstacle represented by exchange control in European capital exporting countries (except Switzerland) is disregarded, the immobilization of the market for new foreign loans may be attributed to two factors. One is the recollection by individual investors of unfavourable experiences.

[3] In the United States the average effective yield of new foreign bonds in the 1920's was about 6½ per cent, but this average was affected by the relatively low yields of bonds of Canada and certain other countries. Bond yields for most typical under-developed countries were generally higher.

These include not only losses resulting from defaults and only partly mitigated by subsequent agreements with the borrowers that bondholders have accepted in order to avoid more severe loss, but also the reduction in the real value of monetary claims through the rise in commodity prices during the last decade, affecting purchases of domestic and foreign bonds alike. The second factor is the reduced importance of the individual saver as a supplier of funds for long-term loans. This, in turn, is due in large part to high rates of taxation and the channelling of individual savings into corporate and institutional investment. In several European countries in particular, individual investment income, which traditionally has been an important source of savings available for portfolio investment, has been affected by the restraint shown by corporations in their distribution of dividends, given the fact that corporations have recently relied to a very great extent on the reinvestment of undistributed earnings for modernization of plant and equipment and for normal expansion. If the profits were distributed, they would be subject to individual income tax;[4] the shareholder would thus not be able to use the whole amount of additional distribution for new investment. Furthermore, from the point of view of exchange control, the expansion of a foreign-controlled enterprise through reinvestment of earnings has the advantage of rendering unnecessary the transfer of both capital and investment income.

In these circumstances, the private capital market in most European countries is supplied largely by insurance companies, pension funds and investment trusts. In the United States, too, savings flow increasingly into such savings institutions. Such institutions are concerned primarily with the security of their investment and less anxious than individual investors to be compensated for the loss of real value through monetary inflation. Their conservative policies in placing their funds is reinforced by various legal restraints on the nature of their investment. The very policies and restraints, however, which render the institutions natural buyers of domestic government bonds, tend to exclude them from acquiring the bonds of foreign governments. The importance of this matter is apparent, for instance, in the case of bonds issued by the International Bank for Reconstruction and Development. The bonds, which are eligible for institutional investment in the United States and several other countries, have been successfully issued in prominent capital markets, under the guarantee of governments that are members of the Bank, at rates giving investors only a slightly higher yield than domestic government bonds. In the United States the bonds thus sold are held almost entirely by institutional investors.[5]

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[4] An additional tax saving resulting from the reinvestment of profits by corporations is that it will normally lead to an appreciation in the market value of the stocks held by individuals; if sold, the gain resulting from such appreciation is usually subject to lower tax rates (if any) than current income from dividends.

[5] The Bank's own lending has recently been made at rates varying between 4¼ and 5 per cent, including a commission which is allocated to a special reserve. According to its articles of agreement (section 4 (ii) of article III), the lending is subject to the condition (among others) that "the Bank is satisfied that in the prevailing market conditions, the borrower would be unable otherwise to obtain the loan under conditions which in the opinion of the Bank are reasonable for the borrower".

Post-war experience concerning the ability of international markets to absorb foreign government bonds is confined to special cases, principally the sale in the United States of Canadian securities and in the United Kingdom of the bonds of certain governments of countries within the sterling area. The Bank has sold only a small amount of bonds from its portfolio without guarantee. The effective yield of outstanding bonds of several under-developed countries, particularly when the remaining period of the loan is relatively short, has declined in international financial centres to a level not substantially above that at which these countries might be willing to raise new loans. The market for such bonds, however, is usually narrow, and the prices are frequently supported by demand from nationals of the borrowing country. New loans of a certain magnitude may not necessarily be absorbed by the market at a yield corresponding to the prices at which outstanding bonds are sold.

Various unofficial proposals have been made as to action which creditor countries might take in order to render bonds of under-developed countries readily marketable abroad. They include a relaxation of the legal restraint on the choice of securities that can be acquired by institutional investors, guarantees by the government of the lending country and a measure of tax exemption in that country on income from interest on the bonds of foreign governments. Measures of this kind would involve the assumption of risk-bearing or other financial sacrifice by the government of the lending country.[6]

Even without such action, a revival of the international market for government loans, at least on a limited scale, remains a possibility. The principal conditions for such a revival appear to be a discontinuation of the inflationary tendencies which have persisted during the post-war period and have deterred individual savers from investments in bonds in general, and an approach to international economic equilibrium implying a diminution of the risks run by investors on account of defaults or blocking of transfer.

Direct investment in public utilities

Unlike foreign funds raised through government loans, foreign capital for direct investment in public utilities must be confined to profit-generating projects. Government control of public utilities is of long standing, and private direct investments in utilities have been dependent on concessions by local or central governments. More recently, there has been a tendency to reserve the establishment of new projects for government enterprises or, when this has not been possible, for enterprises under domestic management.

[6] Some indication of the effect of transfer difficulties on international lending may be afforded by the large export credits on short and medium term granted by European countries. Such credits, usually covered to the extent of 70-90 per cent under official or semi-official arrangements for guarantee or insurance against certain non-commercial risks, among which the blocking of transfer may be the most important, have increased greatly in recent years and in 1953 amounted to at least $2,500 million; of this amount a considerable proportion was extended to under-developed countries. It will be observed, however, that both the nature and the relatively short period of mercantile credits tend to reduce the risk involved.

The tendency is widely spread and is manifest in independent under-developed countries and dependent territories alike. Thus the low percentage of private investments in public utilities in African dependent territories of European countries indicates that local or metropolitan authorities take on the principal burden of investment in this field.

Few countries exclude private foreign capital as such by law from investment in public utilities. An example is Argentina, whose constitution does not allow the granting of concessions to private entities for the operation of public utilities and in addition provides for the purchase or expropriation of existing utilities in private hands. Elsewhere in Latin America, a large proportion of the electric power generated is derived from private concerns, mostly foreign-owned, but publicly operated enterprises have been growing steadily in number and importance. *De facto* exclusion of private enterprise through extended operation by central or local governments of electric power plants and certain other types of utility is common, for instance, among the under-developed countries in the Middle East and Asia.

The trend towards government operation has been most strongly felt in the field of transportation. Mention has been made of the acquisition by several countries in Latin America, Africa and Asia of foreign-owned railways that began during the inter-war period and continued after the Second World War. Recently various other types of public utilities have been acquired by governments. In some countries there is a more or less explicit policy of nationalizing existing public utilities that remain under foreign control, but even where this is not the case, privately owned public utility enterprises have frequently been taken into public ownership. The forms have varied, from outright expropriation with different degrees of forewarning and compensation to the owners or enforced disposal to the wholly voluntary sale of foreign enterprises to public authorities or the transfer of assets upon expiration of concessions. New investment is naturally discouraged by government action that leads to the transfer of ownership, irrespective of the form in which the transfer takes place and the contractual undertakings concerning the payment of compensation. The apprehension of foreign investors is enhanced by the facts that public utilities are capital-intensive, the amounts invested frequently very large and the foreign payments situation of the expropriating country often such as to hamper the prompt transfer of the compensation that may be agreed upon.

The relatively low yield on the capital involved has contributed to the stagnation of new foreign investments in public utilities and to the willingness of some investors to liquidate existing enterprises. The low yield has been due either to economic factors proper or to the policies pursued in the country concerned in its control of the rates charged customers by public utility companies.

The former factors have principally affected railways. Competition from motor traffic, and recently from air traffic, has undermined the profitability of many railways. In most countries the railway networks have hardly expanded in recent decades. As long ago as the 1920's British-owned railways in Latin America distributed to shareholders on the average only between 3 and 4 per cent of their nominal capital; during the 1930's the average yield fell to 1.4 per cent.[7] Even higher rates would not necessarily have materially improved their financial situation at that time.

The policies with regard to rates charged have become of importance since the war and have affected electric power companies in particular. As late as the 1920's, United States direct investments in public utilities abroad, which have been predominantly in electricity generation and distribution, were regarded as lucrative. The enterprises have, however, found it increasingly difficult to obtain authorization to increase their rates so as to compensate for the higher costs of operation and of replacing worn-out equipment that have resulted from the inflationary trends characterizing the post-war period. Operations have thus become less profitable. In 1950, for instance, earnings of United States foreign direct investments after taxes payable abroad represented 4.3 per cent of the book value of equity investment in public utilities as against an average of 17 per cent in other industry groups.[8] The exceptionally low yield has hampered the expansion of foreign-controlled public utility enterprises in two ways. It has discouraged the transfer of fresh capital from the investing country and reduced the amounts which the enterprises have been able to reinvest out of current profits.

Since the generation and distribution of electric power is one of the most rapidly growing industries, the result of the policies pursued has been to concentrate an increasing proportion of this industry in the hands of local or central governments or governmental enterprises. Considerable amounts of foreign funds have nevertheless been required owing to the large amounts of capital involved and the dependence on imported equipment. As mentioned above, the foreign funds have been obtained principally through public loans and grants and through loans by the International Bank for Reconstruction and Development.

EXTRACTIVE INDUSTRIES

The conditions under which capital is able to engage in extractive industries abroad have changed radically in the course of the last generation largely because of new concepts as to national rights and responsibilities.

The location of extractive industries depends on the geographical distribution of natural resources of different kinds. The operations of such industries frequently have to be carried out on a large scale. The considerable amounts of capital required and the economic advantages of integrating the primary production with various types of processing or with marketing abroad are handicaps to production financed by local capital in underdeveloped countries. Frequently, the foreign enterprises are very large in relation to the entire economy of the countries in question and have to provide basic utilities, such as transportation, communications and electric

[7] *Cf. The South American Journal* (London), e.g., 25 January 1941.
[8] These percentages overstate the real profitability of the investments (see page 16).

power, as well as facilities for the housing of workers. Such a range of activities tends to give the enterprises a quasi-public character.

The exploitation of exhaustible natural resources is in many countries subject to special legal control, and large-scale operation has traditionally been contingent on concession contracts of long duration. Until recent decades such contracts, which also used to give the concessionaire certain accessory rights with regard to taxation, import duties, etc., were frequently granted without extensive compensatory undertakings on the part of the concessionaire. With the increased concern about the conservation of resources and the expanding power of governments, national control of local resources has been strengthened. This has been reflected in arrangements through which the countries conferring the concessions have been able to share substantially in the gains derived from production. In particular, this is true when the local expenditure on wages and other cost elements is small in relation to the value of the commodity produced or the capital invested, as in the case of petroleum investment. An interesting method of governmental sharing in investment profits is the acquisition of equity participation in the enterprise concerned in exchange for the granting of a concession.

The more stringent attitude of governments towards foreign investors has tended to affect existing concessions. By agreement with the holders, concessions of long standing have sometimes been modified before expiration to the advantage of the government. In other cases the payments due by the holder have been increased. A concession may protect him, for instance, against an increase in taxation; but by varying the rates (in countries with multiple exchange rates) at which he can acquire domestic currency for defraying local production costs or foreign currency for remittance abroad, the government may achieve the same result as through higher taxation. From the point of view of the country of operation, the use of multiple exchange rates has the advantage of being easier to manipulate than taxes for the purpose of imposing levies with special incidence on foreign enterprises.

It is natural that the increase in the payments due by such enterprises, and various other government policies, have in some cases caused friction between governments and concession holders. As in the case of public utilities, risk of nationalization of industries developed by foreign capital or expropriation of assets of foreign-owned enterprises is likely seriously to discourage foreign investors. In the case of such nationalization or expropriation it is not only difficult to arrive at agreement as to the amount of compensation that would have to be paid to the concessionaire, but the amounts involved are likely to be so large that their transfer abroad cannot easily be undertaken by the country concerned over a short period of time. The bitterness of the disputes that have arisen on such points stresses the importance of establishing conditions for entry of foreign capital that will give strong guarantees to investors against treatment which might be regarded by them as unfair or arbitrary and that at the same time are flexible enough to protect the interests of the country of investment under varying conditions, for instance if concessions granted should become more profitable to the holder than anticipated.

Private investments by metropolitan enterprises in Non-Self-Governing Territories, including Trust Territories, are less affected by the risk of conflict with the authorities in the territories concerned. This does not mean that local interests are disregarded by these authorities. It would be unrealistic not to take into account the radical change in attitude towards oversea dependent territories that has taken place over the past few decades. The control of investments exercised by the administration in these territories is frequently strict and to an increasing extent imposed in the interest of the local population. In fact, the metropolitan Power which, besides indirectly exercising authority with respect to production in its dependent territories, also controls the home office operations of investing enterprises, may find it easier to prevent abuse than an independent country able only to control business activities within its borders. Nevertheless, conflicts are likely to be fewer and an investor generally has greater confidence in his own than in a foreign government. At the same time, authorities in dependent territories may be inclined to give investors in the metropolitan country preferential treatment in matters regulated by administrative decisions.

For a closer study of the use of foreign capital in extractive industries, it is helpful to distinguish among the petroleum industry, mining and agriculture.

The petroleum industry

The amount of capital needed for petroleum extraction and refining, the financial risk involved and the managerial and technical skill required are such as to hamper the establishment of domestic enterprises in this field in most under-developed countries. Even governmental petroleum extraction or refining in such countries is likely to depend on co-operation with foreign private enterprise.

A few countries—for instance, Brazil, Iran [9] and Mexico—formally exclude foreign investment in petroleum extraction. Several countries have established governmental enterprises for the extraction and refining of petroleum or for the distribution of petroleum products.

Thus, in Mexico *Petróleos Méxicanos* (PEMEX) enjoys a monopoly in extraction, refining and distribution. In Brazil, provision is made under recently enacted legislation for a government-controlled enterprise (PETROBRAS), without financial participation of foreign capital and with functions similar to those of PEMEX in Mexico; however, foreign enterprises engaged in refining and distribution are permitted to continue operations. In Chile, a governmental agency has a monopoly in extraction and refining; imports and distribution are in the hands of a local government-financed enterprise and the subsidiaries of two foreign concerns. In Argentina, no legislation excludes foreign capital from the petroleum in-

[9] The Iranian government in 1951 nationalized the petroleum industry and dispossessed the Anglo-Iranian Oil Company, holder of a 1933 concession.

dustry, but new concessions have not been granted to private enterprises, domestic or foreign, for many years. Existing foreign enterprises account for a fifth of the extraction and about a third of the refining and are also active in import and distribution.

Monopoly or actual domination of the petroleum industry by governmental enterprises does not exclude hiring the services of foreign concerns without financial participation of an equity nature on their part. Arrangements of this type have been made, for instance, in Mexico and also in Peru prior to that country's relatively liberal petroleum legislation of 1952. In Colombia a foreign company extracts and exports petroleum for the account of a government enterprise which in 1951 acquired the assets of a foreign-owned firm whose concession expired. The company shares the export proceeds with the Government and has lent the government enterprise funds for financing capital installations.

Foreign enterprises admitted for equity investment in the petroleum industry are sometimes required to allow participation of domestic capital in share issues offered to the public; such requirements, however, have proved of little practical importance. Requirements concerning the employment and treatment of domestic labour do not appear particularly burdensome in the petroleum industry, which in any case does not employ much labour.

Of great significance is the adoption in recent years by a number of countries—for instance, Venezuela, Peru and certain countries in the Middle East—of a special régime for the petroleum industry under which gross profits earned are shared, as a rule equally, between the private enterprise concerned and the government. Normally, payment of half of the profits to the government of the host country will eliminate or at least greatly reduce tax liability in the capital exporting country of the company concerned.[10]

In a few countries, petroleum extraction has been made contingent upon the establishment of domestic refining. Thus, in Venezuela the Petroleum Law of 1943 provides that 10 per cent of the petroleum extracted under new concessions would have to be refined domestically. Four refineries subsequently established in Venezuela have required a capital outlay of over $400 million. In Peru, concessionaries have to supply the domestic market with refined petroleum products at prices stipulated by the Government.

In India, where there is little petroleum extraction, the Government has recently permitted three foreign petroleum concerns to establish refineries. This action was taken following a declaration of April 1948 according to which certain major branches of the economy, among them the petroleum industry, would be reserved for government enterprises except when the admission of private enterprise was considered in the

[10] See pages 52 and 53.

national interest.[11] In the latter case the Government may, under the Mines and Minerals Act of 1948, require the licensee to associate Indian capital in the enterprise to an extent agreed upon.

Mining

Foreign capital is usually more readily admitted into mining than into the petroleum industry and, as in the case of the latter industry, domestic financial participation in the enterprise is usually not required. One exception may be mentioned: in Brazil a law—not upheld, however, by the Constitution of 1946—which limits the participation of foreign nationals in mining enterprises appears to be one reason why there has been no significant inflow of foreign capital into Brazilian mining for a considerable period. In most countries where rules limiting foreign participation exist (for instance, in India, Mexico and Pakistan), they are subject to administrative discretion. The establishment of foreign enterprises is sometimes stimulated by exemption from duties on imported equipment.

Concession contracts frequently include conditions relating to the control and sharing with the government of the profits earned. Thus, in Venezuela certain contracts provide for profit sharing on a 50-50 basis, as in the case of petroleum operations. Otherwise, levies on foreign enterprise are made in various forms—royalties, taxes on production or exports and corporate income taxes. In Chile the Government has set up sales monopolies for nitrate and copper and absorbs through them part of the difference between the cost of production and the sales price. One form of levy is collected through the operation of exchange control; in Chile, for instance, the large foreign copper and iron mining companies have to acquire local currency for their expenditure in the country at a rate which attributes a value to the peso that is up to six times that which the authorities apply when buying the foreign currency proceeds of most exports.

Since mining generally requires considerable use of local labour, the conditions stipulated concerning labour are more important than in the petroleum industry. Such conditions apply mainly to public facilities and housing in "company towns".

In 1952 the Bolivian Government decided to expropriate the assets of the principal tin mining companies (largely foreign-owned) that operated in Bolivia. A government agency was established and instructed to take over these assets and determine the value of the property expropriated. While arrangement has been made for setting aside part of the proceeds of the export of tin from one company with a view to compensating its shareholders, agreement has not been reached as to the amount of the compensation.

[11] The same declaration states that "while the inherent right of the State to acquire any existing industrial undertakings will always remain . . . Government have decided to let existing undertakings in these fields develop for a period of ten years, during which they will be allowed all facilities for efficient working and reasonable expansion . . . If it is decided that the State should acquire any unit, the fundamental rights guaranteed by the Constitution will be observed and compensation will be awarded on a fair and equitable basis". In the case of the newly authorized investments in refineries, the relevant period was extended to twenty-five years.

Agriculture

Foreign investment in agriculture is confined to large-scale operations (plantation agriculture) for export and is usually regulated by concession contracts. Some countries limit or forbid foreign acquisition of land in specific locations, particularly in border areas. Mexican legislation limits the size of agricultural landholdings and thus practically excludes foreign enterprise from this sector. Another type of legislation affecting land tenure is that enacted by Guatemala in 1952, providing that land not under "direct" cultivation may be expropriated by the State and redistributed. While the legislation does not formally discriminate between landholders, it has affected, in particular, the major foreign enterprise in the country, the United Fruit Company. A similar provision relating to the expropriation of unused agricultural land is contained in the Haitian Constitution of 1950.

Several of the conditions which relate to mineral investments apply also to investments in plantation agriculture. Reference may be made to a recent official statement by the Government of Costa Rica, announcing its intention to open discussions with the United Fruit Company with a view to renegotiation of the concession of that company; it is anticipated that the Government will wish to arrive at an arrangement for sharing the company's profits.

MANUFACTURING FOR THE DOMESTIC MARKET

Most foreign direct investment in manufacturing is of a special nature. Operations are on a large scale, associated with the production of the parent company and often dependent on equipment, materials and "know-how" supplied by that company. Foreign plants assembling imported automobile parts and, in general, subsidiaries of parent companies engaged in complex mechanical or chemical industries afford examples of the type of integration that accounts for a large part of the manufacturing enterprises under foreign control. The advantages the parent companies possess within their specialized field are such as generally to preclude effective competition by locally controlled enterprises in under-developed countries. As in the case of extractive industries, therefore, these countries are not seldom faced with the choice of admitting the foreign enterprise or forgoing the type of production in question, rather than of having production financed with foreign or domestic capital.

One condition for manufacturing of the type considered is a market sufficient for large-scale production.[12] The very sheltering of the domestic markets, which has attracted foreign manufacturing to some under-developed countries, has tended to confine the scale of production to what each such market is able to absorb. Since most under-developed countries have very limited domestic markets, they are not suitable for the type of manufacturing referred to above. The importance of the size of the market

[12] This does not imply that small-scale manufacturing is unsuitable for countries with a limited market. In manufacturing as in agriculture, however, foreign investment is most suitable for large-scale production.

may be illustrated by the distribution of United States investments in Latin America, which is the only under-developed area that has absorbed large amounts of United States capital for manufacturing. By the end of 1950, the book value of total United States investments in manufacturing in this area amounted to $780 million, of which $579 million was accounted for by the three countries representing the largest domestic markets, namely, Argentina, Brazil and Mexico. In these countries manufacturing accounted for 43, 44 and 32 per cent, respectively, of all United States direct investments; the corresponding average for all other Latin American countries taken together was only 6 per cent.

The fact that foreign direct investments in manufacturing bring with them technical knowledge and foreign personnel of special competence is of obvious advantage to countries in an early stage of development. A few arrangements have been concluded in recent years whereby foreign technology and skilled personnel in the manufacturing field have been supplied to under-developed countries through management contracts on a fixed fee or royalty basis, but they have not been of great importance. The joint participation of domestic capital with foreign capital in manufacturing ventures in under-developed countries has also been relatively limited, although there is indication of a slight trend in this direction.[13]

The balance of payments effect of foreign investment in manufacturing for the domestic market of an under-developed country is worthy of special consideration,[14] particularly when the natural resources of the country are sparse in relation to its population. The transfer abroad of investment income (to the extent that it is not reinvested) is in this case not facilitated by export of the goods produced. Substitution of the manufactures produced for manufactures previously imported may render foreign exchange available for transfer. There are limits, however, to the reduction in imports, particularly since domestic development is likely to lead to an expansion of domestic incomes and to be accompanied by a demand for products not previously imported. Further, manufacturing may be contingent upon imports of foreign raw materials or may absorb domestic raw materials which would otherwise have been exported. An under-developed country unable to develop its exports (for instance, of primary products) and lacking other sources of income from which outward transfers can be financed, is likely to depend, therefore, to a relatively large extent on domestic financing of the growth of its manufacturing industries.

Various policies in under-developed countries affect foreign investments in manufacturing. Of principal importance is the sheltered market which these countries provide and which tends to attract such investment. Tariffs which in many such countries formerly served fiscal purposes have to an increasing extent been adapted to afford protection for industry. Even

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[13] See United States Department of Commerce, *Foreign Investments of the United States* (Washington, 1953), pages 19 and 23.

[14] The possibility of developing manufacturing for export in under-developed countries is generally limited to what on an earlier page was referred to as processing of primary products. In a few other cases of manufacturing for export (for instance of textile products in India), the goods are sold to neighbouring under-developed countries.

more important are the quantitative restrictions and exchange controls applied by most under-developed countries since the 1930's, originally in order to support the balance of payments but to an increasing extent serving as additional defence against foreign competition.

There are limits to the protection such measures can afford. As already mentioned, they tend, when applied nationally, to divide potential markets into national units too small for profitable production. On the other hand, when applied to an area including many countries, as for example the exchange control common to the countries of the sterling area, they may attract foreign investment not in the less developed but in the more developed countries of that area.

Manufacturing in under-developed countries, whether financed by domestic or foreign capital, is frequently offered the advantage of freedom from duty, or tariff reduction, on imported raw materials and equipment, and taxation relief for a given period. These privileges are seldom automatic but are granted in each case according to such criteria as the essentiality of the industry or its anticipated effect on the balance of payments. They may thus be regarded as measures to channel investments in certain directions.

Certain considerations underlying regulation of entry of foreign capital into manufacturing, as well as other fields, have been described as follows:

> "Public opinion in the under-developed countries . . . urges the imposition of certain conditions on the entry of private foreign capital. Among the more important of these conditions which are usually mentioned are provisions for domestic participation in the capital structure of enterprises promoted by foreign concerns within the country, for effective domestic participation in policy making and management of these concerns when operating within their boundaries, the imposition of an obligation on such concerns to reinvest within the country at least a portion of the profits that they make within the country and of an obligation on these concerns to give adequate technical training, in the working of these concerns, to the nationals of the country, and the provision of facilities for the acquisition by such nationals of the technical know-how possessed by these concerns."[15]

Unlike foreign investment in extractive industries and public utilities, that in manufacturing is rarely excluded by specific legislation; the conditions of entry and operation are largely determined in each case by administrative action based on broad enabling legislation.[16] In a few countries,

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[15] Extract from the Report of the Sub-Commission on Economic Development (Third Session), *Methods of Financing Economic Development in Under-Developed Countries* (United Nations publication 1949.II.B.4), pages 113 to 132.

[16] Mention may be made in this connexion of the United States programme, undertaken since the end of the war, to conclude bilateral treaties—sometimes entitled Treaties of Friendship, Commerce and Navigation—with various countries, governing, *inter alia*, the status of foreign enterprises of each of the signatories in the territory of the other. Limitations on entry of foreign enterprise of the sort referred to in the text may stand in the way of full "national" treatment of foreign enterprise, which is in general the governing principle sought in the treaties. An alternative is to accord full national treatment to enterprises that are admitted by the signatory country.

Since the end of the war the United States has negotiated treaties of the kind just referred to with twelve countries and initiated negotiations with ten. Of the signed treaties, only three have been ratified by both parties and have entered into force (see United States Senate, Committee on Foreign Relations, Executive Report No. 5, 83rd Congress, 1st Session, 17 July 1953; and United States House of Representatives, Committee on Foreign Affairs, Subcommittee on Foreign Economic Policy, *The Mutual Security Act and Overseas Private Investment,* Preliminary Report, 3 June 1953).

so-called saturation laws, the origin of which may be traced to conditions prevailing during the depression of the 1930's, limit the expansion of investment in specific industries in which production is considered adequate. In several countries legislation or administrative control relating to the entry of capital provides for a relatively high participation by nationals in the share capital of enterprises. Such regulations are usually applied in a flexible manner and in practice many foreign-controlled enterprises have been established with little domestic participation, if any, in the countries concerned.

A considerable degree of administrative discretion is usually also applied to labour laws or conditions imposed by administrative action regarding such matters as the employment of a minimum percentage of domestic personnel and the training of such personnel.

Finally, in some countries the government is engaged, through State enterprises formed for this purpose, in various manufacturing industries. Such governmental participation is usual in industries the products of which are subject to special taxes (for instance, tobacco products and alcoholic beverages), but it also extends—for example, in Brazil and Chile—to steel, and a variety of products in several Latin American countries, India and Indonesia. In some cases, government participation is accompanied by the exclusion of private capital from the types of enterprise in question. Thus, in India the Government has reserved for itself the establishment of new enterprises in certain manufacturing industries (iron and steel industry, shipbuilding, manufacture of aircraft and of telephone and telegraph apparatus), except if the national interest demands otherwise. Frequently, however, governments do not limit competition on the part of private enterprise and permit investment of foreign capital.

Factors which in some under-developed countries involve a risk of nationalization or expropriation of foreign investments in public utilities or extractive industries appear not to affect investments in manufacturing to the same extent. The only significant action of this kind affecting manufacturing for the domestic market in recent years appears to have been that taken by mainland China and a number of countries in eastern Europe.

Foreign investments in manufacturing—as indeed in certain other fields, such as public utilities and various services—are generally subject to lower corporate taxes in under-developed countries than are extractive industries. Both for this reason and because manufacturing enterprises, whether domestic or foreign, frequently enjoy special tax concessions in such countries, the credit allowed for income taxes payable abroad is usually not sufficient fully to relieve a parent company from paying corporate taxes in its home country for income from a foreign manufacturing branch.[17]

[17] In the United States credit is allowed for foreign business income taxes (no credit is allowed for indirect taxes); moreover, a special tax reduction applies to United States corporations deriving at least 95 per cent of their income from sources within the Western Hemisphere but outside the United States. In the United Kingdom full tax credit was until 1953 generally dependent on bilateral tax agreements (concluded with most countries inside the Commonwealth, India and Pakistan being exceptions, and with Denmark, France, Ireland, Israel, Netherlands, Norway, Sweden and the United

These circumstances have contributed to the tendency to organize foreign-controlled manufacturing enterprises as subsidiaries and to a high rate of reinvestment, since in the case of a subsidiary the parent company pays taxes only on dividends, not on reinvested earnings. In the extractive industries, on the other hand, high taxation abroad and high depletion allowances for tax purposes in the country of the parent company have favoured the organization of controlled enterprises abroad as branches. These facts are reflected in differences in the relative importance of reinvestment by subsidiaries in manufacturing and in extractive industries (see table 3).

In cases where parent companies have to pay taxes on their income from controlled manufacturing enterprises abroad—for instance, in the case of subsidiaries not reinvesting a considerable portion of their earnings—tax concessions by the capital importing country obviously do not act as special inducements since they do not reduce the aggregate taxation on income. Conversely, some capital importing countries have been able to raise corporate taxes without increasing the total tax liability of corporations. Certain such countries apply special taxation to dividends so as to encourage the reinvestment of earnings.

The effect of taxation on investment in manufacturing, as indeed in other industries, is complex and cannot be dealt with in detail here. It appears, however, that "the special risks of foreign investment, not unfavourable tax treatment, appear to constitute the principal deterrent to it."[18]

Exchange restrictions

It is useful to consider, first, the direct effects on capital movements of exchange control, particularly as applied by under-developed countries.[19]

States); otherwise, only partial credit was allowed. A Royal Commission has recently recommended extension of full tax credit to United Kingdom investors in all countries, and also some action by which the United Kingdom would permit the benefit of tax concessions in capital importing countries to accrue to the investor when the level of the overseas tax is less than the investor's tax liability to the United Kingdom (see Royal Commission on the Taxation of Profits and Income, *First Report*, Cmd 8761 (London, February 1953)). The former recommendation was put into effect by the Finance Act of 1953. Some capital exporting countries, for example Belgium and the Netherlands, accord preferential tax treatment to income earned abroad.

[18] This conclusion is reached in *United States Income Taxation of Private United States Investment in Latin America*, page 67. This study discusses the effects of taxation on investment in considerable detail.

[19] A summary of controls in effect is contained in the International Monetary Fund's *Fourth Annual Report on Exchange Restrictions* (Washington, 1953). Among the under-developed countries not maintaining exchange control are the following: El Salvador, Guatemala, Haiti, Honduras, Lebanon, Mexico and Panama. In several other countries, control is largely nominal, for example, in Cuba, the Dominican Republic and Venezuela. In several other under-developed areas the authorities freely grant exchange for the remittance of yields on foreign capital, for example, in most countries of the sterling area. Some countries of the latter group, particularly in the sterling area, also permit repatriation without limit on capital entering the country after a recent date. Countries that freely grant exchange for the remittance of yields usually impose a strict control on the entry of capital for new investment, and may also discriminate between capital originally transferred to the country and capital accumulated from reinvested earnings.

Foreign enterprises are bound to feel the impact of such control in connexion with both the remittance of income (and the repatriation of capital, if desired) and the payment for imports required for operations. Exchange control is usually a symptom of balance of payments pressure; should the pressure increase, control may be tightened or the currency devalued. Either alternative, but particularly the former, may represent a powerful deterrent, even if account is taken of the sheltering effect of exchange control or the import restrictions with which it is frequently associated.

The stringency of exchange control and its inhibiting effect on foreign investment vary considerably among countries and, in some cases, within a given country, among particular fields of investment, among individual foreign enterprises, between old and new and between officially approved "essential" and other investments. Exchange control naturally does not hamper the reinvestment of earnings; but the expansion of a business enterprise through the reinvestment of earnings or through funds raised locally in the country of operation may be hampered if the control does not allow the enterprise the foreign exchange required for the purchase of equipment abroad, particularly in the case of industries which, like public utilities, depend greatly on such equipment.

In some cases the authorities license transfers on an individual basis; in others quantitative restriction on exchange is combined with a system of multiple exchange rates. Either of these systems may be combined with a ceiling on remittances, usually based on a specified percentage of invested capital as defined by the authorities. When such a limit on transferred earnings is imposed under a system of multiple rates, the enterprise is usually permitted to transfer additional amounts (but not necessarily capital) above the limit at a less favourable rate than that applied to transfers below the limit. Even when an enterprise producing for export is permitted to retain abroad part or all of its foreign exchange proceeds, it may be required to purchase local currency needed for operations in the capital importing country at a special rate of exchange, so that the authorities are able to regulate the earnings of the enterprise in an indirect manner, and at the same time provide the government with a source of revenue.

In general, limitations on the outward transfer of capital withdrawn are more widespread and more severe than on transfers of income from investments. In fact, one of the chief objects of exchange control is the prevention of an unforeseen outflow of capital. Wholesale and rapid withdrawal of foreign capital invested in the usually large foreign enterprises would in any circumstances be difficult; nevertheless, an investor is likely to consider important his right to potential repatriation of capital. Several under-developed countries have recently established the right freely to repatriate capital of new investments admitted with the approval of the authorities; certain other countries maintain a more stringent control, limiting the amount of capital that may be transferred to a fixed percentage, for example 10 or 20 per cent a year, of approved investments. Still others maintain licensing of outward capital transfers in each case.

In general, during the past several years under-developed countries have tended to relax exchange restrictions affecting foreign capital, with a view to encouraging foreign investment. Such relaxation, however, is usually conditional. It applies to investments in approved projects or particular fields regarded as essential, and discriminates between old and new (approved) investments.

Originally adopted to cope with balance of payments pressures, exchange restrictions have come to serve various purposes, such as limiting non-essential imports, protecting domestic industry and—when combined with the use of multiple currency rates—providing a source of revenue to the government, and are in many under-developed countries regarded as a more or less inevitable concomitant of their economic development programmes.[20] The deterrent effect of exchange restrictions on international investment, however, is bound to counteract the pursuit of other objectives. An attempt of the major capital exporting country, the United States, to find a temporary solution to the difficulties arising from this source has resulted in a programme for guarantees against the risk of inability to transfer funds derived from United States investment abroad. Pursuant to the Mutual Security Act of 1951, the United States Government provides insurance for certain new United States investments against the risk of currency inconvertibility and loss through confiscation or expropriation. All the countries for which aid is authorized by the act, as amended, are eligible to participate in the programme, provided they give certain assurances to the United States concerning the treatment of funds derived from guaranteed investments that cannot be transferred.[21]

THE WIDER IMPLICATIONS OF INTERNATIONAL ECONOMIC DISEQUILIBRIUM

Quite apart from the direct effect upon transfers, there are other, and in some respects even more disturbing, indirect effects of the international disequilibrium of which exchange control is a manifestation. These are considered briefly below.

It is sometimes suggested that the transfer of investment income from debtor to creditor country depends on these two countries alone. If the former is willing to pay, and the latter to allow the import from it of the amount of goods and services that corresponds to the transfer, the prevailing disequilibrium would, according to this view, have no harmful effects on international investments.

Such a view fails to take into account the role of triangular trade in the transfer of investment yields. In particular, yields due European countries are normally transferred through third countries to a very large extent.

[20] See International Monetary Fund, *Fourth Annual Report on Exchange Restrictions*, pages 2 to 10.

[21] By mid-1953, seventeen countries had entered into agreement with the United States with respect to such guarantees, including four non-European countries: China: Taiwan, Haiti, Israel and the Philippines. At that time fifty-three guarantees totalling $41 million had been issued, covering investments in seven European countries, and seventy applications for guarantees, totalling about $58 million, were under consideration (see *Report to Congress on the Mutual Security Program*, Washington, D.C., 1953).

Through such transfer, investment income can be received from countries having no export balance to the creditor country and whose exports are widely distributed, as is likely to be the case if they consist of a few primary products in demand the world over. A typical example is afforded by United Kingdom investments in Malayan rubber plantations. The income from such investments is transferred through a net import of the United Kingdom, in particular from the United States and countries in continental Europe that are buyers of rubber and at the same time net exporters to the United Kingdom. A very considerable part of the bilateral balances forming the system of multilateral trade as it once functioned had its origin in the transfer of investment income.

In the balance of payments difficulties which many countries have experienced during the past two decades, investing countries as well as some intermediary countries have sometimes found it necessary to reduce, through exchange control or import restrictions, the bilateral trade balances upon which this transfer depended. The effects have been far-reaching, though to a certain extent concealed during the post-war period by inter-governmental grants and loans facilitating the settlement of accounts. Among the intermediary countries, those in Europe have experienced certain difficulties in financing the import of primary products. Since in the 1930's the demand that they could exercise for such products was reduced, prices in the world market fell, in some cases rendering production for export unprofitable. To the countries exporting primary products this implied a deterioration of the terms of trade, a general reduction in domestic economic activity and unfavourable conditions for investment; hence capital exports to them were discontinued. As the world market disintegrated, attempts were made to overcome difficulties of supply by the formation of trading blocs. In some cases new sources were developed for the supply of primary products, a fact which protracted the depression affecting former suppliers.

The war changed this situation in several respects. Many foreign equity investments, particularly of European countries, had to be written off as war losses. The incidence of debt service payments was reduced by the increase in commodity prices; several countries, particularly in southern and south-eastern Asia, were able to liquidate a large part of their outstanding foreign liabilities; their incentive to export primary products was reduced with the expansion of domestic incomes while their ability to export foodstuffs declined, at least temporarily, as their populations grew faster than their agricultural production. The effect of these changes has been offset to a certain extent by the ability of the United States to deliver commodities in short supply to Europe, and its willingness to finance the delivery by loans and grants. This has given European countries time to rebuild production, raise export and export balances so as to offset the loss of investment income and to invest new capital overseas, particularly in Africa. The adjustment to the new situation has been accompanied by a partial return to a more integrated international economy; thus, through the European Payments Union the settlement of accounts, and hence the marketing of exports, is rendered feasible over the large trading area of the whole of western Europe and its affiliated monetary areas overseas. European investments in these territories have profited from this arrangement and the supply of primary products to the industrial countries of western Europe has been rendered more ample.

Nevertheless, international disequilibrium persists, as is indicated by the maintenance of exchange controls and the general inconvertibility of "soft" currencies. The fact that the flow of private capital from each of the principal capital exporting countries tends to be oriented towards specific areas—from the United States towards the Western Hemisphere and from European countries towards their oversea territories—is itself an indication of the obstacles to the movement of capital, to the transfer of capital yields and the related marketing of goods entering into international trade.

Without attempting a complete analysis of these factors, a few cases will be briefly considered below with a view to indicating how foreign investment is affected by the circumstances just referred to.

Before the 1930's, European creditor countries regularly turned a large part of the investment income accruing to them into dollars for the financing of purchases from North America. Their trade with the principal areas in which their investments were made frequently resulted in a surplus. Today the possibility of such roundabout transfer is limited. A United Kingdom enterprise, for instance, investing in a country outside the sterling area that applies exchange control is generally allowed only to transfer in sterling the investment income owed to it. Similarly, interest on a sterling loan is paid in sterling with little possibility of conversion into hard currency. This may be of little importance to the particular investor whose concern is his profit in sterling; but it limits the choice of countries in which the investment income can be used by the receiving country for the purchase of goods and hence the choice of goods that can be bought. The national interest in the investment is naturally less than if the income from it could be spent in any desired currency—a fact which is likely to influence the attitude of authorities upon which the capital export to soft-currency countries depends.

From the case just considered it will be seen that if a European country wishes to derive the same benefit from capital invested abroad as under international equilibrium—in the sense that the income could be used to finance imports from the dollar area—the investment will have to be such as to yield income in dollars or reduce dollar outlay. Much of the United Kingdom investment, for instance, has been of this kind. Investments in the dollar saving petroleum industry have been encouraged. Investments of metropolitan countries in their dependent oversea territories exporting to the United States have also been favoured since the dollar earnings of such territories are controlled by the metropolitan country. Recently, the United Kingdom has taken steps to facilitate investment by its citizens in the United States and Canada and in dollar securities. The obvious difficulty of allowing such investment on a large scale lies in the weakness of the balance of payments with the dollar area that is the principal reason for exchange control. On the whole, therefore, authorized capital exports from European countries have since the war been oriented towards soft-currency countries. In particular, capital has moved so as not to be interfered with by exchange controls—from the United Kingdom to the outer sterling area, and from certain countries in continental Europe to their oversea dependent territories.

Under prevailing conditions, the acute or latent balance of payments difficulties are such as to discourage new direct investment by hard-currency countries in many soft-currency countries, except in the production of goods which the creditor country can itself absorb. Under such conditions the case for allowing the enterprise concerned to retain as much of its export proceeds as corresponds to its net profit is undoubtedly very strong. The question of obtaining permission from the exchange authorities to transfer interest and dividends on the capital invested is then eliminated; the transfer in fact takes place through the transportation of the goods. Part of the direct United States investment in, for instance, South American mining is of this kind. In general, it may be said that, as an investing country, the United States has been less affected than European countries by the elimination of a large part of the triangular trade that used to serve the transfer of interest and dividends. This is due to the size of its manufacturing industry and the large share it accordingly absorbs of many primary products entering into international trade.

A hard-currency country will also avoid a direct investment in an export industry of another hard-currency country in cases when the goods produced would have to be sold by the enterprise concerned in soft-currency countries, unless the latter are able and willing to pay in dollars for the product. Investment opportunities are thus reduced, and substitute production that might otherwise not be economical is encouraged elsewhere.

The problem may also be looked at from the point of view of the capital importing country. Normally, it will have to take into account the fact that foreign investment, to be economically justified, should be accompanied by an increase in domestic production enabling the country to improve its trade balance at least by an amount corresponding to the investment yield or debt service payable abroad. Under conditions of convertibility of currencies it is, from the point of view here considered, of no importance what additional currency is earned. But at present a country experiencing a shortage of dollars may not necessarily find it to its interest to encourage a United States direct investment the consequence of which is, for instance, an increase in the export balance to a soft-currency country. Since the country will not earn more dollars, the change in trade balance will not help it to transfer in dollars the yield of the investment. For similar reasons, a soft-currency country may hesitate to raise a dollar loan which will not sustain its future ability to earn dollars, however beneficial it may be with regard to its economy and balance of payments in general.

What has been said may be sufficient to indicate that international disequilibrium has tended to reduce the volume of capital exported for investment, in particular by narrowing the area within which each country can invest with advantage. Restoration of equilibrium, quite apart from its more general effects, would permit countries to abolish the exchange and trade controls they have introduced in order to support their external payments position and thus open up new fields for international investment and widen the geographical distribution of capital exports.

Since so much attention has been paid above to the transfer of investment income, it may be observed that the export of capital to countries with a weak payments position may tend to strengthen that position and to that extent contribute to overcoming international disequilibrium. In the absence of active foreign markets for government loans, however, this factor should not be overestimated. Direct investments, it has been pointed out above, tend to grow through the reinvestment of profit rather than by the transfer of fresh capital and, to the extent that such transfer takes place, it is likely to be used in part for financing the purchase of capital equipment by the enterprises concerned. The role of foreign investment in the restoration of international equilibrium depends rather on the extent to which the increase in production through such investment, and the effect of such increase on international trade, is such as to alleviate existing shortages of currencies and goods. European countries have a special interest in favouring foreign investment in the production of goods that can be sold against hard currency or that will reduce their expenditure in such currency.

Conclusions

It may be useful to set out some of the more important conclusions which may be drawn from the analysis made and which call for consideration in the formulation of policies for promoting economic development.

(*a*) The prevailing international disequilibrium, reflected in inconvertibility of currencies and exchange controls, tends to reduce the volume of private capital exported for investment purposes in a variety of ways and, in particular, to narrow the area within which each capital exporting country can invest with advantage. Restoration of equilibrium, quite apart from its more general effects, would open up new fields for international investment and widen the geographical distribution of capital exports. On the other hand, an increase in capital exports, however important might be its effect on production in the long run, could not be expected to make a major contribution to the restoration of equilibrium in the present situation.

(*b*) In general, foreign private investments operate in a less favourable "climate" than before the economic depression of the 1930's. This is due not only to various governmental regulating measures as such but also to the insecurity created by the fact that these measures, particularly exchange control, are subject to change on short notice. In view of the difficulty of eliminating this insecurity, various suggestions have been made for compensating investors against the risk involved, for instance, by tax concessions or guarantees against non-business risks, extended by the capital exporting country.

(*c*) The floating of government loans in international capital markets is hindered as a result of profound economic, social and political changes since the 1920's. This has affected in particular the ability of governments in under-developed countries to finance the expansion of public utilities through the use of foreign private capital and has increased their dependence upon domestic financing and loans from foreign governments and from the International Bank for Reconstruction and Development. A revival of private lending in such markets on a limited scale is possible but depends on the discontinuation of inflationary trends and on an approach to international economic equilibrium.

(*d*) Public utilities, traditionally the largest objective for foreign business investment, do not any longer attract fresh external private capital, given strong tendencies towards reserving such utilities for government operation and supplying the services to the public at rates that are frequently not sufficiently remunerative.

(*e*) The prevailing form of capital flow into other industries takes the form of heavy investment in enterprises producing on a large scale, controlled by a parent company in the capital exporting country and depending largely on that company for the absorption of their products (if production is for export) or for the supply of materials, equipment and technical knowledge. Once established, the enterprises grow by reinvestment of profits rather than by the transfer of fresh capital.

(*f*) Extractive export industries, particularly petroleum enterprises, have become the principal objective of foreign direct investment, which has thus tended to favour areas with an abundant supply of natural resources rather than dense population. The conditions under which foreign capital is admitted to investment in most extractive industries have gradually been tightened in recent years, and many countries endowed with plentiful natural resources have been able to increase considerably their revenue from foreign enterprises permitted to exploit them.

(*g*) The friction which has in some cases arisen in the course of this change stresses the importance of establishing conditions for the entry of foreign capital that are mutually advantageous to both the investor and the country of investment, without being subjected to frequent change. In case of nationalization of industries developed by foreign capital or expropriation of assets of foreign-owned enterprises, difficulties of transferring compensation, when offered, frequently preclude equitable treatment of the foreign investors who are accordingly seriously discouraged by any risk of such nationalization or expropriation.

(*h*) The inflow of private capital for investment in manufacturing for the domestic market is encouraged by many under-developed countries, through provision of a sheltered market and sometimes other advantages, and the regulatory measures imposed, with the possible exception of exchange control, are generally less severe than in the case of foreign investment in public utilities and extractive industries.

(*i*) In most under-developed countries, however, the domestic market is still too small, or other conditions for the large-scale manufacturing most suitable for foreign investment are lacking. Moreover, the balance of payments of these countries generally permits the development of manufacturing through a continued inflow of foreign capital only if primary production for export is expanding.