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SUGGESTIONS OF MR. LIEU CONCERNING THE FINANCING OF ECONOMIC DEVELOPMENT

Although the central problem to be discussed in this session is the mobilization of financial resources, the scope is still quite broad. Fortunately, the Sub-Commission does not have to consider specific cases. It need not make recommendations as to how a particular developmental project in a particular country is to be financed. We may therefore confine our attention to certain general considerations.

I. Common features of under-developed countries

From the documents supplied to this Sub-Commission and from information obtained elsewhere, it is apparent that in spite of their wide geographical distribution, the under-developed countries have many features in common. These are the common defects in their economic structure, and it may be of advantage to us to pay special attention to them in considering financial mobilization.

1. Lack of diversification of their national economy.
2. Lack of technical skill and know-how. This was thoroughly discussed at the last session and I will therefore not go into it any further.
3. Lack of manufacturing industries, especially on a large scale.
4. Lack of facilities for channeling savings into long-term investments on a comparatively large scale. Most of the under-developed countries have long-term investments in the form of land-holdings, but there are usually no facilities to utilize the savings of a large number of people for developmental purposes.
5. Lack of modern transportation facilities.
6. Lack of electric power supply. In some countries there is also no sufficient fuel supply, but since, for the sake of economic development, electric power can to a large extent take the place of coal, emphasis is here placed on the former. Also, a country may have no coal or oil deposits, and therefore no way of developing such resources, but it can always have power plants. Italy furnishes a good example of the use of "white coal".

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Although agriculture in the under-developed countries is generally not modernized, I have not listed it above because that defect is under the careful consideration of FAO.

By "lack" I do not mean that they are entirely absent, but that they are inadequate for the economic development of these countries. Mr. Guimaraes has especially pointed out the lack of the last two kinds of facilities. They are also emphasized in the third annual report of the Bank. (Page 17). In my opinion, the inadequacy of the last three sets a limit to the economic development of the under-developed countries. Manufacturing industries can not prosper under such conditions, and the national economy can not be diversified. I think the Sub-Commission, if you gentlemen agree with me, should stress this fact, and go into the matter more fully in its future sessions. The deliberations in the Transport Commission, the regional commissions and the Conference on the Utilization and Conservation of Natural Resources, as well as studies prepared by the various agencies of the United Nations, will furnish us with much material if we wish to make recommendations in these connexions. In particular, I hope the International Monetary Fund will continue its studies into the financial institutions of the under-developed countries, with special emphasis on their relation to economic development.

In the study on capital movements, a conclusion is drawn that direct foreign investments entered only to a very small extent into manufacturing for the domestic market of the under-developed countries. (Page 41). In view of the usually small scale on which such manufacturing is conducted, foreign portfolio investments must be even more negligible. There is thus a situation which more or less corresponds with a similar gap in technical assistance discussed at our last session, but until the Secretariat study on industrial patterns is completed, we can go no further than calling the attention of the Economic and Employment Commission to this matter.

II. Domestic aspects of financing economic development

Since the under-developed countries generally have low per capita national incomes, capital formation is a very slow process, and whatever domestic capital is available is inadequate for the purpose of economic development. Of course the governments of these countries may levy more taxes in order to raise funds for this purpose, but no matter how the tax system is devised, the proceeds will not be sufficiently large. Often a significant proportion of such proceeds will have to be used to meet the expenses of tax collection. There is also the danger of lowering the standard of living of the people if the tax basis is too broad. If, on the other hand, the governments should resort to deficit financing, it is

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apt to lead to inflation, which is usually very difficult to control. For these reasons I believe we should limit ourselves to a recommendation that the under-developed countries should rely, only as far as possible, on domestic financial resources.

III. International aspects

Being members of a Sub-Commission of the United Nations, I believe we should pay more attention to the international aspects of financing economic development. This may be discussed under a number of headings.

1. Basic Conditions. Most of the conditions have been mentioned in the discussion of this Sub-Commission or of other agencies of the United Nations. I am only trying to summarize them here. (These conditions naturally do not apply to aids and grants.)

(a) Foreign investments must not involve any infringement of the sovereign rights of the under-developed countries in which they are invested. The Agreement of the International Bank of Reconstruction and Development provides that its loan policy should not be based on political considerations, and the same principle should be applied to investments from other sources.

(b) Foreign investors should not enjoy monopolistic privileges. This is a general principle which requires elastic application. For instance, most kinds of public utilities are natural monopolies, and we can not for that reason rule out foreign investments from that field. What should be done is for the government (national or local) of the country concerned to exercise some degree of control over the enterprises (with regards to the fixing of the rates, etc.). Such control is necessary also to domestic private enterprises in these fields.

(c) On the part of the under-developed countries, security must be offered to foreign investments if they are to be obtained at all. This would imply that the governments of these countries must not expropriate the foreign capital without fair compensation, or tax the profits derived therefrom more heavily than they do to similar foreign investments of other nationalities.

(d) Double taxation should be avoided. There need be some agreement between the governments of the capital-exporting and capital-importing countries to attain this end. The criterion, I think, should be the net income that is produced in the country in which the tax is levied. The pamphlet prepared by the former League of Nations, entitled "Conditions of Foreign Investment", also considers the net income to be the best basis of taxation.

/(e) Provisions

(e) Provisions should be made against transfer risks. In this connexion, if the capital-importing country should set aside certain foreign exchange resources for the purpose, the conditions should be considered to have been fulfilled. Such countries should also be encouraged to diversify their economy and particularly their exports so as to enable them better to service their foreign loans and meet the transfer requirements of direct foreign investments.

2. Form of investment. There are different opinions about the preferability of equity to portfolio investments. The advantage of the latter is that the capital-importing country knows exactly how much foreign exchange it must provide in a specific period to meet the requirements of the foreign investors, and, in the opinion of some people, it does not give the foreign investors any direct control over the enterprises concerned. (In the history of foreign investments of many under-developed countries, however, foreign loans have often involved a good deal of foreign control.) On the other hand, the advantage of equity investments is that the transfer of funds outside the country will automatically decrease in periods of depression, when the country is less able to meet the transfer requirements, because in such periods the investments will produce less profit, and the unfavourable exchange rate may also induce the investors to delay the transfer. Which form is preferable depends among other things, on the economic system of the particular capital-receiving country, its balance of payments conditions, the enterprise in which the foreign capital is to be invested etc. No definite conclusions can therefore be drawn and made applicable to all under-developed countries and all kinds of enterprises.

I have mentioned the above points because I think they are appropriate subjects of discussion. However, if the Sub-Commission decides on a different approach to the question of finance, I will have no objection to it if we can thereby reach definite conclusions.
