UNITED NATIONS

ECONOMIC AND SOCIAL COUNCIL

ARCHIVES
LINGUISTIQUE

GENERAL

E/1562
16 December 1949

ORIGINAL: ENGLISH

Tenth Session

ECONOMIC DEVELOPMENT OF UNDER-DEVELOPED COUNTRIES

Methods of Financing Economic Development
of Under-Developed Countries

Methods of Increasing Domestic Savings and of Ensuring
Their Most Advantageous Use for the Purpose of
Economic Development

Study by the
Secretary-General

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INTRODUCTION

In resolution 222 (IX) D (b) the Economic and Social Council requested the Secretariat to prepare a study which it defined as follows:

> "Methods of increasing domestic savings and of ensuring their most advantageous use for the purpose of economic development.
>
> A study to include an examination of the various types of financial institutions already existing in the less-developed countries and those which could be most effective in promoting economic development, and of the fiscal and other means whereby Governments can affect the volume and use of domestic savings;".

In responding to this request, the Secretariat has utilized the results of a meeting of experts on problems of economic development, the first one to be arranged under General Assembly resolution 200 (III). This meeting took place at Lake Success from 24 October to 2 November 1949, and had for its subject the study of prevailing practices and problems of domestic financing in selected under-developed countries. Since the meeting was organized in accordance with resolution 200 (III), the experts were not expected to produce at their meeting a specific set of recommendations of the kind which could be directly submitted to the Economic and Social Council; rather the purpose was to enable a group of persons in responsible positions and concerned with problems of financing economic development in their respective countries and territories to exchange experiences and formulate suggestions, and ultimately to enable interested persons in under-developed countries generally to benefit from the views expressed at the meeting.

The experts, participating in the meeting in their individual capacities, were: Sir Sydney Caine, Head of the United Kingdom Treasury and Supply Delegation in the United States; Antonio Carrillo Flores, Director of Nacional Financiera, S.A., of Mexico; Felix de la Costa, Vice-President of the Philippine Bank of Commerce; S. L. Descartes, Treasurer of Puerto-Rico; Desiderio Garcia, General Manager of the Cia. de Acero del Pacifico of the Chilean Corporacion de Fomento de la Produccion; Bal K. Madan, India's Executive Director of the International Monetary Fund; and Mohamed Aly Rifaat, former Controller of Exports and Imports in Egypt. Members of the staff of the International Monetary Fund and of the International Bank for Reconstruction and Development and of the United Nations Secretariat also participated in the discussion.

/The report

The report is presented in three parts: Part I consists of a survey of general views expressed at the meeting of experts. This survey, based on a Secretariat draft, has been debated and unanimously approved by the seven participants in the meeting.

Part II contains a detailed report on the proceedings of the meeting. It has been prepared by and on the responsibility of the Secretariat and has not been submitted to or approved by the participants of the meeting. It has been organized in a way which it is hoped will facilitate the discussion in the Council of the various problems involved.

Part III consists of the seven individual papers prepared by the participants in the meeting, dealing with prevailing practices and problems of domestic financing in the under-developed countries or territories in which they have special experience, together with an annotated guide and summary of the seven papers prepared by the Secretariat. In this annotated guide, the common characteristics representative of the under-developed countries and territories dealt with, and also particular divergencies of opinions and circumstances, are presented. In addition to the seven papers, the Secretariat has also been able to draw upon three research studies previously prepared by the International Monetary Fund on banking and financial institutions in three of the countries covered by the meeting, on the results of the United Nations Mission to Haiti, and on a preliminary draft of the first of a series of studies on financial institutions in various Far Eastern countries, prepared under a resolution adopted by ECAFE on 5 April 1949.

PART I: SURVEY OF GENERAL VIEWS EXPRESSED AT THE MEETING OF EXPERTS

General Results

Where physical and other resources are lacking, no improvement in financial organization can by itself enable development to take place. What improvement of financial habits and institutions can do, is to promote the utilization of existing resources towards the aim of economic development and prevent unnecessary hardships and dislocations arising in the process. Good financial organization cannot by itself produce development; bad financial organization can hamper it. The financial machinery in the under-developed countries is capable of improvement in a number of directions and the striving for such improvement should be a part of all policies directed towards development. The financial institutions of under-developed countries share in the state of general economic under-development, and added to this general weakness and insufficiency there is specific weakness in financial provision for these productive investments and improvements which form the essence of economic development.

Voluntary Savings

Facilities for the deposit of savings should be wide-spread, easily accessible and varied to provide for different types of savings and savers. Such facilities may be provided either through governmental or private agencies. Governments, apart from acting themselves as the depositories of savings (often through a Postal Savings Bank or Agricultural Bank system), can also encourage the growth of private facilities by appropriate banking legislation, provision of liquidity for banks, laws and practices encouraging the use of cheques and other credit instruments, and in general by policies of financial stability. More specifically, Governments can encourage the growth of banking facilities by such measures as regular use of banking institutions, depositing of Government funds, and other measures which in detail must depend on particular circumstances. Education of the public and publicity measures should also be generally used to spread the habit of saving and deposition of savings.

A fundamental consideration should be the safety of the depositor. Confidence in banking institutions of all types in many under-developed countries is a tender growth, and development must suffer serious setbacks if such confidence is undermined. The principle of safety of savings deposits should be paramount, and should govern the investment policies of public depositories of savings as well as

/Government

Government policies in relation to private depositories. In particular, Governments should not, in trying to utilize commercial banks as instruments of economic development, induce or compel banks to involve themselves in riskier or less liquid investments without taking appropriate measures to safeguard the savers and depositors. Such measures may consist in deposit insurance, liquidity and rediscounting facilities, provision of guaranteed Government or other public securities, etc.

Confidence may also be promoted by local direct knowledge of the banker. Hence, in certain conditions the establishment of small local single-unit banks, of co-operative credit unions, or the establishment of separate local boards for branch banks may all be found advisable. Protection of savers against fluctations in the value of money and individual currencies has wider implications and needs further study. Rates of interest offered must vary with local conditions and the general objectives of Government monetary policies. A lottery element has been found useful in some countries in attracting additional savings, or obtaining them at lower rates of interest, but in general such lottery features should be confined to the interest element, and should not endanger the security of the capital saved. Tax exemption of savings in certain forms from income tax, death or other duties is a frequently adopted inducement, but it was noted that such exemption was in effect an addition to the effective rate of interest paid.

A linking of specific savings with specific investment fields or investment projects has also been widely found to be useful, e.g. in attracting subscriptions to public loans, but it should be pointed out that Government resources for all purposes (of which development is only one) should be considered as a whole. The earmarking of particular savings for particular development projects does not in itself ensure that the projects subscribed to will in fact obtain a larger share of total Government funds than would otherwise have been the case. The obtaining of local savings for specific local development occurs naturally in credit co-operatives, building societies, etc., but is hardly capable of more than supplemental application. A more important problem is the reservation of national savings of under-developed areas for local investment. Attempts to encourage national savings to show preference for national use are possible and widely used. It may in particular be desirable to attract the investments of the local depositories of savings mainly into national securities or other local assets, with the proviso that where local savings are deposited in foreign currencies, the

/depositories

depositories must be enabled to hold foreign investments to correspond to their foreign currency commitments. Those under-developed areas which form part of or are in close relation to larger and more highly developed financial systems form a special case since they gain on balance through a net inflow of funds at low rates of interest; and the practice in those areas has not been to make any attempt to reserve local saving for local investment.

The direct re-investment of profits without the intermediary of specific institutions, or their retention as business deposits in banks, forms an important part of total savings in under-developed countries, as it does in more fully developed countries. Although this source of finance may not necessarily produce the best direction of investment, it undoubtedly tends to increase the total volume of savings, and therefore the tendency in under-developed countries is to encourage and welcome it. Tax discrimination in favour of non-distributed profits or in some cases of re-invested profits is used, re-investment of profits made a condition of certain types of Government assistance and company laws encourage or enforce the retention of profits. The encouragement of re-investment of profits which would otherwise go abroad, i.e. specially those of foreign companies, is particularly desirable.

At more advanced stages within the general sphere of under-development when there is a supply of marketable company and Government securities a Stock Exchange is a valuable supplement to other financial institutions to give an opportunity for individual investors to contribute without excessive risk finance to development in other ways than through the medium of banks or other deposit institutions. Stock Exchanges also contribute to expanding the large family-owned enterprises into some form of joint stock companies. Stock Exchanges in under-developed countries often suffer from a narrowness of the market and the resulting large price fluctuations may make investment in industrial or even Government securities risky for the individual investor. The general principle which can be established is that Governments should not prematurely force the establishment of a Stock Exchange before a sufficient supply of securities exists. Once established the Government should encourage and supervise the Stock Exchange to prevent abuses. Where Stock Exchanges exist they offer a medium through which private participation in public enterprises can be arranged.

Private savers in under-developed countries often show a tendency to save by acquiring gold, real estate or other real assets instead of depositing their

/savings in the

savings in the form of money. In reflection of this preference, banking institutions themselves may also prefer to invest deposits made in them in real estate financing or in the financing of hoarding activities. As far as the individual saver is concerned, this tendency can be partly counteracted by education and by making safe, easy and attractive depositing facilities widely available. Governments should at least refrain from making investments in such forms as real estate holding financially more attractive than more socially desirable forms of saving by giving real investment more favourable treatment in tax rates, assessment or administration or by special requirements for the investment of institutional funds. The suggestion that savers' preferences might be paralleled instead of counteracted by the issue of gold certificates, real estate certificates, etc. deserves further examination but has obvious limitations. Where actual gold, real estate etc. has to be held as backing little is gained. Where savers can be persuaded to accept certificates without backing it would seem that they could also be persuaded to deposit savings in the form of money.

The encouragement of a proper agricultural credit system raises problems of its own. The weakness of many existing systems is evidenced by the widespread use of private money lending at exorbitant rates of interest and accompanied by other abuses. Some countries have tried to fill the gap by co-operative or governmental credit facilities. Co-operative forms of organization, both specialized credit co-operatives and multi-purpose co-operatives have improved agricultural credit, and controlled its use by linking credit with supplies and advice. Their existence has also served as a check on the abuses of private lenders. Governments should go on giving encouragement to the growth of co-operative forms of credit organization, even though such forms have not been found equally successful everywhere. In some regions inadequacies in education or local traditions, etc. have worked against their wider use. Communal ownership, excessive sub-division and fragmentation of holdings, laws preventing the use of land as collateral are obstacles in the development of agricultural credit, which public or co-operative organizations may be required to overcome. Thus, there is scope for improving agricultural credit facilities as part of the process of general agricultural reform.

Commercial banks and other depositories of private savings do not normally provide long-term capital for development projects in long-term loans, and even less so in risk capital. There are significant exceptions, however, and in some under-developed countries private banks, insurance companies, investment trusts and similar institutions are supplying such long-term capital needs and even promoting and setting up enterprises of their own. As a general principle, commercial banks and similar private institutions should not be encouraged to go further in long-term industrial investment than they spontaneously decide to do, in accordance with the nature and structure of the deposits. Where long-term investment in industrial loans or capital on the part of private banking institutions is desired, it will be preferable to create specialized institutions (which may be associated with existing commercial banks) for this purpose. In the case of intermediate, as distinct from long-term, loans for productive purposes, there is some scope for Government encouragement of an active credit policy on the part of banks, provided that their liquidity is safeguarded.

Governments have adopted a number of measures designed to induce banks to increase the proportion of intermediate or long-term productive investment. Such measures include, in particular, special re-discounting facilities. In any measure of this kind, the position and security of the saver and depositor should be carefully safeguarded. Where public or semi-public bonds for the financing of development projects exist, and private banking institutions are induced to invest in them more than they spontaneously would, it becomes an even more direct responsibility of Governments to provide liquidity for banks in need of cash, either by free facilities for encashment of the bonds, or by general Central Bank policy.

As a general principle, it would seem preferable for the state to direct investment into preferred fields whether by such fiscal measures as more favourable tax treatment or by direct use of public funds (public enterprise or subsidy to private enterprise). Where credit regulation of private institutions is attempted, this may be more effective if used negatively, i.e. restricting credits in undesirable directions, such as undesirable speculation and consumption credits, rather than by positive direction.

Saving through Government funds - Taxation and Borrowing.

In view of the insufficiency of voluntary savings in under-developed countries, the total volume of deliberate saving can be increased through the use by the government, for purposes of capital development, of the proceeds of compulsory savings, namely taxation. Governments can, and do, utilize a substantial part of voluntary savings by borrowing. Another form of compulsory saving is by credit

/expansion or

expansion or other monetary devices which are inflationary in nature. Certain forms of "borrowing", especially by governments from central banks and the private banking system, constitute the most common form of such monetary devices. As a general principle, such devices, because of their inflationary tendencies, are the least desirable method of financing. They cannot, however, be categorically excluded since in certain circumstances they are the only possible method of bringing unused resources into operation or increasing productivity rapidly. However, in view of the inflationary conditions already prevailing in many under-developed countries, this must in the general case be considered as a very dangerous method of financing. It is in any event essential to recognize any inflationary policies followed and keep them under control.

The general structure of taxation in under-developed countries is so different as between the various countries that no detailed suggestions of universal application on the different types of taxation to be preferred can be made, but certain general principles do emerge. The trend is towards an extended use of direct taxation and where such taxes can be fairly administered and collected they are suitable to the great concentration of incomes characteristic of many under-developed countries. There is, however, a limit to the proportion of income which can be taken in this form, and it appears that latterly the limit of direct taxation has been reached or approached in a few under-developed countries, and increased reliance on indirect taxation and excise duties can be observed in such countries. Difficulties of assessment and administration of direct taxes, as well as their possible deterrent effects on investment, are further limits to the extent to which they will be able to displace indirect taxation. Import duties are widely used in under-developed countries for revenue purposes. Insofar as they have a protective effect, they raise problems of commercial policy beyond the scope of the meeting. Exemptions from existing import duties can be used to facilitate the import of goods which are needed for selected fields of economic development.

In a number of cases taxation has not yet reached a level where its burden would prevent the extended use of this method of financing development.

While increasing tax revenue is generally desirable in under-developed countries, one must take into account the fact that such increases of tax may result in some diminution of private savings, so that the total sum available for capital development will not be increased by the full amount of the tax.

/Specific tax

Specific tax and duty exemptions and other types of fiscal concessions to encourage saving and investment have indeed widely occurred. There is, however, a limit to the over-elaboration of the fiscal structure beyond which administration becomes difficult and the fair and impartial treatment of all residents more difficult to ensure.

The allocation of specific taxes to particular development projects or fields or corporations has been preferred in some countries with the intention of giving a greater degree of security, independence and continuity to specific development expenditures. Sometimes, the method has not been found satisfactory and been abandoned. Similarly, the allocation of income from royalties or export taxes arising from the depletion of wasting natural assets to productive investment seems a plausible policy, but this also may not be generally applicable where such revenue forms the bulk of all Government revenue. Government revenue and Government expenditure for all purposes, including those for regular Government functions other than developmental, should be considered as a whole, and the allocation of particular revenues to particular expenditures is not a guarantee that development expenditure will be larger or more stable.

In view of the paucity of domestic financial resources in under-developed countries, it is particularly important that the Governments should receive substantial tax revenues from foreign investments without thereby discouraging them. Since foreign investors are usually also taxed by their home governments, a problem of multiple taxation arises. Tax credits granted through unilateral legislation or bilateral tax agreements by capital exporting countries for taxes paid to the countries where the assets or enterprises are located, can effectively solve this problem. Under-developed countries can then raise their taxes to the limit of this credit without imposing an additional burden on the foreign investor. The avoidance of multiple taxation by reserving exclusive taxing authority over foreign assets and income to the taxpayer's home country is not recommended, since under-developed countries which have scant foreign establishments and investments would lose important sources of revenue without any quid pro quo.

As to the relative share of taxation and Government borrowing in the fiscal structure, few general principles can be stated. Taxation should cover at least current expenditure on normal government services. Borrowing is particularly appropriate to finance government expenditure which results in the creation of

/capital assets

capital assets or which is otherwise directly productive. Experience varies as to the relative degree of control over expenditure from the proceeds of taxation as compared to expenditure of borrowed money. In some countries, it has been found that borrowed money is more carefully and efficiently spent than tax money; in others, the opposite. Insofar as borrowing is resorted to, proper techniques of efficient debt management may become an important factor in lowering costs of financing economic development.

Public funds may flow into development either directly through Government Departments, or else through specialized public or partially public financing institutions or corporations. Such specialized institutions are now a generally accepted feature of development policy in a number of countries. They have been found useful in decentralizing decisions, in admitting of joint participation of private and public capital, in assuring re-investment of profits and in other ways. On the other hand, where various public and semi-public organizations are at work, problems of overlapping both with each other and with Government departments arise, cost of administration may be heavy and there is a danger that Governments may lose control of over-all development policies. These problems will have to be weighed against each other in particular conditions. The only principles which can be enunciated are that the device of separate corporation or similar institutions is more appropriate, the more directly operational and commercial is the task and that general policy control should be retained by Governments.

It cannot be pronounced as a general principle that public funds should be confined to fields in which there is no competition with private profit making capital. State activities in profit making fields has been found useful in a number of countries to prevent private monopolies, provide profits to carry other activities carried on at a loss, serve as a yardstick for assessing the efficiency of private enterprise etc. Since one of the purposes of government action is the fostering of private capital engaged in useful activities, it may be advisable to engage private capital in joint participation and turn the enterprise over to them for full operation, when other reasons do not impede it (strategic, public welfare, general state policy of national ownership, etc.). Similarly, the employment of public funds cannot be restricted to particular fields although it can be said that the more certain fields are of the nature of general services or utilities the more suitable they are for the deployment of public funds.

High rates of interest

For established enterprises high rates of interest for borrowed funds are often compensated in their deterrent effects on investment by correspondingly high profits. Obviously, there is no such compensation in the case of non-profit making government enterprise, specially in the provision of social capital required for economic development. Even in the case of private enterprises, compensation by high profits does not apply in the early years of new investments. Where the interval between the original investment and the earning of normal profits is considerable, the high rates of interest are a considerable net burden and a powerful deterrent to new development. Similarly, where the development is in fields where rates of profit vary considerably, the high rates of interest add to the fixed burden and hence to the risk of investment. Thus high rates of interest are at the same time a symptom and a cause of risks in investment.

There is a part of the high rates of interest which is due to the absence of proper financial and credit machinery. This is a very important part and it is essential to attack this part of the high rates by developing the banking and credit organizations. This part is especially noticeable in the remoter part of the under-developed countries outside the main concentration of banking institutions. The greater diffusion of banking facilities is therefore important, not only in order to reduce rates of interest but also in order to diffuse actual development more widely inside the under-developed countries. It is noteworthy that in a number of under-developed countries the extension of credit facilities has already resulted in a marked fall in interest rates in important sectors. Governments can further contribute to lower interest rates by low rates of re-discount and the lending of public funds at low rates of interest.

But it has to be recognized that an important part of the high rates of interest reflects the capital shortage and pressure on available funds in under-developed countries and is also part of the natural means of invoking additional savings to reduce this shortage. Since to that extent the high rates of interest are due to real factors, no purely monetary or financial measures can be recommended. Some other part of the high rates reflects the greater risks of investment in under-developed countries and in speculation; this is reducible mainly by diminishing such risks, specially by orderly development policies and the prevention of unsound investment. To some extent, in many countries the high rates of interest are a reflection of past inflationary experiences and uncertainty of the

/future.

future. Insofar as this goes, they can only be lowered by avoidance of inflationary techniques of financing and by restoring confidence.

It has been noted that where foreign financing has been obtained for particular projects, domestic finance has also been obtained at lower rates of interest than are generally prevailing. It may be similarly expected that international co-operation in the form of technical assistance in preparing and assessing projects may help to induce domestic capital to come forward at lower rates of interest. If there is a depreciation in the currency of the borrowing country, the rates of interest on debts incurred in terms of foreign currency are, however, effectively increased and may be raised above domestic rates; where the lender depreciates, the effective rate of foreign borrowing is lowered but this will be less frequent.

Limits of the contribution of domestic financing of specific projects in relation to total finance.

In a few under-developed countries generally, and in some fields of development in others, it may be that domestic savings in various forms should be sufficient to cover the total costs. The more frequent case, however, is that of a desirability or necessity of supplementing domestic by foreign sources of finance. It will also generally be the case that development projects will involve immediate foreign exchange expenditure. There is, however, no direct logical connection between the immediate expenditures in local and foreign currencies on the one hand, and the desirable proportion of foreign and domestic financing on the other hand.

The most desirable proportion of foreign financing for given development projects can only be determined by assessing the domestic savings opportunities, whether voluntary or involuntary, as a whole. In such an assessment, it is important to be aware of the secondary repercussions (recurrent and non-recurrent) of given development projects, including the balance of payments repercussions. When such an assessment is made, it will often be found that the requirement for foreign financing may be either larger or smaller than the foreign exchange expenditure immediately involved. It is hoped that the techniques for such general assessment will be developed so that in the execution of sound development programme, on the one hand the savings possibilities existing in under-developed countries can be fully utilized, and on the other hand foreign financing is sufficient to prevent domestic inflation.

In general, it must be expected that in a number of cases, specially in the least developed countries, the opportunities for covering the whole of the domestic

/expenditure

expenditure part of important development projects by voluntary or fiscal savings do not exist. In such cases, to restrict foreign financing to the foreign expenditure part would mean either that the under-developed countries would be thrown back on inflationary techniques or that they would simply not be able to provide the necessary funds. Under such circumstances it may even be envisaged that the required expenditure would only be possible if it is provided by international funds, especially when projects of high public interest and doubtful commercial value are involved.

It is, therefore, felt that foreign loans should not be restricted to covering expenditures abroad in foreign currencies, but where necessary, in the line of the above discussion, should be available to cover domestic expenditure as well.

It may be noted that where foreign financing is not of the type of Governmental or international loans but of the type of direct private investments, in general the total expenditure involved, whether in foreign or domestic currency, is supplied from abroad, often together with the required technical skills and assistance. Subsequently, a satisfactory relation between foreign and domestic financing can be established by arranging for participation by local capital. In this respect, the problem of satisfactory relation between domestic and foreign financing seems easier of solution in the case of direct private investment than in the case of governmental or international loans.

PART II: SUMMARY OF DISCUSSIONS OF THE MEETING OF EXPERTS

/Section I:

Section I: Promotion of Voluntary Savings by Individuals and Business Units

(a) Banking and savings habits

What measures can be taken to make the general public more willing to deposit savings and give them confidence in the stability of banking and financial institutions?

The group debated this question, and in the course of the discussion a number of views were brought up on which there was agreement, others on which suggestions for further study were made. It also became apparent that experience and problems of the various under-developed countries represented varied.

The measures which it was suggested governments should take can be divided into definite classes:

1. Measures of general economic policies, such as the avoidance of inflation, and the pursuit of economic and financial stability.

2. More specific measures could be taken either to insure banks against illiquidity, or else to protect depositors from the effects of any such illiquidity. Among such measures were mentioned governmental deposit insurance and control of bank investments designed to prevent illiquidity and insolvency. The view was put forward that inasmuch as there is public supervision of the banking system by a Central Bank, Ministry of Finance or other government institution, a failure of a bank really indicates a failure of supervision, and that for this reason there is an implicit responsibility of governments to compensate depositors for losses suffered in depositing their savings with recognized institutions.

3. Governments could improve the effective provision of banking facilities by appropriate banking legislation controlling the establishment of banks and supervising their operations and by enabling the banking system to expand its reach to new strata of the population, especially in more remote and rural parts; of such measures which governments could take, the following were mentioned as being applied with good results in various countries:

   (a) Liberalization of bank laws by eliminating or reducing initial minimum capital requirements while, at the same time, maintaining supervision over banks to insure solvency;

/(b) Avoidance

(b) Avoidance of special taxes on bank deposits and the use of checks; conversely, it was mentioned that one government has gone even further and given tax exemption from death duties for assets held in the form of deposits up to a certain maximum.

(c) The use of checks by government departments in paying out salaries and settling other expenditures, ready acceptance of checks by government in payment of taxes, and other dues (one instance was cited where such acceptance does not exist).

4. Positive encouragement of extension of the banking system through the setting up of branches of government banks, use of local authorities as agencies of government banks, extension of banking facilities through such decentralized government offices as post offices, etc., by guaranteeing to hold government accounts in new branches of banks or new unit banks, by providing premises for strong rooms, by allowing initial expenses of opening new banks as a charge against profits before assessing taxation, by helping to train bank officers and arranging for an orderly system of examinations, etc.

5. Measures of publicity, especially education of school children in the importance of saving through banking institutions and other educational and publicity measures.

6. Furthering the establishment of organizations, especially of rural organizations, which fulfill the functions of collecting savings and lending productively as part of their general activities, such as agricultural co-operatives, building societies, credit unions, etc.

It was pointed out in the course of the discussion that international organizations could effectively help governments in promoting the growth, use and effectiveness of a proper banking structure in under-developed countries by advising them on measures under each of the various headings listed above. The establishment of banks as branches from other more developed countries was mentioned as one method of international co-operation in this field, although foreign banking was also agreed to contain certain dangers in some cases[1/] and the ultimate aim should be the growth of a vigorous domestic system. The

1/ See Part IV (annotated guide to experts' documents prepared by the Secretariat), page 320

/development

development of international model banking laws, suitable for countries at varying stages of economic development and meetings of experts to provide for the implementation in detail of these banking laws were mentioned as suitable means of such international co-operation.

It was pointed out that in some countries the law did not yet provide adequate protection against the fraudulent use of checks and that confidence in banking could be increased by tightening up legislation. The prevalence of usury was also mentioned as an obstacle in the growth of institutionalized banking, and the suppression of usury with its high rates of interest with which banks cannot compete in trying to attract deposits and funds was put forward as an important prerequisite for development of banking institutions.

Views and experience differed as to whether the method of branch banking or single unit banking was preferable in under-developed countries. Both methods found their defenders and in some countries it was said that both systems had proved equally useful and were developing side by side.

In favour of single unit banks it was stated that:

(1) It was desirable in under-developed countries to decentralize bank decisions and spread banking into small rural communities by setting up small single unit banks where the decisions were made on the spot. For the Philippines, for instance, it was stated that experience with branch banking was not favourable in that decisions were not sufficiently decentralized and, thus, the interests of the small and remote rural areas tended to be neglected. This argument was not accepted for the British Colonies; for these, it was stated that branch banking had worked satisfactorily, with sufficient discretion given to the local managers to make decisions on the spot and to cater for local requirements. The method of establishing separate local boards for different regional units of branches had also been found useful.

(2) It was stated that the single unit bank was useful in increasing the volume of local savings and in the education of people in under-developed countries towards banking habits because people prefer to entrust their savings or come for credit to a local banker whom they know and trust.

(3) It was stated that single unit banks were easier to establish because of their lower capital requirements and that this contributed to a general increase in banking facilities.

/As against this,

As against this, the following advantages for branch banking were urged:

(1) That by the use of branch banking, experienced staff could be economized.

(2) That by the establishment of branches, experience and resources already available at the head office, either inside the under-developed country or abroad, could be utilized.

(3) That depositors could have more confidence in an institution whose resources and assets were larger and more widely spread than was the case with the single unit bank.

(4) That it was easier for governments to control banks, guarantee their liquidity and solvency and influence their investments in the case of larger branch banks than in the case of a large number of single unit banks.

For India it was stated that a highly developed corporate banking system of the branch type and an indigenous banking system of the local type were co-existent side by side, and that one of the difficulties of training development was caused by the fact that there was little rapport and contact between the two systems.

For most of the under-developed countries represented, the view was expressed that control of banking by a Central Bank was essential to establish confidence among depositors. For the British Colonies, it was stated that there was full confidence in the stability of the banking system without any kind of direct central banking control inside the Colonies.

/(b) Government

(b) Government savings institutions

What are the best methods for organizing Government savings institutions and what terms have been found necessary to protect savers?

In the discussion of this question, it was clarified that governmental encouragement of savings does not necessarily presuppose the establishment of particular savings institutions, and even less so of special Government institutions. Governments can encourage savings by providing particular savings instruments, such as Government bonds issued in very small denominations, without having to provide special depositories for savings. Also, the provision of savings institutions can be in the hands of private banks, in which case the general recommendation could be made that a special savings branch or savings department would be advisable, in order to separate savings deposits from ordinary banking business. In general, however, it was believed at the meeting that Government encouragement of private savings would in most cases include the provision of special public facilities for the depositing of savings.

In encouraging private savings, three principles were put forward and met with general acceptance:

(1) Public savings institutions should be highly decentralized and an attempt should be made to extend them to every nook and cranny of the country. In this connexion the device of itinerant or travelling savings banks to serve the needs of remoter areas was mentioned. This has been used with good results in several under-developed countries.

(2) It was desirable to offer attractive terms to savers, either directly in the form of a high rate of interest, or else in the form of special tax exemption or other concessions. The principle was accepted that the rate of interest offered to savers, especially to small savers, should be generally higher than that offered on general Government securities in larger denominations, held by banks, insurance companies, or larger investors. On the other hand, it was also declared without contradiction that no attempt should be made to offer rates of interest which would compare with commercial rates, especially where commercial rates are very high as in the case of private money lending. Rather than in high rates

/of interest,

of interest, the main attraction offered by Governments to savers should be absolute security, and the absence of any possibility of depreciation of the money value of the savings. One member went even further in putting forward for further study a suggestion that the real value of savings - as distinct from their money value - should be protected by linking them to prices through some form of sliding scale. To this scheme the following objections were made:

(a) That in under-developed countries with inflationary experience it would further undermine the confidence of people in the value of money, since such a sliding scale amounted to an admission by the Government that the value of money was likely to fall;

(b) that it would result in a demand for similar protection on the part of other groups of the population, e.g. wage and salary earners, and thus restrict the freedom of the Government to manoeuvre in matters of general monetary and price policy; and

(c) that it would involve Governments in unspecified and inadvisable liabilities in case of a rise in prices. To this last argument, the reply was made that in case of a rise in prices, Government revenues would also go up, and thus the real burden of a commitment to savers under sliding scales would not really be increased. The general result of the discussion was that such schemes should be warily approached, especially in countries suffering from inflationary pressure, but that they deserved further study.

Where a high rate of interest or other special inducements such as tax exemptions are offered, these may often be confined to small savers by limiting the maximum capital deposit or maximum yearly addition to the deposit in respect of which such special concessions are made. This would prevent such concessions from resulting in loss of State revenue without corresponding encouragement to saving.

(3) To encourage saving it is desirable to provide different types of securities which in respect of dates of maturity, ease of encashment, use as collateral for credits, rates of interest, capital appreciation, lottery features, or in other ways would appeal to savers with different requirements and different tastes. The device of a progressive rate of

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interest, under which long-term regular savers who do not withdraw their savings, are rewarded by a rising rate of interest according to the length for which savings are held on deposit, is used in some countries and was stated to be widely applicable with good results.

As to the special methods which Governments use to encourage saving habits, it seemed generally agreed that it was proper for Governments not just to provide saving facilities, and passively wait for savings to come forward, but to encourage savings by more active measures. Some Governments encourage savings by general publicity but it was stated that in some under-developed countries the real problem was one of a distrustful attitude of the population towards Government, and that in such cases too intense an association of Government with savings institutions might undermine rather than strengthen confidence. In such cases, the best kind of Government contribution would be such financial conduct as would strengthen the confidence of the population in the security of savings made.

A particular method of promoting savings brought to attention was the encouragement of saving-up for specific purposes, or generally the linking of savings activities with specific individual desires and objectives. Among the applications of this method mentioned were the building societies, where savings is closely linked to the provision of houses (although savers and borrowers are not necessarily identical groups), small "industrial insurance" schemes, under which regular small contributions are made for old age benefits, payment of fixed sums in certain cases of need, etc., and the organization of co-operative agricultural savings banks, closely linked to the credit requirements of rural communities. Experience with these practices in various countries varied. In India and Cyprus it was stated that the use of co-operative savings banks was widespread but it was found that institutions of the type of building societies and small-scale insurance schemes are not widely used in the under-developed countries represented.

Mexico provides an illustration of a country where a lottery feature is used as a device to encourage private savings. This takes the form of the so-called capitalization companies rather than straight lotteries. Participants make regular contributions and in return they receive a certain amount of capital after a period of 5 or 10 years, even if their bonds are not drawn in the lottery. If their bonds are drawn they receive the total

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amount of capital earlier, often much ahead of the normal time. The device is described as successful because the people like the element of chance contained in it, and as constituting a means of utilizing traditional public habits as a means of building up funds for development purposes. The institutions specializing in this type of savings with lottery features were able to build up reserve funds almost as long as those of the large insurance companies. By legal requirement, 20 per cent of these funds were invested in government bonds. There is a tendency for the investments of these companies to run towards real-estate projects, but there seems little doubt that they have increased the volume of available savings.

The method was also used in Palestine under the British mandate. Loans were issued at a very low rate of interest, and the balance of what would normally have been paid as interest was divided up as prizes to be drawn in a lottery. The prizes consisted of a small number of large prizes and a larger number of smaller prizes. The system is described as having proved very attractive to investors and successful in attracting savings at lower total effective interest rates. It was agreed that the lottery method deserved further study, especially if the proceeds are devoted to specific desired projects.

In India a smaller lottery scheme has been started but did not prove equally successful because it was not strongly supported by the government.

The general agreement was that the system may tap a source of savings which could otherwise not be reached, but that the chance element should not be extended so as to include the safety of the capital itself; prizes should be relatively small and confined to the interest element. It was pointed out that otherwise lotteries might be harmful in encouraging in the public a desire to get something for nothing, an attitude not easily compatible with the requirements of economic development.

Further discussion took place around the suggestion that it might be useful to utilize existing savers' preferences rather than go against them, by issuing gold certificates where gold is being hoarded, issuing mortgage certificates where there is a tendency to over-invest in real estate etc.[1/] It was agreed

1/ This idea was developed in the Secretariat report on the "Methods of Financing Economic Development" (E/1333) to which reference was made.

that this method should be used, but that its usefulness was rather limited. Thus, in connexion with the issue of gold certificates, it was pointed out that if people trusted governments sufficiently to accept gold certificates in place of gold, they could also probably be persuaded to accept general government bonds or put their money into savings deposits. If peoplc tended to hoard gold because of their past history of government bonds being repudiated the same doubt would be felt about gold certificates. Experience in the past history of gold clauses in contracts have not been very encouraging. Secondly, if gold were actually to be held against the certificates there would be no advantage in issuing them. Thirdly, such preferential treatment designed to reassure some savers by issuing special gold certificates might cause people to doubt the security of other government bonds.

However, in spite of such doubts expressed, in respect of one of the forms suggested for using savers' preferences, the meeting agreed that financial policy should be adapted to existing psychology, that governments should be encouraged to try out the type of approach suggested, and that in some cases flank attacks on undesirable hoarding habits might lead to a gradual diminution in the amounts hoarded and might perhaps be more successful in the long run than direct attacks by way of prohibitions and direct controls.

(c) Links with particular development projects

How can local savings be encouraged by a direct link with local investment and local development or between savings and particular development projects?

The discussion on the possibilities of increasing savings by linking the act of savings to specific pieces or acts of investment of special local or direct personal interest brought out both the benefits and the limitations of this method.

Illustrations of the benefit and promise held out by this method are:

1. Where monetary and fiscal institutions are little developed, it may be possible to "finance" development by the pooling of voluntary labour and other contributions in kind. Such methods - which have also been used in advanced economies - are only suitable for specific or local projects; they may be supplemented by special local savings drives. Thus, in India, direct local contribution of labour and savings has brought about the establishment of dispensaries and schools, improvement of roads, digging of wells and other useful work.

2. In Mexico, experience with the linking of savings, specially subscriptions to government bonds, with specific purposes has been favourable. Where the public is in doubt about the use to which funds are put, there is a better chance of evoking savings and subscriptions where a definite project is presented. The method has been found specially useful in raising funds for road construction.

3. In the Philippines, it is found that there is a tendency to drain off rural savings to the metropolitan areas where the head offices of the banks and savings institutions are concentrated. It is felt that this has a discouraging effect on rural saving which might be counteracted by investing savings directly in local projects.

4. In Chile, too, it was found that local savings which otherwise would not have been forthcoming were mobilized when specific local or regional enterprises were offered, although this did not invariably prove effective.

5. In India, again, experience shows that the possibility of eventually becoming the owner of their land is a definite incentive to cultivators to save.

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6. Further, it was stated that where long-term advances for direct agricultural improvement are given, subsequent savings are encouraged by the prospect or experience of the direct benefits which can be obtained by wise investment.

Among the weaknesses or limitations of this approach brought out in the discussion were the following:

1. The method of building societies although old-established in the United Kingdom and instrumental there in furthering savings habits and increasing savings, did not work equally well when it was tried out in some colonies. It was felt that some of the methods of linking saving and investment are more suitable for highly developed countries than for under-developed countries.

2. It was stated for the Philippines - and also confirmed for other countries - that municipal bonds and other issues are held by banks and financial institutions rather than by private individuals. This evidently reduces the effectiveness of promoting savings by calling on local or personal interests, in issuing bonds.

3. In some cases, for instance some British colonies, experience with local bond issues has been disappointing. Local interest was not sufficient to overcome the paucity of local sources, and the customary higher rates of interest. It would be cheaper in such cases to issue the bonds abroad or in the metropolitan area rather than rely on local subscriptions.

4. In India, it is found that although the knowledge that money invested was to be spent on a particular project was helpful in inducing confidence and interest, such considerations are limited and often overridden by consideration of the general financial position and policy of the authority raising the money. Indian investors are likely to choose between issues of different provincial governments on the basis of financial soundness rather than of the location of the project.

5. Another method of promoting savings by relating it to a known act of investment of direct interest is the method of profit sharing with workers and employees, inasmuch as that method can be described as the saving by employees of part of their real wages and the re-investment of that part in the firm of employment. This has not been widely tried in under-developed countries but some experience exists in Mexico where there is constitutional provision for profit-sharing. Present experience is not too encouraging,

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since neither employees nor workers seem much interested in applying this provision and workers prefer higher cash wages to a profit share. The possibilities of increasing savings by the method of profit-sharing in under-developed countries were suggested for further study.

(d) <u>Flow of savings to and from larger financial areas</u>

> <u>Should areas which form part of a large financial area, such as Puerto Rico or United Kingdom Dependent Territories, attempt to reserve local savings for local investment, or do they derive greater advantages from forming an undistinguishable part of a large financial area?</u>

The upshot of the discussion on this point was that where under-developed countries form part of or are in close relation to a larger and more highly developed area, whether by present or past political association or by economic gravitation, it is the best policy for them to try to make the best of both worlds. This they could do by deriving all possible benefits from the larger area of close association, and yet encouraging local investment of local saving by measures short of such controls and regulation as would lessen their links with the wider area. In particular, it was stated that in such cases where the association is particularly strong, as in the United Kingdom colonies or Puerto Rico, the benefits of association are of great importance.

1. It was stated that although in such cases there is some outward movement of savings and capital from the more under-developed part to the more highly developed part which superficially would seem harmful to economic development, yet in fact there was a cross-flow of capital which usually resulted in a net inflow into the under-developed areas. Attempts to stop the outward flow might easily have the end result of reducing the net inflow and thus do more harm than good.

2. It was stressed that through their financial association with more developed areas, under-developed countries were often enabled to borrow money at lower rates of interest abroad than would have to be paid locally. It was also stated that such access to markets with low rates of interest had the effect of reducing domestic rates themselves. As an illustration, the case of colonial governments was cited which can borrow money at rates very little above those of British Government securities.

3. It was stated that access to the securities and capital markets of the more developed areas provided a large reservoir of safe and liquid investments

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for the financial institutions of the under-developed areas, thus improving their stability and effectiveness. Investment in British securities by colonial savings banks was cited as illustration.

4. It was stressed that the technical facilities of the more developed areas could in that way be beneficially used by under-developed countries. The application to Puerto Rico of the United States Federal Deposit Insurance Scheme and of the Federal Housing Agency was quoted as illustration.

5. It was stressed that reservation of domestic savings for national investment would often involve foreign exchange control applied to a small area which might be difficult to work and harmful to normal trade and international relations.

6. It was also said that sometimes in under-developed areas no useful immediate employment for existing funds, specially short-term funds, might be found, and that in such cases limitation of funds to domestic uses might be useless or even embarrassing. There was agreement, however, that this should be an abnormal position in under-developed countries, and that where there was a danger of this happening, a public works reserve or secondary development programme should exist to absorb all locally available funds, specially public surplus funds. Where conditions are abnormal, local employment of surplus funds may be impossible because other prerequisites of development for instance, equipment are lacking; in such cases it may be necessary to hold funds abroad until domestic development can proceed.

7. Association with the capital-rich areas provided the under-developed countries with an opportunity to publicize and promote investment prospects and approach potential investors. This was specially stressed for the relation of Puerto Rico to the United States.

While these benefits were stressed, some degree of encouragement of local savings to go into local investment was reported from all the areas represented, and local feeling was in favour of local investment. Such movements in favour of local investment were reported from the Philippines, India and Mexico. In the United Kingdom colonies, although there is a completely unhindered flow of capital between the colonies and the metropolitan area, there now exists a ten-year development programme which envisages the utilization of all existing local financial surpluses.

The question was raised whether close association with a larger financial area would not introduce an element of instability in the under-developed countries by causing net outflows from them in depression years and large inflows in boom years. The prevailing view was that the trend had been in the opposite direction, that reserves were accumulated by the under-developed countries in good years and drawn upon in bad years, thus stabilizing the actual spending power of the under-developed area. This was stated to be the general position in United Kingdom colonies where it was further stated that the metropolitan area would make special assistance available to individual territories badly affected by adverse movement of capital. For Puerto Rico, certain types of public investment were suggested in case of a depression or recession in the United States, and similar measures were suggested for further study and recommendation to areas closely dependent on trade movements in a dominant financial area.

/(e) Re-investment

(e) Re-investment of profits (business savings)

What legislation and administrative experience exist showing the usefulness of different methods of inducing companies to re-invest their profits in productive enterprise?

It emerged from the exchange of experience in the group that no special measures to favour re-investment of profits had been taken in Puerto Rico, Egypt or the Philippines, but that special privileges were given in India, Mexico and Chile, and the United Kingdom colonies.

Taking first the countries where no particular steps had been taken to cause profits to be re-invested:

1. For the Philippines, it was stated no special problem was felt to exist; most enterprises were young and growing and needed no artificial inducement to re-invest their profits.

2. Puerto Rico had no experience but would welcome information, specially on how to overcome the practical legislative obstacles.

3. For Egypt, it was stated that while company statutes gave encouragement to re-investment of profits by providing for the building up of statutory reserves, legislation was in some aspects antagonistic to company reserves by levying higher rates of taxation on non-distributed reserves.

In respect of countries having regulations in favour of retained profits, the following points emerged from the discussion:

1. Mexico gives not only tax relief in favour of re-invested profits but there are also provisions under which certain types of medium-term bank loans can only be obtained by companies on an undertaking not to distribute dividends during the period of the loan. The intention is to prevent the bank loans from being used for the indirect financing of dividend distributions.

2. Tax concessions are given on re-invested profits in Chile. Retention is not sufficient to secure the concessions but re-investment must be proved to the Revenue authorities. This policy was described as having proved very successful.

/3. In India,

3. In India, distribution of dividends is limited as part of the general campaign against inflation rather than as a deliberate encouragement of business re-investment, but there is also reduced taxation on re-invested profits.

4. In British colonies, the position is similar to that in India. Favourable tax treatment of capital expenditure by such measures as liberal amortization allowances also help to induce re-investment of business profits. Further, the dividend limitation by informal convention now in force in the United Kingdom also extends to colonial enterprises and tends to induce retention and re-investment of profits.

The question was raised whether the re-invested profits - where such re-investment had been encouraged - should be directed to particular projects or industries. The sense of the meeting, however, was that if re-investment was encouraged, the earning firm should be free to re-invest in a freely selected field. If a limitation of investment to preferred fields was intended, this should be a matter of general state action and not merely of direction of re-invested profits. This latter would penalize existing firms but would not prevent the establishment of new ones.

The objection was made that re-investment of profits was non-selective and that tax exemption in favour of such re-investment deprived governments of revenue for directed investment. Further, it was pointed out that a proportion of distributed profits was also saved. Hence, the balance in favour of special encouragement of retention of profits might be close, depending on the amount of revenue which had to be sacrificed. On the other hand, it was pointed out that to the extent that foreign firms were induced to re-invest their profits, this would constitute a considerable net gain in domestically available investment funds since their distributed profits would otherwise have been taken out of the under-developed country.

/Section II:

Section II: Raising of Public Funds by Taxation and Borrowing; Utilization of Funds Thus Raised

(a) General taxation - specific taxes - borrowing (inflationary and non-inflationary)

What are the relative advantages and disadvantages of providing government finance for economic development (a) from general taxation, (b) from the yield of specific taxes and royalties, and (c) through borrowing?

General Taxation

The principle generally approved by the group was that taxation should be used to the highest practicable degree in under-developed countries to finance economic development. The fact that a good deal of social non-profit making capital is required was recognized as a special argument in favour of the extended use of compulsory forms of savings. Schools, universities, vocational schools, health services, provision of pure water and electric power were mentioned as illustrations of social capital to be provided by taxation. It was felt to be a rather paradoxical situation that in industrialized countries the burden of taxation was often so much higher than in under-developed countries even though in the latter the provision of social capital is so much less advanced. For at least two areas, the Philippines and Puerto Rico, it was stated that the present burden of taxation was not too heavy to prevent increased use of this method of financing. It was mentioned that Puerto Rico collects only 15 per cent of the national income in taxes as against 25 per cent in the United States.

Two other factors were put forward in favour of the preferential use of involuntary savings in the form of taxation for economic development, namely, (a) the inflationary position prevailing in under-developed countries, and (b) the inequal income distribution inside under-developed countries. On the first point, it was agreed that it constituted an argument in favour of taxation as against inflationary forms of borrowing. All members were aware that economic development tends to create inflationary pressure although not necessarily inflation; the inflationary pressure may be overcompensated by other forces such as a world-wide

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deflation or deflation in the dominant financial area to which an under-developed country is linked or it may be counteracted by domestic policies. Thus, it was stated that even in under-developed countries governments should pay attention to the general state of business and might have a policy of increasing the share of borrowing at the expense of that of taxation in bad years; but this was felt to be a secondary problem in under-developed countries compared with its importance in industrialized countries.

The question was, in fact, raised during the meeting whether taxation is an adequate way of offsetting the inflationary pressure generated by economic development. The view put forward was that taxation might be too blunt a weapon to deal with the specific inflationary pressures and bottlenecks of development which would always be concentrated at particular points and sectors. The alternative suggested was the use of specific controls, such as price controls, rationing, allocation, etc., but it was agreed that these were often more difficult to administer than taxes, and hence often not applicable in under-developed countries on administrative grounds. This heightens the role of taxation.

The point was raised at the meetings that the present post-war situation of under-developed countries contained specific inflationary factors and that one should be careful not to put emphasis on the use of taxation for the general case of economic development in the light of conditions which might be only temporary. The general conclusion, however, was that the danger of inflation was a long-term problem of under-developed countries and that this also heightens the role of taxation.

On the second point mentioned above, it was stated that

(1) In under-developed countries the distribution of incomes is generally more unequal than in industrialized countries, and inequalities are in any case more serious because of the low average levels of income.

(2) the demand of higher income groups is concentrated on luxury articles which do not provide a basis for the development of industries suitable for an under-developed country.

(3) the articles demanded by upper income groups have usually to be imported from outside, imposing balance of payment strains.

(4) re-distribution of income by taxation can thus set free foreign exchange for imports of goods required for development, and create markets for domestic industries.

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(5) existing inequalities generate feelings of discouragement, instability and unrest in the population, and thus tend to retard both domestic and foreign investment. Thus, corrective taxation can improve the general prospects for economic development.

(6) as against the above advantages, high taxation may reduce the savings and investments by upper income groups, hence the case for careful selection of taxes and tax exemptions for saving and investment. The use of property taxes in place of progressive income taxes was suggested for study in under-developed countries.

In agreeing on the necessity for the extensive use of compulsory savings through taxation, the meeting also agreed that not all taxes are equally suitable and that while the general rule of "as much taxation as can possibly be carried without harmful effects" could be applied to under-developed countries generally, in laying down desirable levels of taxation for particular under-developed countries, account must be taken of what kinds of taxes were used or applicable in the particular country. There is always some leakage effect in taxation in that part of the incidence may be on savings; the net effect on development rather than the gross amount of revenue raised is relevant. Apart from generally - though not always and not by the full sum raised - increasing resources available for development, the transfer of resources to public spending will also change the nature and direction of the development which will take place, and thus the desired types of development as well as total resources were considered as a determinant factor in levels of taxation.

In selecting types of taxation, it was stated that governments have sometimes mistakenly supposed that particular industries were so profitable that they could bear excessively high taxes such as export taxes, and thus have killed the industry to which it was applied. Ill-considered taxation can thus be an obstacle to development, and not even result in raising finance to offset this loss. Where tax systems in under-developed countries have not properly developed it was declared that the burden of taxation falls too heavily on well-organized industries which are the spearhead of development and this was mentioned as an argument against the full use of taxation for economic development. In such cases, taxation would merely reduce business savings.

In connexion with problems of taxation of foreign companies, the meeting also touched on problems of taxation of foreign investment. It was agreed that this was a big and complex problem and the following remarks arising out of the meeting do not exhaust it.

The group considered such methods as special income tax privileges extended by the under-developed capital importing countries, mutual exemption systems, and also the system of tax credits. Of these three systems, it was agreed that the last mentioned was much superior to the two others especially if effected through bilateral international tax agreements. Both under a system of special income tax privileges, as well as under the mutual exemption system under-developed countries tend to loose revenue without clear evidence of compensatory gain through the attraction of additional capital. In the case of mutual exemption systems, it was pointed out that companies generally have their headquarters in the more developed countries, and since the mutual exemption systems usually provide for taxation at the seat of headquarters or countries of registration, this tends to work to the disadvantage of under-developed countries. In that respect it was agreed that the position of under-developed countries in relation to more highly developed countries was different from those between different industrialized countries where registration of companies is more evenly divided and where also there is more of a two-way flow of capital.

A system of tax credits will generally work in such a way that the more highly developed country where the headquarters of the firm is located will give that firm a tax credit for any taxes already paid in the under-developed country of operation. It was pointed out that where this system operates it was possible for under-developed countries to raise their rates of taxation up to the level prevailing in the more developed countries of registration, without a deterrent effect on investment since the total tax burden imposed on the foreign company is not increased. In general, rates of taxation are lower in under-developed countries so that there is scope for such increases to operate. It was, however, admitted that a straight comparison of rates of taxation as between under-developed and more developed countries is difficult and may be misleading, since in addition to rates such matters as bases of assessment, treatment of depreciation allowances, offset of losses, etc., must be taken into account.

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It was also pointed out that where a system of tax credit obtains, this facilitates the taxation of foreign companies operating in under-developed countries by reducing or removing the arbitrary element involved. Under such a system foreign companies have to pay a fixed total of taxation and since in general they will be indifferent whether they pay their taxes in the under-developed countries of operation or the more developed countries of registration, there will be no temptation to shift profits by arbitrary accounting prices, arbitrary allocation of overhead cost, etc. It was stated that internationally agreed provisions for mutual assistance in matters of tax payment and tax assessment between the country or registration and the country of operation may also be of help to under-developed countries in collecting tax revenue from foreign companies.

Allocation of Special Taxes and Royalties to Economic Development.

Experience with this method of financing economic development was mixed. Adverse comment included the following:

(1) If specific yields are allocated to specific projects, it is quite impossible to predict whether the actual amount of revenue obtained from that particular tax is going to be more or less than what should be spent on the designated purpose, looked at as part of the general plan of capital development. It seems irrational to tie the importance of particular projects to the unrelated event of the yield of particular taxes.

(2) Such allocation of specific taxes or funds to particular types of development tends, in practice, to remain purely nominal, and the specific funds set aside tend to be raided or supplemented according to overall needs. The history of the Road Fund in the United Kingdom was cited as an example.

(3) The earmarking of specific taxes or royalties may obscure the real position since, in economic as distinct from legal fact, all state expenditure comes out of the general revenue pool, and it does not follow that expenditure in the designated fields is in fact increased or stabilized by the earmarking.

(4) For the United Kingdom colonies, it was stated that with small exceptions, no earmarking of revenue took place or was considered desirable.

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(5) For Puerto Rico, it was stated that there is a definite trend away from earmarking and "hidden budgets". Revenue is now concentrated in the general Treasury fund. This is found to facilitate review by the legislature, understanding of the revenue and expenditure picture by the people, and better choice of alternatives of expenditure by the government.

(6) For Egypt, it was also stated to be the tendency to unify the tax system and do away with different forms of special taxation. Royalties from the Suez Canal Company are devoted to finance social projects and public utilities in the area of the Suez Canal but this is felt to be an exceptional case.

(7) In some cases - Saudi Arabia was quoted as an illustration - the entire revenue is derived from one or two special taxes and royalties, such as royalties from oil and taxes on pilgrims. In such cases, in spite of the theoretically cogent argument that revenue derived from the mining or working of wasting natural assets should serve for financing the substitution of such assets by capital development projects, no earmarking is possible since all government purposes have to be covered from the proceeds of the single tax.

(8) For Chile, it was also stated that the trend is away from special taxes for specific projects or corporations, and that as a general rule this method is not now considered advantageous. Difficulties in assessing and collecting special taxes were also experienced.

(9) For Mexico, it was stated that a general Treasury fund has been found preferable, and that earmarking was confined to the proceeds of specific government issues - as distinct from taxes - and in the case of taxes to the provision of sinking funds for repayment and servicing of government debts.

(10) For British colonies in the Far East, it was stated that these colonies used to derive considerable income from land sales, and that there was an understanding or informal principle that such income should be earmarked for capital works. Since in fact, however, expenditure on capital works on the average substantially exceeded income from land sales, the principle was never really tested.

(11) In the case of royalties from wasting natural assets - such as oil or metals - further limitations to the principle of earmarking for development purposes were mentioned. Part of the royalties may be required for the

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various services and additional expenditure immediately required as a result of the activities of the original development, such as the requirements of oil and mining companies, and to that extent they are not all available for new development. The case was also mentioned of a Pacific area where the local government derives considerable income from its share in the proceeds of phosphate production - the only natural resource - but where it would be neither practicable nor economic to build up corresponding capital resources. Similarly, there may often be no case for new development in particular areas where natural resources have been worked out. In such cases, the corresponding capital development should take place in other areas or other regions of the same country, and the proceeds of special taxation should be used to finance the re-settlement of population.

Subject to these limitations, the principle of earmarking of special taxes was approved as of usefulness in the financing of economic development in the following ways:

1. The building up of social security funds from special taxes or contributions from workers, employers, and governments is widely practised in under-developed countries. This special earmarking was felt to be justified by the greater confidence and security which the existence of separate funds gives to the contributors. The establishment of such funds has promoted savings through the accumulation of contributions, provided a market for government securities and helped financing of new enterprise through the employment of the reserve assets of the social security institutions or funds, and has been an instrument of social progress in under-developed countries. No objection was raised to the linking of social benefits with specific contributions.

2. The earmarking of special funds and specific revenues for the servicing of government issues made for the finance of development projects was stated, in the case of Mexico, to have been necessary and helpful when all government debts were in default as a result of prolonged political disturbances and confidence had to be restored.

3. The case of special charges or taxes on the direct beneficiaries of particular development projects for the purpose of new development or improvement in existing services was also agreed to be a significant case where special earmarking may be justified. Such earmarking would serve the

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purpose of diverting the profits or income increments arising from original projects into savings to be utilized for the finance of further development. An illustration mentioned was that of the Puerto Rican water resources authority which has to make regular payments to the municipalities as well as to the in the insular government; this arrangement has been found to be a good method. In India, water charges to users help to pay for the cost of irrigation schemes. In Mexico, since 1933 a tax on increases in value of property, due to public works, is collected and earmarked for the improvement of public utilities; experience with this tax is described as good.

4. In India, earmarking is practised in local taxation; the earmarking of petrol taxes for road development, and the earmarking of some charges on land revenue for local development are other applications. Earmarking in India, within its limited application, has been found useful.

5. In Chile, special earmarked taxes are considered justified in the case of well-defined limited fields of development activity such as irrigation and ports.

Non-inflationary Domestic Borrowing

In discussing the place of borrowing in the financing of economic development, a distinction was drawn between genuine borrowing which is a type of voluntary savings in the form of subscriptions to government or other public issues, and inflationary borrowing where there might be a legal act of borrowing but where the significant economic act is one of compulsory saving induced by a rise in prices and corresponding devaluation of incomes.

There was general agreement that non-inflationary borrowing has a proper place among the investments of financing economic development. One member of the group went further in stating that in his experience borrowed funds were more carefully spent than funds obtained by taxation and hence there was a case, to that extent, of substituting borrowing for taxation. This was, however, contradicted by another view; based on experience in United Kingdom colonies, it was pointed out that expenditure which has to be met out of taxation is scrutinized a great deal more carefully than expenditure which is going to be met out of borrowing, since in the latter case legislatures do not feel the burden of it so directly.

There was no difference of opinion:

(a) That an increase in the internal debt of a country is not a burden in the same sense in which an external debt is a burden; but

(b) That nevertheless there are limits beyond which the burden of interest and repayment may raise serious problems of a budgetary, incentive and distributive nature. In some under-developed countries these limits are, however, in no way in sight; in some - Puerto Rico was mentioned as an illustration - the public debt in relation to national income is much smaller than in the major industrialized countries. Where the limit of borrowing has been reached, it is more in terms of public confidence and credit standing enjoyed by the government than in terms of absolute burden of repayment. This, at one stage, was the position reached in Mexico and it was described at the meeting how the resulting situation was dealt with by the government setting a constitutional limit on its own borrowing powers, new borrowing in respect of social capital being limited to the amounts previously repaid on outstanding debts.

It was agreed that borrowing is specially justifiable where capital assets are created. It was mentioned that the Organic Act of Puerto Rico relates the capacity to borrow to property assets. At the present time, the government of Puerto Rico is conducting a reassessment of property which is expected to expand the opportunities to borrow. The following types of development were mentioned as suitably financed by borrowing:

1. Where publicly owned assets are created.
2. Where profitable returns are expected from the specific projects.
3. Where the development is not of a very long-term character and will result in increases in productivity in the more immediate future. Borrowing for road construction in Mexico was described as coming within this category and yield definite results within two to three years.
4. Where the development is such that charges, fees or specific taxes can be imposed upon the beneficiaries of the development so that any original debt incurred for the construction of the asset can be serviced from the fees received.

As a general rider to such attempts to list cases where borrowing was appropriate, one member warned that in practice, although the state may borrow for specific purposes such as irrigation, in fact the monies received go into a

/general

general pool, and it would be difficult to make out whether hospitals or schools had not been built instead. One really had to look at expenditure as a whole to see whether a significant proportion of total expenditure goes into productive development. It was agreed that it was always possible for the state to justify a particular issue of bonds by a productive project, but use the proceeds to free funds for use in other projects which could not be directly presented to the saver.

For British colonies, it was stated that partly because of this fact and also because of the formulation of long-term development programmes the previous practise - never formalized in law - of not asking for loans for non-productive purpose had been weakened. Expenditure was looked at as a whole, and borrowing was determined as the margin which it was not possible or convenient to cover by borrowing. The tendency to allocate the loans to productive expenditure was becoming a matter of form, partly as a matter of tradition, partly because it helps to attract savings and subscriptions, and partly because it may serve as a check to undesirable expenditure.

The principle that borrowing should be allocated to capital or non-recurrent expenditure is also not easy to operate in practice. It was pointed out that there is often an element of doubt about whether a particular item is a capital or recurrent item, and there will be a temptation to manipulate the budget between the two halves. In any case, the habit of separating recurrent and capital items in budget accounts is only just beginning.

For Puerto Rico, it was stated that the budget distinguishes clearly between current expenditure, capital expenditure and contributions to the public corporations, and that it would be inconceivable to issue long-term bonds for current expenditures.

The use of borrowing was also described as tending to be associated with the indirect method of government operations, through special institutions, Development Corporations, etc. Such Corporations have no direct taxing powers of their own but they enjoy public borrowing powers. Hence, where this indirect method is widespread, public borrowing also tends to be more important.

Inflationary Measures of Financing

There was agreement at the meeting that any development should be achieved with a minimum of inflation. Where voluntary savings were not sufficient, compulsory savings by taxation should be used. Where this was not sufficient,

/controls

controls of various kinds and external financing should fill the gap. Where this was not sufficient and the development programme was essential, inflationary borrowing or printing should be considered as a last resort but it was a dangerous method. However, the group was not prepared to say that development should be suspended in such cases in order to make it unnecessary to use inflationary methods.

Nor was it possible to consider inflation as an inevitable companion of economic progress. The example of more highly developed countries and of countries within larger financial areas was quoted as illustration of development proceeding within the limits of domestic saving, taxation, and external help.

It was also found that the great danger was that governments often resorted to inflationary types of borrowing, not deliberately, but in the belief they were restricting themselves to non-inflationary types of borrowing. The non-correspondence of particular forms of borrowing with their ultimate inflationary or non-inflationary contents makes it even more difficult to pursue clear deliberate policies. The only deliberate choice which governments were said to make was not to limit development to voluntary savings.

The view was put forward at the meeting that it would be wrong in principle to block, or fail to provide for access by governments of under-developed countries to Central Bank borrowing or other inflationary borrowing. Apart from the need for cash in emergencies - which proportionately affect under-developed countries much more seriously - mention was made of the fact that where inflation was unavoidable it was better not to leave an aftermath of debt burden behind. It was also suggested that where inflation was necessary open inflation was better than hidden inflation. However, the general sense of the meeting was to affirm that inflation is a dangerous and self-defeating method, and should not be used until all other possibilities have been exhausted. This view also influenced the findings of the group in respect of the relation between foreign and domestic financing of given projects. It was felt that the external share in finance should not in principle be confined to the immediate foreign exchange expenditure involved, where the under-developed country could not cope with the pressure of development by other than inflationary methods.

/(b) Direct

(b) Direct and indirect taxation

What is the role of direct and indirect taxation in the formation of compulsory savings in under-developed countries?

The structure of taxation in under-developed countries, especially as between direct taxation and the various forms of commodity taxation, was also discussed in the group. It was generally recognized that partly for historical reasons, partly for administrative reasons, and partly for economic reasons, commodity taxation was more important in under-developed countries than in developed countries. The trend, however, is in the direction of building up direct taxation, although in one or two countries a stage has been reached where there is a reaction from the high rates of direct taxation, and a shift back to indirect taxation in the taxation structure. Within indirect taxation, there was stated to be a general trend away from general taxation for revenue purposes towards selective taxation designed to promote and encourage economic development.

Egypt was mentioned as an illustration of the historical explanation of the prevalence of indirect taxation in many under-developed countries. Under the regime of capitulations, the Egyptian Government had no authority to levy direct taxation except with the consent of many other governments which was difficult to secure. Hence a strong development of indirect taxation, which more lately developed especially towards tariffs. The only direct tax developed under the old regime was the land tax. Later on, war-time and post-war inflation raised domestic prices much above import prices, and this again led to the development of indirect (import) taxation to utilize the big price gap between imported and domestic goods. As a result, the rate of taxation of imports was stated to have more than doubled since before the war, and to reach 58% now. Customs duties alone form 50% of total revenue. Egyptian experience with introduction of direct taxation was stated to suggest that although direct taxation was more equitable in principle yet where it was newly introduced in under-developed countries, its introduction should not be introduced too rapid. Within the taxation system (mainly import duties) there was a definite trend towards selectiveness; i.e. taxing luxuries and semi-luxuries, and goods competing with the expanding Egyptian textile industry and the use of long-staple Egyptian cotton, especially imported clothing. The question was raised in connexion with this trend of

/shifting

shifting import duties towards luxuries whether the assumption that such taxation did not affect the general cost of living was really justified. It was stated that some of the increase due to taxation on such items as automobiles, rayon goods, etc., was likely to be transmitted to the articles consumed by the general population.

India provides an illustration of an under-developed country where direct taxation had reached such high levels that there was a danger of disincentives for saving and investment, and where as a result there was a tendency back towards indirect taxation. Before the war, customs revenue formed over 50% of total revenue, income tax only 23%; in 1947/48 income tax formed 60% of total revenue and customs had fallen to half their previous share. In the 1949/50 budget, however, the share of income taxes has been reduced to 45%. This corresponded to present thinking in India where it was thought that for further increases in tax revenue main reliance should be placed on indirect taxation. The trend towards selectiveness of import duties can also be observed in India, both in the form of increases in rates of duty on luxuries, such as United States automobiles and certain chemicals, and also in the form of relief from direct taxation and import duties in order to encourage productive investment

Conflicting views were expressed on the question of the disincentive effects of high direct taxation on savings and investments. One view was that with the groups affected by high direct taxation there was no certainty that they were going to invest in the economy of the under-developed country if taxation were relaxed or not imposed; they might instead consume or export their capital. Also, it was stated that taxation did not reduce total investment since in any case it merely transferred from private into public hands. In reply, the question was raised whether high direct taxation does not itself serve to drive assets abroad, and thus make them unavailable both for private and public investment. There was agreement that there was some danger of this happening, specially in under-developed countries where foreign exchange control was not operated or where it was not effective. On the other hand, it was mentioned:

(a) that income tax laws could be amended in such a way as to include income from abroad in the taxable income

(b) that rates of direct taxation in under-developed countries were still generally below those of developed countries where assets could seek refuge, and

/(c) that even

(c) that even where the assets of individual individuals or companies were driven abroad by high direct taxation, basic improvements made possible by the creation of social capital and public investment giving the population a feeling of steady progress could far outweigh the disadvantages of individual timid capitalists seeking investment abroad, and would ultimately attract them or other capital back.

Thus, there seemed some difference of emphasis in assessing the importance of the disincentive argument against high direct taxation. Some members maintained that after a certain critical point high progressive direct taxation could be harmful to capital formation. Such disincentive effects were also noticeable with certain indirect taxes, such as taxes on the production or exports of particular commodities. In this connexion, it was stated that the relative decline of mining in the Mexican economy might have been due to high taxation. In British colonies, it was now felt that export taxes or royalties should be on a sliding scale related to prices or profits and not at a flat rate so that they should vary with the profitability of the particular line of production and not stifle production.

The shift towards direct taxation is also noticeable in British colonies. Most colonies now have income taxes and estate duties, and the tendency is for income taxes to become more progressive, so much so that the rates applying to higher income brackets were stated to carry the dangers of disincentive to saving and investment.

In Mexico, the trend has been strongly towards direct taxation; export and import duties have now been replaced as the biggest source of revenue by income tax. One of the chief advantages of this development was that it made revenue less dependent on foreign trade variations and thus has been a stabilizing factor in the formation of compulsory savings. It was also stated that *ad valorem* export duties were considered essential as an anti-inflationary measure to absorb some of the high profits arising out of exchange depreciation which resulted in disproportionate gains for the sectors of the economy directly concerned with export trade. On the other hand, the mining companies complain that the mineral export duties are excessive and have discouraged new investment. The taxation of mining companies in Mexico has added difficulties because they are often international corporations with headquarters abroad, and it is difficult to tax such companies by means of ordinary income or profits taxation. There

/is an arbitrary

is an arbitrary element in the share of profits ascribed to local production since that depends on the allocation of overhead costs between the local and foreign installations, and on the prices at which the raw materials are transferred to the refineries and markets abroad. Thus export duties could be described, in such a case, as an administrative substitute for direct taxation. Furthermore, for Mexico, too, it was stated that lower taxation of higher income groups would change the nature of investment but not increase its amount, and lead to a flight of capital and to luxury investment in real estate. Hence, high rates of taxation coupled with special encouragement of desirable private investment was the best policy for a country like Mexico.

In further defense of high direct taxation, it was argued that an indirect tax such as a turn-over tax or a production tax does not permit of an offset for losses made while a proper corporate income tax should only apply where profits are made. For this reason it cannot be generally said that any system based on indirect taxation is automatically less deterrent to investment than direct taxation.

For Puerto Rico, it was stated than on experience there a system of selective sales taxes was suitable for under-developed countries. They were easy to collect and administer. The main items of general consumption and the main raw materials of industries in development fields should not be taxed. The numbers of different taxes should be small, and payments simplified. Another factor making sales taxes easier to administer in under-developed countries than income taxes was the absence of proper and even elementary accounts in the smaller business units; this made income tax difficult to apply fairly. Although Puerto Rico had widely applied a system of special tax exemptions, a well-designed general tax system which did not hamper the development of industry was thought preferable to special transitional tax exemptions.

In the light of the comments made on the use of export taxes in Mexico as a substitute for an income tax, the tendency to shift indirect taxation to luxury consumption and of what had been said for Puerto Rico about the easier administration of indirect taxes, the question was raised in a more general form whether in under-developed countries indirect taxation has not an entirely different significance than in more developed countries. In the latter, it represents the form in which the general population is taxed, and serves to

/balance the

balance the direct taxation of the upper income groups. In the under-developed countries many of the existing indirect taxes seem to be more designed to tax the upper income groups or business units and thus seem to serve as an administrative substitute for direct taxation. It was agreed that some tendency in this direction was inevitable and advisable in under-developed countries, but that it was a question of degree rather than of a clear difference between developed and under-developed countries.

/(c) Techniques

(c) Techniques of borrowing

What is the experience with different techniques of government borrowing in under-developed countries, and what are the relevant merits of absorbing government paper in the financial and credit system rather than with the general public?

From the observations of the group regarding government borrowing practices in under-developed countries, it was revealed that there was no uniformity in techniques followed. In certain countries, like the Philippines and Mexico, the sale of government bonds was mainly, if not exclusively, confined to financial institutions. It was, nevertheless, hoped in these countries eventually to approach the general public directly after educational campaigns had helped to popularize government securities.

In the case of other countries, a mixed policy was pursued and the government borrowed both from the financial and credit institutions of the country and from the general public. This was true in the cases of India and Egypt, for example. India had a highly developed financial market and all the different techniques employed in the highly developed countries were utilized. India, however, had special experience in the matter of tapping small savings for government securities. A diversity of investments was devised to suit the different preferences of different classes of investors with respect to the denomination, maturity and yield of securities.

Egyptian experience was peculiar in several respects. Firstly, the problem of borrowing was not very important there in view of the existence of large accumulated reserves and it was not known what to do with the money in the savings banks. Secondly, the Egyptian government did not experience any difficulty in borrowing from the public and it was believed that new issues were likely to be heavily oversubscribed. Finally, Egyptian practice was to earmark long-term issues of low denominations for the private investor and medium and short-term issues for the institutional investor.

The reason mentioned for predilection in favour of dealing with institutional investors, where this was the case, was that the public response to governmental securities had been found unsatisfactory. It was, thus, clear from the opinions expressed that this was by no means entirely a matter of deliberate choice on the part of governments. It was explained that the investing public in these countries

/had not yet

had not yet learned to appreciate the merits of investing in government bonds and failed to absorb the government securities which had been floated from time to time. It was accordingly felt that the institutional investors, especially the banks, should assist the central banks in these countries in the marketing of government securities by turning them over to their respective customers. It was felt that the banks, by virtue of being in more direct contact with the investing public, were the agency best fitted to explain to the public the advantages of investing in government bonds. When government securities had secured in this way a place in the investment habits of the public, they could then be issued in appropriate denominations and marketed directly to the investing public.

The main reason, on the other hand, advanced at the meeting against the marketing of government paper through the financial and credit institutions of a country as a major policy was that such a procedure inevitably would lead to inflation. Opinion was, however, divided regarding the exact character of the possible inflationary effect.

The meeting also discussed the question whether the rate of interest on Government securities issued should be low or whether it should compete with the high returns obtainable on other types of investment in under-developed countries. It was agreed that it was often difficult to induce an individual to buy government bonds for, say three or four per cent, when he could obtain a distinctly larger return by investing in a house, or loaning to a trader or farmer, or setting up in business himself. It was observed that these alternative forms of investment were likely to yield in under-developed countries a return from six or seven per cent to as much as ten or twelve per cent. But it was at the same time agreed that there were weighty reasons why the public should, nevertheless, be disposed, and therefore should be induced, to investment in government bonds. The following reasons were given:

1. Although government bonds yielded relatively much lower rates than other securities or loans, they were practically devoid of the risks accompanying the latter. The interest in the case of usurious loans, for example, was very high indeed but the risk involved was also enormous. It was felt that the government (or even banks) could enlighten the public on the merits and advantages of government bonds, particularly with respect to the lower risk involved.

/2. The public

2. The public could also be induced to invest their funds in government bonds on grounds of patriotism. In addition to the lower risk involved, the public could also be impressed that such loans had special developmental value for the country and consequently it was their duty to invest in government bonds.

3. It was also felt that government bonds offered investment opportunities to a person of limited means, who had neither the funds to invest in a house or to risk in a business, or to loan it to someone else. This, of course, implied that the government bonds should be of small denominations.

4. It was also possible that government bonds meant for sale to the public, as distinguished from those meant for sale to or through financial institutions might be offered at relatively more attractive rates of interest. Such specialized types have been issued in different countries, as in the case of India or the United States.

5. It was also observed that the small investor is a more long-term holder of government paper while the large private investor is more likely to hold government paper as a transitional investment and to dispose of it at an opportune moment.

As a supplementary issue, the group considered the main differences in the character of government bonds meant for sale to financial institutions and those meant for direct sale to the general public. Three chief differences were pointed out:

1. Their denominations were different, those of large denominations were meant for institutional investors and those of low and minimum denominations for the general public.

2. The rates of interest were not necessarily the same, a higher rate being offered in respect of the special issues meant for the public.

3. Another difference sometimes observed was that long-term loans are offered to the public, while short and medium-term loans were sold in the money market to the banks and insurance companies, because of the difference in liquidity preferences.

The group next examined the reasons for governments pursuing a policy of differential rates of interest. It was pointed out that some government securities meant for absorption by individual as well as institutional investors yielded rates of interest as much as 5 to 7 per cent, or even higher, but the short-term securities meant for holding by the banking system were very often offered at very

/low rates

low rates of interest. It was admitted that such differentials were by no means peculiar to under-developed countries, but they were even more marked in them. The issue, however, was whether in the case of under-developed countries the rate on institutional securities was kept so low as to be out of line with the general structure of interest rates in these countries with a view to exercising indirect pressure on banks to invest their funds in commercial and industrial fields, rather than with a view to obtaining funds for borrowing.

/(d) Markets

(d) Markets for government securities

What can governments do in order to promote and stabilize domestic markets for government securities? In particular, what is the proper technique in using stabilization funds in such policy?

The group recognized the importance of maintaining stability in the domestic markets for government securities in under-developed countries, which had not yet adequately developed their securities market. Such measures were important in at least two directions:

1. If governments fail to maintain the value of their bonds, the interests of the general public would suffer. The investors would then have to contend not only with the low rates of interest which are normally associated with government bonds, but with loss of capital as well.

2. Governments would, in their turn, be unable to mobilize any real savings for their own requirements in the absence of public confidence. It was recognized that government bonds should be the safest of all investments.

Opinion was, however, divided regarding the best methods to fulfill the government's obligation to stabilize the market for government securities, particularly with regard to the establishment of a stabilization fund for the purpose.

The following reasons were given in favour of governments setting up a stabilization fund:

1. It was urged that both in the interest of the investing public as well as the borrowing governments, it was imperative to take strong measures for stabilizing the market, particularly in countries where the money market was not highly developed. The existence of the stabilization fund would offer the maximum security to the public and build up their confidence in government securities. In the event of a panic, the funds could immediately be utilized to absorb at the market rate any offering from the public who wished to cash their bonds.

2. It was admitted that the central bank was an alternative agency for helping in the maintenance of the value of government securities through its open market operations, but it was claimed that the under-developed countries either did not have central banks or their central banks were not properly equipped for the task.

3. It was also pointed out that the ability of central banks, of stabilizing the securities market effectively through maintenance of the rate of interest, was definitely limited. If there was a considerable extension of credit to industry and business such as to attract money away from government securities, that would, in any case, be an unstabilizing factor. This was precisely the situation in many countries today, where there has been a shift, after the war, from government securities to commercial and industrial securities. In other words, the banking system and the various investment institutions want to part with government securities in favour of more remunerative securities. The central bank may try to support the market for government securities by buying these securities at a level that would maintain the low rate of interest, but it cannot go on doing this indefinitely. Stabilization will be more effective and more desirable where it is a question of smoothing out a temporary fluctuation. But when major trends are involved in the securities market it is problematic to what extent the central bank should go in its stabilization activities. It may be desirable, for instance, in the interest of the economy to allow the rate of interest to move up and the persistence of the central bank to maintain the rate of interest would lead to inflation. Similarly, it may be desirable sometimes to allow the rate of interest to fall very low in order to stimulate private initiative. Reference was also made to the possibility of the central bank and the stabilization fund pursuing two conflicting policies: one being the buying of government securities in the open market and thereby extending credit and lowering rates of interest in the capital market and the other of maintaining a high rate of interest by restrictive policies relating to money markets.

4. The amount of funds initially needed would not be very considerable because the issue of bonds would necessarily be relatively small in the beginning.

/The following

The following reasons were given against the creation of stabilization funds by governments:

1. The main argument advanced was that it was primarily the function of the central bank to assist in the maintenance of the securities market. This it could do through its open market operations.

2. The stabilization fund is an instrument which should be used only in the absence of a central bank or during the period when it does not have effective control over the money market.

3. From the point of view of mechanism, there was not much difference between the stabilization fund and a banking department of a central bank.

4. The establishment of the fund would in effect sterilize and immobilize presumably much needed resources.

5. It was furthermore feared that it was more proper to expect the size of the fund to be large in the beginning when the public was most hesitant in investing in government securities.

6. Need for special stabilization funds would not really arise when the change in the value of government securities was part of a general downward trend in the securities market. The special need for stabilization of government securities arises when government securities fall independently of the trend in other sectors of the stock market, due to lack of confidence in government.

7. In order to minimize the dangers of possible contradictory policies, referred to earlier in the discussion, it was advisable that the central bank alone should undertake open market operations. The establishment of a stabilization fund independently from the central bank would throw the whole fiscal policy out of gear.

The question was also raised whether compensation might not be given to private investors when they had lost money by investing in government securities, so as to maintain the credit standing of the government. It was suggested that such compensation might be offered in the form of special fiscal treatment of losses on government securities.

/(e) Loans

(e) Loans or grants for public funds to private units

Should governments make direct loans or grants from public funds to (a) private banking institutions, (b) private firms?

The general feeling of the group was that governments may encourage private banking institutions or private firms through loans or grants out of public funds. It was felt governments should not rigidly adhere to the principle that public funds obtained by taxation or government borrowing should exclusively and specifically be invested in public enterprises and not be employed to encourage privately owned undertakings.

However, it was at the same time agreed that public funds should be so used only under certain special circumstances. The conditions under which public funds may be employed for encouraging private enterprises were:

1. Assistance to private banks or undertakings may be given under emergency circumstances to tide them over a difficult situation of a temporary nature, such as have arisen in various countries; like in the Philippines, immediately after the war, when private banking institutions and insurance companies could not reopen for lack of financial support, because of the ravages of war. The government, in order to help these banking institutions and insurance companies, directly subscribed to their preferred shares for the sole purpose of rehabilitating them and enable them to function normally.
2. To assist undertakings which are of basic importance to the economy of a country, or are of importance for developmental purposes generally. This was done, for instance, in Mexico and Chile.
3. To assist enterprises whose capital requirements are very large and not easily obtainable from private sources, such as airlines, overseas shipping, or even an industrial or development bank as in Mexico or Egypt, or even to assist relatively smaller enterprises when a country has a weak limited capital or securities market.
4. When the grant of a subsidy is considered preferable to the levy of a protective duty. For example, when an article is a basic raw material of other industries, (as in the case of the subsidy to the Indian steel industries), or the local production is relatively small to the local market and the cost of the subsidy is small or as a matter of administrative

/and legislative

and legislative convenience. It was explained that in India, for instance, in such cases a direct subsidy was found useful in keeping the matter before the public eye.

5. Financial assistance to the agricultural community which has no adequate sources of meeting its capital needs, as in India, Egypt and many other countries.

The discussion revealed considerable opposition to the grant of direct loans to private firms or banks. The general feeling was that such funds should preferably be made available indirectly through specialized governmental agencies entrusted with the task of direct developmental activity or of sponsoring and aiding private undertaking in the interest of general economic advancement. The main reason for this seemed to be that the ordinary administrative machinery was not very suitable for the purpose. The grant of loans or subsidies in every case needed careful investigation and scrutiny by a competent body which specialized in that kind of activity. Most countries now had such specialized government institutions already functioning, and tended to rely increasingly on this indirect method of granting credits and subsidies as in Mexico, Philippines, Chile, etc. In India the Tariff Board was responsible for the grant of subsidies, in addition to the Industrial Finance Corporation recently set up.

(f) Finance of development corporations

Where specialized public institutions or corporations have been set up, what principles should govern the financing of such institutions from central government funds?

On the general principles applying to the financial relations between the central governments and the specialized institutions and corporations which are set up for purposes of promoting economic development, the following statements were agreed:

(1) It should be the duty of governments to give to such corporations and institutions the real resources required to undertake the job assigned to them. This involves that the monetary allocations made to such bodies are not to be undermined by inflationary developments, nor are they to be allowed to suffer from a fall in the yield of specific taxes or other sources of revenue assigned to them. In both cases it should be a duty of governments to supplement the resources of corporations so as to maintain the real resources available to them, and thus enable them to undertake the tasks assigned to them. Alternatively, where the monetary resources have become insufficient, the State should relieve the corporations etc., from their assigned tasks, rather than expect them to struggle on with insufficient means.

(2) The State should keep corporations etc., viable by going to their assistance when an emergency arises.

(3) Where public corporations etc., have been set up, the primary duty of financing such bodies belongs to the State and not to the private banking system.

The discussion revealed that in actual practice the borrowing powers of public corporations are usually limited and that they do not freely obtain their funds directly from the money market. It is, in fact, sometimes considered preferable to eliminate altogether the independent borrowing powers of the corporation and to make them entirely dependent on the state for their financial needs, like, the Reconstruction Finance Corporation and the Export-Import Bank in the United States which do not issue securities in the market. Similarly, in Chile, state credit institutions do not deal with the market directly but through the government, the government annually deciding what amount they should get and what loans they should be allocated. Even when these corporations are also authorized to issue bonds they do it through the Public Credit Committee which centralizes all these activities. In the Philippines, before the war, public corporations were empowered to borrow directly from the market. As there was, however, no developed securities market, direct borrowing was somewhat meager. Since the establishment of the central bank no corporation except the Rehabilitation Finance Corporation, was allowed to borrow directly from the public.

In India and Egypt public corporations while empowered to borrow directly from the money market had not exercised these powers. In Mexico, on the other hand, they have actually operated in the capital market and it was considered inadvisable to discontinue the practice. However, these operations were strictly controlled by the central bank. In Puerto Rico, too, the public corporations enjoyed the privilege of issuing their own bonds but limitation was imposed on their total borrowing capacity.

Restriction on the borrowing powers of public corporations was either explained or justified on the following grounds:

1. The borrowing powers of public corporations had to be constitutionally defined, including provisions on how they are to obtain their capital and to what extent and in what circumstances they could borrow directly from the money market. These limits should, however, not be unalterable but special sanction should be required in order to exceed these authorized limits. When an increase in the authorization is justified, the state may either provide from the general funds at its disposal curtailing other expenditures, or allow the corporation to borrow money, after taking into account borrowing requirements of the government or other corporations and the capacity of the market.

2. What was even more significant was that although public corporations sometimes enjoy considerable independent powers of approach to the market, in effect they were subject to central bank supervision and co-ordination. In exercise of their authorized borrowing powers, the corporations are necessarily faced with the question of timing and terms of their issues. In respect of timing, the question of available resources of the market and alternative demands on them come in as a decisive factor. The co-ordinating powers of the central bank should enable it to determine the appropriateness of the time and the terms and this is a very effective further limit.

/In other words,

In other words, there is a limit on the authority of corporations etc., to approach the market directly, although the authorization is there. Thus, there are limits within limits. Besides, even if corporations have independent access to the market and do use their powers, in practice they consult a central bank and there is, to that extent, a certain co-ordination of the market. More often than not, as in India or Mexico, the composition of the controlling body is such as to give the central bank a strong voice in the board of directors of all these institutions which ensures that all government corporations' requests in the money market are fully co-ordinated. An example of deliberate co-ordination is to be found in India, where under the post-war capital control system, the Capital Issues Committee exercises the co-ordinating power and permission has to be obtained from this central authority.

3. Resources of the money market are by no means unlimited. This necessitates a balancing of the different requirements against available resources of different kinds. The requirements of each individual corporation must be made to fit into the general financial picture and also into the overall development programme where it exists.

4. If the policies of the government and the corporations are not co-ordinated, the state and its allied institutions would compete with each other and some institutions would be forced to pay a higher rate of interest or be deprived of funds.

5. When institutional investors shift their holdings as between the different government bonds and corporation stocks, depending on their respective yields, the government and the corporation are not thereby securing more savings since they have been merely competing with one another.

6. Another reason for co-ordination is that the issue and flotation of stocks is a highly specialized operation and can not be effectively handled by the corporations themselves. In Puerto Rico, the development bank is handling this under a fiscal agency act.

7. Another advantage of co-ordination is that thereby the ready marketability of government securities can be assured. Thus in the Philippines, the backing of the Central Bank - through its stabilization fund - helps in the maintenance of the market.

/8. If the

8. If the government has large reserve funds, as was stated to be the case with Egypt, it may not be really necessary to allow corporations to acquire or borrow from the money market, although they may be empowered to do so. The Treasury advances the necessary funds without recourse to the money market.

9. Government agricultural banks may not go to the market, even though they have the power, because the public response is unlikely to be adequate in view of the specially risky kind of operation involved. This proved to be the case in Mexico.

10. If the financing of development involves inflationary dangers a single organization should be made responsible for approaches to the money and capital markets rather than have several corporations operate.

11. Large and independent issues of bonds by corporations could lead to undesirable consequences, in undermining the credit standing of the Government itself.

With regard to the question whether the borrowings of public corporations and specialized national institutions should be automatically guaranteed by the Government or whether such bonds should have an independent and private status, it was revealed that in some countries they were guaranteed and in others they were not. Thus, in Mexico the bonds issued by industrial and mortgage corporations were backed by state guarantee and were virtually federal issues. On the other hand, in Puerto Rico or India they were not usually guaranteed, although the capital of the corporations was government provided or government guaranteed.

Attention was also drawn to a possible dilemma: if a government gives a corporation free borrowing powers to use at its own discretion, it may be difficult to combine this with proper overall development policies; on the other hand, if the central bank forces the corporations to come to it for final sanction, the latter will not know at any particular time whether a particular need for more capital will be satisfied and they will be prevented from pursuing long-range policies. It was, however, pointed out that this difficulty was not as great as it seemed. If the government creates a corporation, it initially defines the authority and commitments of the corporation and indicates within what limits the corporation has freedom to organize its programme; if at any time the corporation wishes to extend its authority financially or otherwise beyond these pre-defined limits, it must refer to the government and justify an enlargement of authorization. The government may then provide out of its general funds curtailing other expenditure, or allow the corporation to borrow from the money market after taking into account the government's own credit requirements.

In other words, within the limit of their authorization, the corporations should be free to use their borrowing powers up to those limits subject to consultation with the central bank in order to time the issues so as not to compete with other public securities and to arrange the technical details of issuing or approaching foreign capital markets, etc. These limits, however, should themselves be subject to revision from time to time. In view of the limited resources, it would be too much to expect corporations to be set free from all worries in the matter of obtaining additional funds.

/(g) Profit-making

(g) <u>Profit-making public enterprise</u>

<u>Should the use of government funds in promoting economic development be confined to enterprise normally carried out at a loss or should it be deliberately extended to profit-making enterprise so as to utilize the profits made for further financing of economic development?</u>

In reply to this question, it was stated for Chile, the Philippines and Puerto Rico, that profits made in government or government sponsored projects are deliberately used as a source of finance for further development. In the case of the Philippines, it was stated that as a general principle the government has a policy of disposing of enterprises when they become profitable; but this principle is modified by the consideration that since there are other enterprises which are operating at a loss, the government would like to use the income from profitable ones to carry on and continue unprofitable ones. Illustrating by the case of Puerto Rico, it was stated that for smaller under-developed countries, profits of corporations may assume great importance, and may become and indispensable source of finance for future development.

A different application of the principle of balancing profits with losses was reported for Mexico. In this case, although the private banks claim that the State Agricultural Credit Institutions should confine their activities to the poorer peasants, the State Institutions always have claimed that they must be permitted to undertake profitable credit operations to balance the risk involved in the other ones.

Also for Mexico, it was reported that in that country, where private steel companies and publicly owned steel companies are operating side by side, it is found that the private companies are under some pressure to pay high dividends each year in order to maintain the quotation of their shares and thus have problems of finding funds for re-investment. On the other hand, the public company can re-invest its whole profits because it is not dependent on the quotation of its shares, and thus can re-invest and build up more rapidly than private companies.

For India, it was also stated that the State is not deterred from entering profit making fields in manufacturing, specially in the case of new undertakings, such as aircraft manufacture, ship building and the manufacture of telegraph and telephone equipment.

Other points mentioned in favour of publicly financed enterprise in profit-making fields, included the following:

(1) It was pointed out that in more highly developed countries, private enterprise can be relied upon to operate in all fields in which profits can be made. This assurance does not exist to the same extent in under-developed countries. It was generally agreed that where private enterprise failed to operate in a profit-making field, it was appropriate for publicly financed enterprise to fill the gap and that the profits made could be considered as part of the finance available for further development.

(2) It was further pointed out that it might be suitable for public profit-making enterprise to be carried on in under-developed countries in order to serve as a yardstick of the efficiency, tax paying capacity and fair prices of private enterprise.

(3) It was pointed out that State operation in profit-making fields may put the public authorities in much closer touch with economic realities and thus enable them better to control the process of development, formulate development programmes and improve the quality of economic policies generally.

(4) Attention was drawn to the fact that in some more highly developed countries, public and commercial enterprise exist side by side in the same field. The cases of steamship services and broadcasting systems in Canada were quoted as illustrations.

While it was thus the general opinion that it should not be the general principle to exclude the use of public funds from profit-making enterprise, and also that such public profits may come to be regarded as available for financing of further development, it was also stated that on the other hand the State should refrain from entering into enterprise merely for the sake of the profits that could be made. The point was made that the State should be motivated not by a desire to make profits but by a desire to pursue some of the public interests which are part of the general purpose of promoting economic development. But there was no support for the idea that some fields should be barred on principle from publicly financed activities.

As further limiting the use of profit-making publicly financed enterprise as a source of finance for further development, the following statements were made:

(1) The general principle should be to associate private capital with such enterprises, and finally pass the enterprise on to private capital, as soon

as the proper stages for these two steps had been reached. That at least should be the general principle in countries desiring to encourage private investment although in certain fields, according to national traditions, it might be considered essential to maintain government control.

(2) It was stated that public funds should not be used to impede the use of private funds for economic development. This was stated to be the corollary of the principle of opening up publicly financed enterprise for private participation whenever possible.

(3) Where public enterprise has been established for lack of institutions to arrange for private investment, it was stated that the policy should be for the State gradually to sell shares or even control to private interests, as the capital market grows and the institutions for private investments are developed.

(4) It was pointed out that where profit-making public enterprise has been a substitute for the use of taxation, the general tendency should be to abandon this method as a proper taxation system was developed.

/(h) Specialized

(h) Specialized public financial institutions

What are the relative advantages of channelling public funds for economic development through specialized banking and financial institutions, either public or private, or else investing them through the normal fiscal agencies and government departments?

It was found that in all the countries represented in the group both systems co-existed at the same time. Government departments were both directly channelling public funds into economic development as well as working through some specialized institutions, such as development corporations, development banks, special agricultural banks, etc. The prevailing feeling in the meeting was that the method of working through specialized institutions has a definite usefulness, in particular cases, but that its scope varies in different countries according to political and administrative traditions, and also that special institutions cannot supersede the work of government departments in discharging such obvious government functions as education or technical training.

The following advantages in developing specialized institutions were mentioned:

1. In the case of Egypt, it was stated that the specialized agricultural credit bank has shown that by the development of special institutions certain functions can be fulfilled which are not easily fitted into the ordinary framework of government departments.

2. In the case of the big Indian River Valley projects, involving inter-provincial or administrative questions, and large investments, the method of special corporations formed for this purpose was found preferable, in avoiding administrative disputes.

3. Also in India, where special government corporations have been formed to finance industries, in which half the capital is provided by the state and half subscribed by private sources. The formation of such specialized industrial finance corporations has been found preferable to direct use of public funds. The industrial finance corporation in the state of Mysore was quoted as an example.

4. In the case of Puerto Rico, the main advantage of the method of creating a specialized government development bank and allocating considerable

/public funds

public funds to it, was that the government bank permitted the rapid turn-over and repeated use of the funds made available to it. The money advanced to the development bank was used as a revolving fund; as loans made by the development bank were re-paid, the money was made available to new projects. It was felt that in the case of an ordinary government department, it would have been more difficult to provide for such revolving and repeated turn-over of the funds.

5. In the case of Mexico, it was stated that in the specialized institutions it is easier to have proper control over the use of the funds, and more concrete responsibility than if the funds invested were general funds. It was also found that it was easier in that way to associate private banks as trustees with the use of public funds because the responsibility is clearly differentiated in the President of the Board of Directors of the specialized organization, and thus the private banks know exactly with whom to deal.

6. For India, it was stated that the corporation device has distinct advantage in ensuring efficiency and criteria of soundness on the part of the people who run the projects. It was stated to be Indian experience that projects administered by corporations are run with a different outlook from that of a normal government department.

7. In the British colonies, it was stated, it is the practice to entrust to specialized institutions the activities of a more commercial character, and it was put forward as a general principle that the greater the commercial element the greater the scope for independent institutions. Thus in the case of public services, water supply is generally, though not always, run by ordinary government departments but electricity supplies which are of a more commercial character are more commonly dealt with by specialized institutions. Similarly, the administration of former German plantations in the Cameroons taken over during the war by a special corporation organized by the Nigerian government was quoted as another illustration of the principle; that corporation, although organized by the government, is run on independent lines. It was stated that the degree of independence of specialized institutions should also be graded according to the degree in which the undertaking was of a commercial character.

8. The question was also raised whether specialized institutions would recommend themselves in order to remove economic development to some extent

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from the sphere of party politics and make its direction more technical and more continuous. There was, however, some doubt on the general applicability of this statement. It was maintained that where it is a question of poor or unstable government, these problems could not be evaded by the setting-up of semi-independent institutions. It was said that where there is a bad tradition or bad situation, the correct approach was to remedy it rather than evade it by the setting-up of specialized institutions.

9. It was stated that in Puerto Rico the satisfactory working of the corporations has been due to their independence from day to day regulation by the government. This has enabled them to make quick decisions and deal with daily problems in a business-like manner, and yet at the same time, to be responsive to the central policy of the government.

As against these advantages, a number of disadvantages were mentioned:

1. The possibility of overlapping between several specialized institutions was mentioned, and was said to be confirmed by Mexican and Puerto Rican experience.

2. The excessive cost of administration of specialized institutions was mentioned. The various institutions required special staff, directors, members of boards, and this tended to make administration costlier than if the existing machinery of government departments were used.

3. It was stated that where many specialized organizations existed, there is a tendency for each to conceive of its own job as the most important and to try to fulfill it independently of the general conditions of the country and the over-all development plan. It was said that any reduction in investments is more difficult with specialized institutions than with government departments.

4. The creation of specialized institutions may create a pressure on the limited supply of competent technicians and administrators.

To summarize, the discussion evolved the principles, that the use of specialized institutions is wide-spread and that in a number of cases it has been found very useful. The cases for which special institutions seem suitable, include the following:

1. Where the enterprise is of a special technical nature
2. where it is of a commercial, profit-making nature

/3. where it is

3. where it is of a big scope, cutting across existing administrative and regional divisions

4. where it is intended to associate private capital of private enterprise with the undertaking.

/Section III: Operation

Section III: Operation and Control of Investment through Banking and Financial Institutions

(a) Direction of investment into preferred fields

How can a government of an under-developed country exercise successfully credit control in the sense of directing the credit potential into preferred fields?

Several methods by which it is possible to affect the direction of commercial credit were suggested at the meeting. The principal method proposed was that of "selective rediscounting policy". According to this method, preferred investments by banks and other financial institutions are accorded to a more favourable rediscount rate by Central Banks in their equivalents. The Bank of Mexico's offer of a favourable discount rate on loans to stock breeders, when they were in difficulties, was cited as an illustration. Doubts were, however, expressed by some members regarding the feasibility of such a policy. In their view, it was likely to prove arbitrary, discriminatory, and open to certain abuses. The establishment of a preferential scale of discount rates as against a statement of general principles was considered inevitably exposed to the danger of being arbitrary. Since banks in the under-developed countries were few in number, discrimination against some would be detrimental to the development of banking generally in these countries. It was, however, clarified that in effect such a policy should not be discriminatory against particular banks since all banks, without exception, would be accorded a favourable discount rate in respect of their productive investments. It was further objected that it is difficult to prevent the concealed diversion of funds lent by banks or other financial institutions to operations of a speculative nature or other less desirable forms of investment or consumption. An undertaking might ask for a loan ostensibly intended to improve its production, whilst at the same time taking funds from its own capital for investment in an operation of a speculative nature or for distribution. While on the other hand, a transaction for productive purposes might on the surface appear to be of a speculative nature. It was, however, admitted that the extension of credit to speculative undertakings could be prevented both directly and indirectly. Indirectly, the raising of the general discount rate would prevent private banks from supplying

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credit to undertakings of a speculative nature which are more sensitive to changes in short-term rates. Directly, by discriminating against speculative undertakings, in such matters as margin requirements, acceptance as collateral etc. the monetary authorities could effectively restrict the availability of credit to such transactions.

A second suggestion was the provision of State guarantees to commercial banks in respect of preferred investments. As an illustration the case of Palestine was cited. When the production of oranges was seriously endangered as the result of the cessation of exports following the outbreak of war, the Government Bank had guaranteed the advances previously made to the producers.

Thirdly, it was suggested that privileged fiscal treatment, as sometimes applied to investments in Government securities, might be extended to investments of private capital in avenues of production which the State wished specially to encourage such fiscal privileges would also make such producers better risks for potential lenders. It was, however, pointed out that this was likely to make the fiscal system more complicated and might also prove detrimental to the State revenues.

In general, it was agreed that the State could intervene in diverse ways, either by directly acting as entrepreneur or by advancing loans, or granting subsidies to certain industries or by determining the policy of the bank of issue; but it was problematic to what extent the State could usefully intervene in the operations of the commercial banks. It was stressed that the role of the private banks in the economic structure of a country was clearly defined, and it was accordingly considered desirable to limit governmental intervention in the domain of commercial banking, and to explore other means, at the disposal of the State, of providing a flow of finance for economic development.

It was the general view of the group that the responsibilities of maintaining the liquidity and solvency of the banks in the under-developed countries are in no way less than in the more advanced countries. In fact, it was felt that only in so doing could the banks of the under-developed countries discharge their responsibility in aiding the development of their countries. The problem of commercial banks in under-developed countries lay in the fact that somehow this had to be combined with their greater responsibility for economic development than in the more developed countries.

It was recognized that in view of the differences in local conditions, the nature of banking operations was likely to vary from country to country. In one country, for example, banks might be concerned with the financing of an annual crop, like sugar, in another with trade activities with more rapid turnover. There would be identity of objectives but differences in the manner of their implementation, since banking in the various countries is conditioned by its environment and develops with it. But there are, undoubtedly, certain fundamental principles of general application which must be observed everywhere in order to enable the banking system to discharge its basic functions. One such principle is to ensure the absolute security of the depositor.

It was debated whether the issue of solvency was as important in the case of under-developed countries as it was in more advanced industrialized countries. One view was that where development is spontaneous and automatic, as in the case of advanced countries, it is proper for banks to be mainly concerned with the safety of their depositors and the stability of the whole credit structure, but that, perhaps, in under-developed countries, the banks should be more closely concerned with economic development and that the safety and stability of the banks might not, perhaps, be the responsibility of the banks themselves but more that of the central bank or the government bank. It was also said that developmental improvements, once achieved, provided better safeguards for banks than orthodox rules of operation. In the opinion of others, the under-developed countries were specifically faced with the problem of inducing the general public to save more. This would be impossible if as adequate or even more adequate assurance than in developed countries was not given to the depositors that their savings were going to be safe. But while solvency of the banking system could not be compromised, it should not become the only preoccupation of under-developed countries. Adequate attention must also be given to developmental requirements.

In another sense, the importance of solvency could not be over-stated. To the extent that it was necessary for certain, if not all, under-developed countries to draw continuous, or at least occasional, resources from the outside, it was specially important to maintain a high degree of banking standards.

It was pointed out that real property investments in certain under-developed countries were either inordinately attractive to investors or received preferential treatment, and that in either case the country's limited capital

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resources were diverted from industrial and commercial undertakings which would have contributed more to the country's economic development. In the Philippines for instance, the interest which could be obtained on property investments was exceptionally high and operated as an obstacle to that country's economic development. Some steps had already been taken by the State to restrict the real estate market by reserving the right of ownership of property to Philippine nationals. But such regulation was now considered inadequate and more stringent measures were favoured. In Mexico, on the other hand, property investments were described as exempt from all taxes whereas the income tax on industrial and commercial undertakings amounted to about 38 per cent. There was a case for investigation, in the interest of economic development, whether such preferential treatment should be maintained.

The group considered it imperative that a distinction should be drawn between the various types of property investments. Certain types of property investments such as low-cost housing were not merely innocuous but eminently desirable, while others were harmful in so far as they diverted funds from developmental channels to speculative activities. It was considered natural during a period of inflation that private persons should be attracted by the security offered by property investments and such investments ought not to be regarded as invariably arising from profiteering motives. Similarly, it was justifiable when, as happened for instance in Mexico, it was made obligatory, by statute for insurance companies to invest part of their capital in property when their other assets had depreciated as a consequence of monetary devaluation. It was furthermore felt that in view of the housing shortage prevailing throughout the world, it was natural that governments should encourage some property investments as an emergency measure. But investment in luxury property would definitely be regarded as undesirable.

The meeting unanimously concluded that property investments in general should not be encouraged, but when designed to finance the building of working-class or low-priced houses they should be favoured.

The problem of providing financial assistance to small undertakings was recognized as particularly urgent in under-developed countries but differences of opinion prevailed regarding the form and nature of this assistance. Some members of the group thought that specialized institutions were the more suitable means of providing credit to the small producers, but others saw in this merely

/a multiplication

a multiplication in the number of credit institutions. Present experience of private financial assistance to the small producer was chiefly confined to agricultural undertakings and in that field was too costly to be provided by private banks. It was, therefore, felt that either state-subsidized financing enterprises should be fostered or that the State should itself come forward with direct assistance. It was furthermore suggested that financial assistance to the small producer could also be provided through co-operative credit organizations of the small producers themselves.

It was stressed that although the reluctance of commercial banks to supply finance for small firms was by no means peculiar to under-developed countries, it was more serious in their case because large-scale enterprises were few in number, often State owned or aided, and small-scale production was the prevailing form of organization in the under-developed countries. This suggested that special measures, unlike those found in more developed countries, would be necessary to overcome the reluctance of commercial banks to support small scale producers.

It was pointed out that there is yet another sense in which the position of the small producer is a peculiar one. When large projects come forward to Governments for assistance, it is considered natural that such assistance should be sought because the amount of the investment required is clearly beyond the capacity of the existing financial institutions, but when small concerns present their case for a project entailing new investment, doubt is invariably expressed as to why, if it were a good project, no private capital was forthcoming. It was felt that there was no objection to a strict screening of the small projects seeking assistance but they should not, in general, be discriminated against merely because they failed to attract private capital.

Mexican experience suggested that in addition to governmental assistance, co-operative means could be utilized to provide more ready assistance to small producers. The Credit Unions in Mexico attempted to create some kind of credit pool of small agricultural and industrial enterprises. Taken individually the small concerns were not good risks but when associated with others, especially with successful enterprises, they became more credit-worthy.

The supply of technical staff required in the financing of small producers, it was felt, was another problem to be solved. Small scale enterprises were unlikely to be provided with technical staff of their own and their needs

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extended beyond mere provision of finance; they included many related advisory and technical services. The qualified personnel available for this purpose in under-developed countries was limited, and a multiplicity of such institutions, particularly of a specialized kind, would tend to aggravate the situation. Multiplication of institutions should only be undertaken when required to serve particular needs.

/(b) Participation

(b) Participation of banks in long-term financing

Should commercial banks be encouraged, induced or forced to extend the maturity of their loans from short-term to medium and long-term loans? Should separate industrial banking institutions, as distinct from deposit banks, be encouraged?

In the countries which are now fully developed traditions of private banking vary considerably. In some countries, there is a tendency and tradition to restrict private commercial banks mainly to the business of deposit banking and to refrain from involvements of banks in the finance of industrial operations on a long-term basis. In other now developed countries, there is on the contrary a tradition for the private banks to take part in the initiation and financing of industrial and other productive operations on a longer term basis, in addition to their job as deposit banks. The question arising is whether the private commercial banks in under-developed countries should be encouraged or induced to go beyond the business of mere deposit banking and to play a regular part in the longer-term financing of economic activities. The alternative would be to restrict the commercial banks to the business of safe investment of the deposits received, and develop other specialized institutions, either private or public, for the essential function of long-term financing of economic activities.

It was found that in the under-developed countries represented, commercial banks normally confined their operations to short-term loans and that if they were to assist industrial development, it would be necessary for them to extend their operations to medium and long-term loans as well. Although industrial banks could be especially established for the purpose, it was considered worthwhile also to examine the alternative of how far it was feasible for commercial banks to venture into the field of medium and long-term credit in order to harness all available domestic capital resources for the financing of economic development. It was, of course, understood that industrial financing was not combined to the promotion of new industries. Existing industries also required financial assistance for their current and developmental needs.

In the course of the discussion, it was stressed that there was need for a cautious approach in the matter of utilizing the resources of commercial banks for industrial purposes. Commercial banking experience in the past and current practices in different countries were clearly suggestive of the need for caution.

The overriding requirement was to provide absolute security for the depositor. It was agreed that if industrial activities of banks should raise doubts as to the solvency of the banking system, deposits would decline resulting in a smaller volume of savings being available for developmental work.

Three main measures were indicated by which governments could insure the safety of the depositors of commercial banks, and thus enable them to engage in the field of industrial banking:

1. Governments could guarantee the repayment of medium and long-term loans extended by banks.
2. Central banks could provide special rediscounting facilities or other liquidity guarantees for commercial banks in respect of their medium and long-term assets.
3. Governments could lay down a certain percentage as the maximum limit for the proportion of the total assets of long-term commitments to the total assets of the commercial banks. In the interest of guaranteeing the safety of the depositor, some such limitation was declared to be desirable although no general percentage laid down would be valid for all countries.

It was stated that it would be a dangerous policy to set maximum limits to the assets of the commercial banks which could be engaged in medium and long-term assets without at the same time providing for specialized institutions for the latter type of requirement; this might protect the depositor but did not solve the problem of financing economic development. It was also said that where commercial banks undertook medium and long-term creidt operations, the depositor might be protected by organizing the medium and long-term activities in a separate department of the same bank, with separate accounts, management and separate banking principles.

In Mexico, prior to 1921 commercial banks operated in the field of medium and long-term loans, but this proved disastrous. The majority of these loans were made to the big Mexican farms which were subsequently partitioned as an aftermath of the Mexican Revolution of 1921. The old loans thus became bad loans without any security, reducing many banks to bankruptcy. From 1921 until 1936 existing banks were prohibited from entering into medium and long-term operations on the principle that medium and long-term capital requirements should be met by the securities market. Accordingly, special kinds of institutions called "finance corporations" were established by stature. These institutions

/specialized in

specialized in medium and long-term loans, and were expected to draw their resources from the public by sale of such bonds to them. However, in this direction, too, Mexican experience was not very happy in so far as the response from the public was disappointing. Almost the only clients these corporations had were the central bank and the national industrial bank. It was stated that this really amounted to an inflationary way of handling the problem of medium and long-term loans. Even a statutory modification in 1936, authorizing commercial banks to grant medium-term loans up to five years' maturity up to a maximum of 20 per cent of their deposits, failed to overcome the natural hesitancy on the part of commercial banks to enter the field of medium and long-term credit. As a further step, the central bank adopted the rule that all increases in private bank balances following the devaluation of the Mexican peso, were to be deposited with the central bank, unless these funds were employed by the banks concerned as medium-term accommodations to industrial and financing concerns. It was regarded as too early to predict the outcome of these modifications. Although it was realized that unrestricted operations were dangerous, commercial banks were encouraged to enter the field of medium-term financing for special reasons. It was felt that if publicly owned banks were set up to handle medium and long-term financing, then the government would be assuming an undue share of the the responsibility for industrialization and invade the field of the private banks.

In Chile, commercial banks were at the moment not permitted to engage in medium or long-term financing, but it was under consideration whether their activities might be extended to loans not exceeding five years, with an upper limit to the total volume of long-term financing fixed at ten per cent of their deposits.

The tradition of banking in the British dependencies, as in the United Kingdom itself, had discouraged any extensive entry into the field of medium and long-term commercial loans by the ordinary banks. They normally avoid being involved in medium and long-term loans, but they often make short-term loans which, for all practical purposes, become long-term loans by constant renewal. This is done deliberately for the sake of liquidity. In the British dependencies, as more recently in the United Kingdom, the tendency has been to establish institutions separate from, but under the auspices of, the commercial banks to undertake longer-term credit

/activities in

activities in order to provide absolute security for the depositor. It had been observed that when colonial banks did make medium or long-term loans they often got involved in financial difficulties and were accordingly forced to seek the help of London banks to tide over the crisis.

Egyptian experience revealed that while commercial or deposit banks could undoubtedly help in the promotion of local industry, in practice they often failed to set appropriate limits both in the matter of advances and direct participation, with disastrous consequences to themselves. It was, therefore, necessary to impose some statutory limit on the extent of their participation so as to ensure their solvency. Egyptian feeling was generally against the participation of deposit banks in industrial development and in favour of public industrial development banks. Egypt had set up such an institution in which the government's contribution was 58 per cent. In addition to direct participation, this bank also provides loans of different maturities to industry.

In the Philippines, there was a shift in policy from the strict limit of one year maturity to medium-term loans and in respect of real estate finance up to fifteen years instead of five years as formerly. The reason for this change was the growth of deposits and the difficulty of finding investment outlets for them. Of the one billion dollars in deposits, as much as approximately 50 per cent constituted savings deposits, which were not being utilized. Adequate safeguards were, however, required to ensure liquidity. The real estate loans, for instance, were not to exceed 15 per cent of the savings deposits and the loans granted by commercial banks were discountable with the central bank.

In Puerto Rico, it was estimated that out of total deposits of $250 million, about $50 million were savings deposits. It was felt that these could very well be utilized for development purposes, though the medium of longer-term investment on the part of banks.

The general recommendation arising out of the discussion may be formulated by saying that commercial banks should be encouraged in all possible ways to play their part in long-term financing wherever they can do so without endangering the safety of their depositors. It was also felt, however, that this last qualification would set limits to the extent to which commercial banks in under-developed countries would in fact centribute to the longer-term finance of development, that a gap would still exist which would have to be filled by the development of specialized institutions such as industrial banks, which would operate on different principles from normal commercial banks and often enjoy public support of various kinds.

If specialized industrial banks are set up, several methods whereby they may obtain their capital requirements were mentioned:

1. They could directly approach the public with their bonds, but in view of the risks which have to be taken by industrial banks, it was considered inadvisable to allow industrial banks full freedom in the matter of selling bonds to the public. In the case of new undertakings to be financed, it is not always possible to gauge the degree of risk involved; hence, the banks should promote and finance such undertakings themselves and only when these undertakings have grown and become profitable going concerns, should they be offered to the public.
2. Governments could set up their own industrial banks contributing most, or all, of the capital.
3. Governments could directly participate in the capital of private industrial banks. Such participation need not take the form of a loan from the government but might be an actual contribution to the capital of the bank. According to Mexican law, for instance, the Central Bank acting as an agent of the government, could buy up to 20 per cent of the capital stock of any such private institution.
4. The industrial banks could draw their currently required resources to some degree from the central bank. This carried with it the dangers of industrial financing through inflationary means.

A distinction was drawn between "investment banking houses", common in well developed countries such as the United Kingdom and United States of America, and industrial banks proper. An investment house does underwriting business; it sets up the capital structure of a firm, provides it with initial capital and holds its stock until it can be safely sold to the general public. It is purely a transitory operation. A financial house does not expect to hold anything longer than for a short transitional period, perhaps even a few weeks although it may be forced by circumstances to do so. But an industrial bank, or some such institution, particularly in an under-developed territory, must expect to hold their stocks for a very long time. Another feature of industrial banking in the case of under-developed countries would be the provision of capital to meet the needs of small scale industry, the stock of which

/can not be readily

can not be readily marketed to the general public. It was also pointed out that even in the case of the most developed countries, regular commercial investment facilities have had to be supplemented by government aid, such as the Reconstruction Finance Corporation in the United States. Since there was not the same experience and knowledge of the best means of management and of planning operations, or even of accounting, in under-developed countries, the establishment of an industrial bank was likely to require also much needed technical guidance and assistance.

Comments were made on the question of the desirability of a high degree of specialization among the various banking instutions required in the under-developed countries. The main consideration in favour of specialized institutions was that if commercial banks were also to provide long-term loans for industrial purposes, they would be exposing themselves to the danger of impairing their solvency.

Against the idea of separate institutions for "deposit" and "industrial" banking it was observed that:

1. In many under-developed countries it would be necessary because of the smallness of business transactions to group industrial banking and commercial banking together instead of providing separate facilities, particularly if it is intended to develop banking in the remoter parts of the country which have limited resources.

2. Until such time as a security market is developed in under-developed countries, industrial banking would have to be combined with deposit banking and commercial banking, since it would be difficult for specialized industrial banks to attain either the rapid turnover required or else attract the longer-term resources required.

3. There were dangers in premature specialization. In Mexico, while there was strict regulation of commercial bank operations, the specialized industrial banks at one time were left in the hands of people who did not command the confidence of savers traditionally accorded to the more general banks, and hence financing was largely done through inflationary means, i.e., through the central banks.

4. Part of the resources of the commercial banks should be made available for industrial purposes.

/The general

The general trend of argument was in favour of progressive specialization of banking in the under-developed countries in the course of economic development, but it was at the same time considered inadvisable to specialize prematurely. It was considered that not all under-developed countries were yet ripe for specialized industrial banking institutions. But where there was and where there would be a need for special industrial banks, they should, as far as possible, be entirely separate from the ordinary commercial banks.

/(c) Bank balances

(c) Bank balances held abroad

What can be done to discourage the holding of bank balances abroad?

On this question, general agreement was reached within the group that governments of under-developed countries or areas should discourage, either by legislation or by informal influence, the holding of balances abroad, generally in more industrialized countries, in the following cases:

(1) Where the country is suffering from a foreign exchange shortage. It was noted that there is a tendency for economic development itself to result in foreign exchange shortages even though this need not apply to all under-developed countries.

(2) Where the balance held is in excess of what is required for the smooth conduct and financing of international trade and other approved international transactions.

(3) Where the balances abroad are not needed as a reserve to be held against corresponding foreign exchange liabilities and deposits by the banks. It was agreed that where the foreign exchange regulations permit private individuals or business units in under-developed countries to create deposits in terms of foreign currency, the banks must be permitted in some form to acquire foreign assets to cover those liabilities.

(4) Where balances abroad are not desirable or necessary to form an emergency reserve against unknown and unforeseen contingencies. Such contingency balances may be either public or private.

(5) Where there was profitable or socially desirable use for the money inside the under-developed country or area. Where development projects are not sufficiently advanced, as may be the case specially in least developed countries, restrictions on the transfer of deposits by banks may be useless and reduce the liquidity of the banking system. Assets abroad are sometimes more liquid than domestic assets and serve the purposes of a cash reserve. On the other hand where temporarily there is no use for such balances because of inability of obtaining needed capital goods or other essential pre-requisites of development, the holding of balances against such time when development can proceed is preferable to premature dispersion of foreign assets for non-development purposes.

Within the framework of this general agreement, a number of more detailed points emerged from the discussion. The principle of equivalence of foreign liabilities and foreign assets was described as applying both in India and in Mexico in spite of the difference in foreign exchange regulations. The case of British Malaya was cited as an example of a country where the holding of large foreign reserves in 1939 had turned out to be of considerable advantage and benefit to the country. To some extent, the advantages of internal development and the holding of contingency reserves abroad have to be balanced against each other.

The view was also put forward and met with general approval, that the tendency to transfer balances abroad may often have deeper-lying sources which should be attacked by inspiring or restoring confidence, freeing currencies or trade from restrictions, or other suitable measures, rather than by deliberate control of the location of bank balances.

For Mexico and the Philippines, the problem of the investment abroad of the assets of insurance companies has also become a subject for legislative effort. Special mention was made of a device used by the Mexican Government under which dollar bonds were issued which were bought by the insurance companies and served as a cover for their insurance policies issued in terms of dollars. Note was also taken of impending Philippine legislation requiring insurance companies to invest at least 50 per cent of their reserves locally. It was found that such legislation seemed to be a general tendency in under-developed countries but that the detailed type of regulation to be advised, if any could not be generally laid down.

(d) Banking functions of central banks

Is it advisable for central banks to combine with their fiscal and credit policy purposes ordinary banking business?

As a preliminary to the discussion on the above question, it was considered advisable to investigate whether some form of central banking existed in the under-developed countries represented at the meeting. These discussions served to bring out the uneven development of central banking activities in under-developed countries.

It was revealed that some of the countries represented had a central bank but others did not. In Puerto Rico, there was no central bank but instead there existed a Government Development Bank. Likewise, Egypt had no central bank but the National Bank of Egypt virtually functioned as a central bank. The British Colonial Territories, of course, had no central banks. Chile established a Central bank in 1936 while in the Philippines one was set up only very recently. Mexico set up its central bank in 1925 but until 1931, it operated very much as an ordinary commercial bank. Between 1931-1932 the government reorganized the central bank in an effort to limit its functions to those of an orthodox central bank, that is, acting as a "bank of banks" and refraining from dealing directly with the public. In 1935, legislation was enacted whereby the central bank was precluded from lending money to the other banks of the system. This was done to prevent the latter from conducting operations in excess of resources they could command from their own capital or from the deposits of the public. The position was modified after 1941, when as an exceptional measure, it was made permissible for the central bank to supplement the resources of local banks in areas deficient in capital resources by extending re-discount facilities to the local banks concerned. Thus, the Central Bank of Mexico supplemented the resources of the banking system, as required of a central bank.

The general sense of the meeting was that the development of central banking in a country was a matter of the stage of development reached. In the earliest stage, when there is no properly organized domestic capital market, the orthodox type of central bank is clearly not immediately possible. It then either provides or supplements the ordinary banking facilities of the country, in addition to the

/performance

performance of what central banking functions are required. But in the course of economic development, the requirement of a pure type of central bank was likely to emerge eventually. Accordingly, in the most advanced countries central banks, when fully developed, do not undertake any significant commercial activities. It was thus felt that there could be one kind of central bank in some countries and a different kind of central bank in other countries, depending on the stage of economic and banking development. It was, however, recognized that, with this qualification, central banks ought not to participate in commercial activities.

When a central bank is the offshoot of a commercial bank, that is when it starts as a commercial bank and ultimately "graduates" as a central bank, it is impossible to postulate that there could be an absolute separation of functions. However, the volume of commercial business should tend to become negligible or disappear in the course of time. If it were to continue commercial operations on a large scale, it would, by virtue of its position, be exposing the commercial banks to unfair competition, and might thus retard the normal and spontaneous development of a commercial banking and credit system in the country.

It was agreed that to require a central bank to function as a government development bank could not be regarded as consistent with prevailing views regarding the normal activities of a central bank. In undertaking developmental activity, the central bank was merely undertaking a piece of commercial or business operation and not really enforcing a credit policy on other banks.

The group next discussed how the central bank could best carry out a policy of financing development - whether by functioning exclusively as a central bank or by operating also as a commercial bank. It was generally accepted that a fully operating central bank could operate both positively and negatively in the enforcement of credit control, but doubts were expressed regarding the efficacy of relying on the central bank as an instrument of development. The following reasons were given:

1. There may be no central bank in a country, as was the case in some of the under-developed countries.
2. Even if a country did have some kind of a central bank, it may not have all the attributes of a central bank. This was, for example, true of Egypt, Mexico and certain other countries. In such cases it was more useful to develop the Central Bank into a fully effective Central Bank than into a Development Bank.

3. Financing of developmental activity by central banks was likely to lead to inflationary consequences.

On the other hand, there were good reasons why, in the interest of development, a central bank might combine ordinary commercial banking business with its normal functions as a central bank. Although in theory a central bank should abstain from competing with commercial banks, its participation in developmental activities did not necessarily conflict with the activities of commercial banks. The central bank might be called upon to fill the gaps left by a failure of the commercial banking system to operate fully. Actual experience of countries in which the central bank or a government development bank undertook ordinary commercial business testified to the absence of competition between the central or development bank and the commercial banks of the country. It was claimed that they usefully supplemented the activities of the commercial banks. This was so because of the inadequacy of the normal banking and credit machinery to meet development requirements.

The view was, however, expressed that since central banks were the direct agents of government, they were primarily concerned with the financing of public enterprises and this was likely to become their main preoccupation to the detriment of non-public types of activities. In other words, a different type of economic development was likely to result through more money being put into public projects and less money being put into private projects.

It was also pointed out during the debate that in undertaking developmental activity, the central bank was merely undertaking a piece of commercial or business operation and not really enforcing a credit policy on other banks as sometimes believed. It was added that a fully operating central bank alone could enforce credit control but not one that did not possess all the attributes of a central bank, as for instance, a government development bank. Just as a central bank should not normally be saddled with direct financing of development, so developmental institutions should not be relied upon for exercise of credit control.

In Puerto Rico, it was stated that the government development bank did not compete with the existing banking institutions because it only operated in the field of relatively long-term loans for industrial purposes or for real estate development (from which the local banks were barred). In fact, it supplemented the ordinary credit activities of commercial banks. It did not, unlike ordinary banks receive deposits from private persons or private business houses, but on the

/other hand

other hand it had power, as in the case of a central bank, to make loans to private banks and re-discount their short-term paper. In addition to promoting industrialization through long-term loans, it also functioned as a fiscal auxiliary of the treasury. Some conflict between the fiscal and the development functions had become apparent, but the course suggested was a strengthening of the development branches rather than two separate institutions. Since there was no central bank in Puerto Rico, the government development bank was playing a useful role. It was, however, debatable whether it would not be more useful to have the equivalent of a central bank in Puerto Rico or in a British colony of the size and development of Jamaica. It was also pointed out that Puerto Rico was not concerned with the issue of "created money" and consequent inflationary problems and accordingly the development bank was not inhibited by a fear of inflation from encouraging and helping public corporations to acquire funds.

In Chile, the central bank did not in any way compete with the commercial banks of the country, but it supplemented their activities. The public dealt with the commercial banks and only when the commercial banks reached the limit of the resources which they could place at the disposal of private individuals and institutions, did the central bank come into the picture in dealing with the public directly. Even this practice has not been permitted in recent years, because it was feared that the central bank might, in consequence, compete with private banks and might also, as a result of this, encourage inflationary tendencies in the country.

In Mexico, it was stated that the central bank did not at all compete with the private banks in the sense that normally private means of credit are entirely in the hands of the commercial banks. But when the resources of the banking system are insufficient, either in certain regions of the country or for certain purposes, then the central bank, not directly but through another commercial bank, could give assistance, lending money to a bank so that the bank might be able in turn to lend to the concern for the purpose which was to be encouraged. But it was also stated as the prevailing view in Mexico that the central bank should also directly assist the public corporations which are concerned with the economic development of the country. Such accommodation to national banks or public corporations in the part of the central bank had been restricted since last year as a part of the governments and inflationary programme. Thus the present position was one of complete reparations of the activities of the central bank on the one

/hand,

hand, and the national developmental banking institutions on the other.

The general conclusion which emerged from the discussion was that if it was required for the purposes of national development, central banks whether newly organized or still to be organized, might combine commercial banking business. However, a mature central bank once the country has become developed should be operating as a distinct institution without regular banking functions. This would mean that in general they would not be directly in touch with borrowers, with the accepted qualification that the central bank might stand ready for such direct contact if the commercial banks had exhausted their lending potential.

(e) Stock exchanges

What is the experience with stock exchanges in under-developed countries, and at what stages in economic development is it advisable to encourage the general public to invest through stock exchanges?

The group agreed that the main aim was that of channelling investments into securities and the development of a securities market for that purpose rather than the development of stock exchanges as such.

It was accepted that stock exchanges developed only gradually and it could not be recommended artificially to expedite the process, except by the removal of legislative obstacles, if any. Egyptian experience was quoted as illustrating how legislation could be a factor in hampering Stock Exchange development. It was pointed out that special decrees were necessary in order to form a company and to have the company's shares listed on the exchange; shares could not be offered at denominations small enough to attract the small investor.

It was apparent that the discussion revealed the existence of two conflicting viewpoints. On the one hand, it was believed that stock exchanges were useful at all stages in order to encourage the formation of companies, to make the public investment minded and to attract foreign capital; on the other hand, it was contended that stock exchanges, if prematurely established, might do more harm than good since they might encourage unhealthy speculation rather than the growth of constructive enterprises.

Those in favour of the first point of view agreed that while steps should undoubtedly be taken to improve the operational methods of the exchanges in order to encourage investments on the part of the public, only minimum supervision by the State was really required. Speculation, it was argued, was not peculiar to any particular stage and could develop at any time in other forms. Stock exchanges were an essential link in development and should, therefore, be established as soon as there were any securities to be marketed. Every encouragement should be given to their early formation.

/The opposite

The opposite school of thought felt that stock exchanges should be allowed to develop only at the appropriate stage of economic development. No special initiative should be taken as a certain broadening of the market was a prerequisite. Stock exchanges came into existence only at a certain stage in the advanced countries and played an increasingly valuable part in encouraging further development. The importance of previous company reform and improvement of company accounts was stressed to enable the public to judge the standing of an institution and to prevent speculative activity. In India, for instance, stock exchanges had been spontaneously formed and there inevitably were certain initial failures due to over-speculation and other factors. The State was, however, trying to regulate dealings on the stock exchange in the interest of the investors.

It was also pointed out that when the volume of transactions was not great, as was likely to be in the case of under-developed countries, it was necessary to guard against excessive speculative fluctuations in quotations. In Mexico, for example, there had been a manipulation of a thin market in both public and mortgage bonds and the central bank had to step in to protect the country's savers against losses.

It was made clear that in seeking the regulation of exchanges, it was not desired to surpress fluctuations altogether. On the contrary, it was claimed that fluctuations actually encouraged investment activity. Elimination of fluctuations would obscure the fact that enterprises were risky and Government would then be compelled to assume the risks themselves. Undue fluctuations due to manipulation of the market were, however, undesirable and should be regulated on the same lines as in advanced countries.

It was pointed out that in Chile the exchange played a great part in selling the shares of State sponsored enterprises. The Development Corporation had floated sixty undertakings and had sold shares in approximately one-third of them to the public. The proportion of capital was, however, somewhat less than one-third, as the public was not much interested in buying shares in public utilities. In Mexico too, the exchange played a useful role, in enabling the National Development Bank to sell shares in a third of its concerns to the public. The bank was eager to sell to the private investor, whether national or foreign, but the public was not much interested in public utility stocks.

In addition to examining the importance of the stock exchanges in the trading of securities, it was considered useful to examine the function of the institutions which supervised the issuance of securities, equivalent to the Local and Federal Securities and Exchange Commissions in the United States. These agencies did not regulate the direction of capital investments but were concerned with the form of securities issued, their proper issuance, and with the whole system of security sales and purchases. The group debated whether similar supervisory agencies might not also be appropriate in the case of under-developed countries. This raised the question at what stage a supervisory authority ought to be set up.

The general presumption was that only when a certain stage of stock exchange development had been reached, would the establishment of a supervisory institution be justified. Some, however, felt that a supervisory commission would be appropriate in the first stages of development. The necessity for it had occurred in Mexico, which was in the nascent stage of stock exchange development. The setting up of a commission, on the pattern of the United States Security and Exchange Commission, was under active consideration there. It was found that it was sometimes easier to sell poor or bad securities to the public than good securities because in the case of the former, heavier pressure was commonly put on the prospective investor.

It was considered desirable to avoid excessive supervision and control of the securities markets because instead of promoting the normal and healthy growth of the securities market, it might act as an impediment. A certain degree of minimum supervision, specially to protect the interests of the small investor, was, however, imperative and essential. It was agreed that the nature of this minimum supervision would have to be determined by each under-developed country to suit local conditions.

The group next examined whether the supervision of the stock exchange was to be regarded as a function of the government? It was pointed out that in some countries the supervision of the stock exchange was left to the organized traders themselves. Those advocating governmental supervision, however, made it clear that it was not the intention to control the stock exchanges as such. The American practice was an illustration in point. The stock exchange in each important city was privately controlled and privately managed but independently of the stock exchange there were in the United States public supervisory commissions, both local and federal, which dealt with the supervision of the securities market.

These commissions, it was pointed out, were concerned with the task of examining the regulations under which the stock exchange associations functioned and their rules of working so as to ensure that they offered adequate protection to the public. The stock exchanges themselves, operate as private organizations and function under their own rules, but there is a broad supervision in the sense that the rules of the association have to be approved by the Commission. In India, legislation of a similar kind was under contemplation.

Granting the case for such a commission, it was important to determine when such a commission should be set up. It was felt that that would depend, in general, on whether the securities market had reached a stage which would warrant State intervention. It would also depend on whether the private organizations were functioning satisfactorily or not. If they were functioning satisfactorily, state intervention would perhaps not really be necessary and could be dispensed with, and each under-developed country would have to be guided by local conditions and experience.

The influence of income tax laws on the development of certain forms of business organizations and through them in the development of a securities market was examined. The following effects were noted:

(1) Personal and partnership or family owned enterprises could be encouraged to transform into corporate enterprises by a low rate of tax on companies and a high rate of tax on individual incomes or by a graduated scale of individual income tax above the rate of tax applied to companies.

(2) A result of this might be to increase the volume of corporate securities in the stock exchange. But it was to be noted that the shareholders of companies set up in order to reduce the tax burden tend to hold their shares rather than sell them, for otherwise the purpose of the transformation is defeated. The main issue was not whether it increases the volume of savings through the medium of the stock exchange but whether it affects the total volume of savings of a country.

(3) The promotion of corporate forms of organization also had a bearing on the general question of development. Usually, the predominance of the single proprietorship or unlimited partnership is characteristic of the less developed countries. When taxation laws promote or give an incentive to the

/establishment

establishment of companies, that in itself helps to accelerate the development of the correlated financial and economic institutions. Besides, the corporation has the advantage of having greater permanence and it is more amenable to control by the State. This also tends to affect the use of funds, as also the volume of personal expenditure, since non-distributed profits of corporations increase the funds available for capitalization and restrict consumption. The system of individual proprietorships has the opposite effect in many under-developed countries.

It appeared from the views expressed that in most countries the taxation system displayed a preference in favour of the corporative form of enterprise.

In India the taxation on individuals went to higher levels for the high income groups than for companies. In the Philippines income tax was progressive, whereas corporation income tax was fixed. The progression is probably more noticeable in the case of the advanced countries, such as the United Kingdom where the rate is as much as 19s.6d. for the highest individual incomes but only 9s. in the case of corporations. There, however, the transformation into corperate forms for the sole purpose of avoiding tax incidence was considered an undesirable development and attempts had to be made to deal with it.

Recent Egyptian legislation, however, was stated to militate against the development of the joint stock companies. It was stated that company reserves in excess of 25 per cent of the capital are specially taxed as a result of recent legislation. The Treasury wanted to obtain additional revenue from the joint stock companies because of their large profits during the war, but this legislation was stated to have had the effect of slowing down the formation of joint stock companies in Egypt.

Some doubts are expressed as to whether joint stock companies were essentially a more desirable and efficient form of business enterprise, but it was concluded that when the joint stock company was the only suitable organization, for a particular type of business, because of the volume of capital required or for any other reason, taxation or any other legislative measure calculated to make their formation difficult was clearly undesirable from the point of view of economic development.

/On the problem

On the problem of utilizing Stock Exchange for the marketing of government securities, it was feared that this might lead to an undue degree of competition between government securities and private securities in the Stock Exchanges to the detriment of private issues. Governments might also be tempted to try to prevent or obstruct in some way the issue of private securities likely to compete with their own. Sometimes, for example, government bonds are not taxable or are redeemable by the central banks at par or near par, and therefore, unlike private issues, they carry little or no risk. Government bonds yield a certain interest which is usually the lowest interest on the market, and private companies in need of capital are therefore compelled to pay higher rates of interest. Thus, the terms on which government securities are issued through the Stock Exchange also determine its usefulness as a method of private financing. If the effective rates of interest offered on government securities issued through Stock Exchanges are too high, private companies will be forced to pay correspondingly more for money received by them.

It struck some members as paradoxical that the government should first either set up or organize or permit the existence of a Stock Exchange, and then in effect monopolize it for trading most of the securities itself. It was accordingly asked whether there was not a case for reserving Stock Exchange markets in under-developed countries for private securities, to prevent competition from government securities.

Several reasons were advanced against such a segregation of markets:

(1) It would be defeating the purpose of economic development for governments to agree to deprive themselves of the advantages of dealing in the Stock Exchange.

(2) In some countries, government bonds were very rarely transacted through the Stock Exchange and hence private securities were in no way exposed to excessive competition with government securities.

(3) Governments might sometimes properly interfere with or obstruct the issue of private securities, in order to regulate the direction or flow of capital as part of an over-all development programme. Where development is largely publicly financed the distribution of Stock Exchange issues would reflect that fact.

/(4) Historically,

(4) Historically, Stock Exchanges often begin by dealing exclusively in government bonds. It was only gradually that private stocks commenced to be traded.

(5) Exclusion of government securities would not necessarily mean that larger investments would be made in private issues. Those who had a preference for government securities would continue to satisfy this preference.

(6) There is no guarantee that even if investments in government securities are in some way discouraged that investors would necessarily turn to private issues. They might be diverted in other directions, such as real estate.

(7) If government bonds became "unsaleable" as a consequence of exclusion from the Stock Exchange, this would be detrimental to government credit generally.

(8) The public needed a variety of instruments of investment and in that sense government securities would not necessarily be directly competing with private issues, because they possessed special features of their own.

(9) Sometimes government stocks traded in the exchange might facilitate the absorption of new private issues, if owners of government stocks could borrow money against them in order to acquire the funds to buy prospective private issues. Obstacles in the disposal of government bonds would destroy this facility.

(10) A substantial part of the stock broker's income consists of his commission from dealings in government securities. This helps to reduce the cost of dealing in private issues.

/Section IV: Special

Section IV: Special Problems

(a) External and domestic finance

What are the principles under which the proper shares of external and internal finance for particular development projects can be determined?

In discussing this question the group agreed that there was no general justification for any principle that the amount of external finance required could be accurately measured by the foreign exchange part of the expenditure directly due to a given project. Note was taken of the fact that that particular principle was embodied in the statutes of the International Bank for Reconstruction and Development, although an "exceptional case" clause provided a certain amount of flexibility. The group was unanimous as a result of its discussion that the "exceptional case" clause should be generously interpreted, and the general principle should not be rigidly applied.

In defense or explanation of this principle, it was stated that

(1) it was a reaction from the abuses of foreign investment in the previous century and in the 1920's when foreign financing was indiscriminately applied and included fields and projects for which domestic financing would have been more advisable.

Specially in the 1920's it was stated that foreign loans to under-developed countries had often been wasted in effect because they were not accompanied by a mobilization of domestic resources.

(2) the principle might be useful in drawing attention to the fact that international loans should not be used to finance purely budgetary deficits, and that no international loans should be made except to promote sound development projects,

(3) the principle was useful in putting under-developed countries on guard against the balance of payments difficulties usually connected with economic development. It was, however, pointed out that such balance of payments difficulties do not arise in connexion with such areas as the United Kingdom dependencies where there is a high degree of currency uniformity with the metropolitan country which provides the finance which is external from the point of view of the colonies.

/In such cases

In such cases the defense of the idea underlying the principle of limitation of external finance to original foreign exchange expenditure would not apply.

(4) It was also suggested in further defense of the principle that it might be possible to avoid subsequent balance of payments strain by a separate, subsequent external loan transaction. This argument however, did not meet with much approval since such a second loan would not be related to a particular project and would be merely a currency stabilization measure. Such external loans were declared to be undesirable in the general case.

The balance of the argument was against such limitation of external financing. It was pointed out that the foreign exchange expenditure immediately involved in any given project was not systematically related, either to the real contribution of local resources or to the actual or possible volume of local savings in all forms. The application of the principle of limiting external finance to original foreign exchange expenditure was thus due to a confusion of thought. The preferable approach was to consider the total possible contribution of local savings in all forms, excluding in the normal case inflationary forms, to consider the particular development to be financed in relation to this total possible contribution by local resources and to cover the remainder by external finance, or else reduce the development project if foreign finance is unobtainable. If that were done, it might be found that in the case of least developed countries the external finance required was much in excess of foreign exchange expenditure since the local savings available might be small or negligible. In other cases, also within the general category of under-developed countries, it might be found that the external finance required would be less than foreign exchange expenditure, since all or almost all the cost could be covered by a further mobilization of domestic resources. It was admitted that the appraisal of the external finance requirements by such an economic approach would be more difficult than the simpler rule of thumb to cover original foreign exchange expenditure, especially in the case of independent under-developed countries. All the same it was felt that the task should not be shirked, and that the techniques for such appraisal should be developed.

More particularly, the following objections were made against the principle:

/(1) There

(1) There is no such principle in private external financing. In private external financing, specially in private direct investment, the amount of external financing tends to be more closely related to requirements as determined by general economic appraisal. This is particularly the case where originally the whole of the project, including local expenditure, is externally financed and gradual transfer to local investors takes place in the course of time.

(2) As in private external finance, so there is no limitation to the volume of external finance in the principle laid down by the Inter-American Agreement at Bogotá. It was recognized that when the security markets of under-developed countries were unable to provide all the necessary local expenditure for development projects, such local expenditure could be a proper field for international financing.

(3) It was pointed out that in the case of projects of considerable magnitude, it was often difficult or impossible to give the required assurances that domestic funds for local expenditure were available.

(4) It was pointed out that it was often difficult to raise local finance for agricultural projects, and thus the financing of food producing projects was particularly hampered by the limitation of external finance involved in the rigid application of the principle. International credit institutions had shown a tendency to give preference to industrial projects and exclude food producing projects.

(5) Limitation of external finance was driving under-developed countries into inflationary conditions, by mistakenly assuming that all local currency expenditure could and should be domestically financed.

(6) In over-populated under-developed countries where there was disguised or open unemployment, it was not at all necessary that local savings should equal local expenditure. In such cases only part of the local expenditure involved an extra strain on real resources since the persons who had previously been in a state of open or disguised unemployment had been consumers to some extent without contributing to production. To that extent, there was no need to match the total local expenditure by additional savings.

(7) In the specific case of long term projects, it was pointed out that the share of external finance should be determined by long term re-payment

/and balance

and balance of payments prospects in the future, rather than by the immediate division of expenditure between foreign exchange and local expenditure.

(8) It was pointed out that it was difficult in under-developed countries to distinguish the non re-current local expenditure - such as the provision of wage goods for workers engaged in construction - from re-current domestic expenditure. Thus the construction of a dam, for example, led to the establishment of other industries and thus the need for imported foodstuffs might become re-current.

Since the main danger of undue limitation in the share of external financing was seen in inflationary developments inside the under-developed countries, the question was raised whether a certain amount of inflationary domestic financing could not be considered as legitimate, to the extent that it was merely compensating for hoarding. It was however, agreed that such compensation was only possible in cases where paper currency was hoarded, and not in the cases of hoarding of gold, commodities etc. Also investment in real estate does not constitute hoarding in the sense in which it could be compensated since investment in real estate involved a previous dis-investment by someone else and transfer of currency. Even where paper currency was hoarded the dangers of compensatory monetary policies were great since hoarding was not a complete sterilization of currency but merely a decrease in the velocity of circulation which might be undone again when dis-hoarding took place. Though hoarding of currency notes was ostensible desirable since it amounted to an interest-free loan to governments, it was dangerous to deduce from that the possibilities of compensatory local financing of development and corresponding limitation of the external share.

(b) High rates of interest

Have the high rates of interest in under-developed countries a deterrent effect on investment or are they fully compensated by correspondingly high profits?

During the course of the discussion, it was confirmed that generally high effective rates of interest prevailed in the under-developed countries. The structure of interest rates was, however, by no means identical among the countries represented though there were many common features. It was generally true that the disparity between the rates prevailing in the metropolitan centres and in the remoter parts of the countries was very pronounced and consequently capital required for agricultural purposes generally was far more expensive than commercial and industrial capital. The explanation for this situation was not far to seek and appeared to be the same in the case of most under-developed countries. Whatever modern banking facilities were to be found in the under-developed countries were mainly concentrated in the towns and cities; in the rural regions they were either meagre or conspicuous by absence. As a result, the rates charged to small farmers, who were largely left to deal with private money lenders, were extremely high, if not exorbitant.

Another common characteristic was that the rates for industrial loans were abnormally higher than those for commercial transactions. Although the rate of interest on industrial loans in the under-developed countries was decidedly lower than that for agricultural loans, it was high as compared to the corresponding rates in the industrially advanced countries.

In the Philippines, the rate of interest was very high in the rural areas but low in the metropolitan areas. The difference in rates was attributed principally to the absence of banking institutions in rural areas. In Puerto Rico it was stated that the interest rates were relatively low; in San Juan commercial loans could be obtained at 6 per cent and at an even lower rate for large amounts. The interest rate on government bonds, with 15 to 20 years maturity, was 2-3/4 per cent. The rate in respect of agricultural credit was 4-1/2 to 5 per cent for 30-year mortgages and 5-1/2 per cent for current credit. Interest on housing loans was 4 to 5-1/2 per cent. The interest rate was high only in respect of agricultural credit for small farmers and real

/estate

estate loans for medium and large sized buildings. These high rates were the result of absence of banking facilities in these fields. In Chile, the rates of interest were high. In Egypt the commercial rate of interest was about 4 per cent.

It was generally agreed that high rates of interest were unquestionably an obstacle to investment in under-developed countries, particularly since many of the industries there were in a nascent stage and could not afford the high rates charged. But at the same time it was emphasized that the slow growth of industries in the under-developed countries was by no means wholly explained by the high rates of interest prevalent. There were other factors which accounted for the industrial backwardness of the under-developed areas. It was in fact brought out in the course of the deliberations that high rates were not so much the <u>cause</u> of the absence or retarded growth of industries in the under-developed countries as a <u>symptom</u> of the general economic backwardness of these countries. Experience of most countries revealed that while high rates did have a deterrent effect on investment, industrial progress was being held back for reasons other than, or additional to, the high rates of interest. Thus while in Mexico or Chile the high rate of interest did prove detrimental to investments, particularly with respect to the financing of new industrial undertakings which did not normally yield a profit for three or four years after they were established, in the case of Puerto Rico the comparatively low rates of interest did not have a marked effect in speeding up the rate of industrial development.

The following factors were mentioned as being responsible for the high rates of interest generally prevalent in the under-developed countries:

1. The absence of a proper financial and credit machinery was commonly regarded as an important factor contributing to the prevalence of high rates of interest in the under-developed countries.

2. Capital shortage and pressure on available funds is another important factor. Capital shortage is partly due to the inadequacy of the banking and credit machinery itself and partly to the inadequate development of savings and investment habits amongst the peoples of the under-developed countries, although a high degree of capital shortage is inevitably inherent in the present condition of the under-developed countries.

/3. The rate

3. The rate of interest is closely related to the degree of risk involved in obtaining repayment of the principal lent and payment of the current interest. The high rates accordingly reflect, in some measure, the greater risks of investment in under-developed countries.

4. To some extent, at least in some countries, the high rates are the consequence of past inflationary experiences and the uncertainty about the possibility of avoiding inflationary processes in the future process of economic development.

The meeting considered at length the possible measures which might be adopted for bringing about a reduction in the high rates of interest which generally prevail in the under-developed countries. The main observations were as follows:

1. Steps for the expansion, diffusion and improvement of the existing credit and banking machinery were considered to be of paramount importance. It was stressed that in thus extending credit facilities special regard should be paid to the needs of industrialists and small farmers.

2. Every effort should be made to augment the supply of capital by fostering savings and investment habits amongst the inhabitants of the under-developed countries. This, of course, also implied the development of banking and credit organizations as an accompanying factor or as a condition precedent.

3. It was also considered important to reduce, as far as possible, the investment risks which were relatively high in under-developed countries. This could be done specially by the pursuit of orderly development policies, the prevention of unsound investments and by curbing speculative activities. In this connexion one of the members suggested that governments might consider giving special inducements to banks so that they could more readily come to the assistance of agricultural and industrial undertakings which would otherwise be charged a higher rate because of the greater risks involved in their case as compared with commercial operations.

4. Insofar as in many countries the high rates of interest were a reflection of past inflationary experiences and uncertainty about the future, it was considered advisable to discourage, as far as possible,

/the use of

the use of inflationary techniques in the financing of development activities.

5. The suggestion that ceilings might be placed on interest rates was examined but this was not considered as being generally advisable. Any attempt to control the interest rates without altering the basic factors which determined them would merely drive capital away. This would be highly undesirable for under-developed countries which were experiencing acute capital shortage. A very low rate was also not considered very desirable as it was likely to encourage much unsound and dubious enterprises. The high rates of interest were in themselves a reflection on the need for under-developed countries to be careful in the selection of investment projects which could be undertaken with the limited volume of capital formation possible for them.

6. Another suggestion made was that business in under-developed countries might be protected against the impact of high rates of interest by making available whatever public funds are contributed in the form of equity participation rather than fixed interest credits. This, of course, raises the problem of how far private ownership can be combined with public participation in equity capital.

7. It was felt that foreign financing was likely to have a beneficial effect on the domestic capital market. In practice, it was found that foreign financing did have a salutary effect on the rate at which local funds were made available to borrowers. It was also sometimes possible to give direct loans to local banks and agriculturists out of foreign borrowings at rates lower than those normally prevailing. Thus, the Export-Import Bank's loan to Mexico for agricultural equipment, at 4 per cent, was made available to local banks at 5 per cent and to agriculturists at 6 per cent, which was considerably below the levels domestically prevalent.

The general conclusions which emerged from the discussion were that domestic savings were not adequate to meet the needs of development and even where they were adequate development was handicapped by the lack of proper credit machinery and facilities as reflected in the high interest rates for industrial loans; that domestic savings could and should be increased but nevertheless required to be supplemented by foreign financing; that satisfactory financing was only one aspect of the development problem and that an improvement in the general level of production and management technique was of equal improtance in the case of under-developed countries.

(c) Agricultural credit problems

What is the relationship of terms of land tenure to the development of an agricultural credit system?

It was agreed that the crux of the problem of agricultural credit, in the under-developed countries, was the provision of financial assistance to small farmers who constituted the bulk of the agricultural population. It is they who were primarily responsible for most of the agricultural output of these countries. To make them better producers, they needed, along with instructions in better methods of cultivation and management, credit facilities, both short and long-term. The small peasant farmers either owned small strips of land or rented them from somebody else and had no other security to offer in backing their requests for loans but their insignificant (sometimes fragmented) land holdings or their prospective crops, which in some countries they shared with the owner of the land.

In many of the British colonies, particularly in Africa, the tribal system of land tenure made it practically impossible for the cultivator to raise money because there was no possiblity of selling the land in the ordinary way, so that a bank or a similar institution was not prepared to advance money on the security of the land.

In Egypt, it was stated, such difficulty would not arise since the repayment of the loan could be enforced in the same way as tax collection. The government or the bank can seize the crop either after or before it is harvested, and thus the bank can obtain repayment of the loan. Less than one per cent of the debts proved to be bad. The system was applicable essentially to short-term loans. Such a system was also in operation in some of the British dependencies. Medium and long-term loans, however, presented difficulties of their own; these were illustrated in the case of banana plantations in Jamaica and cocoa plantations on the Gold Coast where replantation of bananas and cocoa trees, hit by diseases took several years, especially in the case of cocoa trees. It was impossible to arrange for any such long-term system of financing because there was no possiblity of seizing or disposing of the land with the result that the whole operation is being seriously held up. Tribal land is owned by the whole tribe and nobody but a member of that tribe can occupy the land or own it; other members of the tribe are generally not able or willing to buy it. This was true also in non-tribal areas in

/other countries

other countries where influential persons owned the land.

It was pointed out that it was impossible within the foreseeable future to visualize the prospects of an industrial revolution in the under-developed countries, of a magnitude that would absorb the major part of the population in industrial activities. Hence for a long time to come under-developed countries would continue to have predominently and in many areas dense agricultural populations, consisting mainly of small farmers whose low living standards would have to be raised. It was also generally appreciated that the rehabilitation of the very small unit was not strictly an economic and bankable proposition. Accordingly, some members felt that means must be found of grouping these cultivators into larger units eventually, for purposes of operation if not for purposes of ownership. Others, however, felt strongly that the abolition of the small farmer was neither feasible nor desirable as a practical proposition. The issue was, therefore, both an economic and a social one, and the credit problems involved could not be solved as an independent technical problem, outside the general framework of social and economic policy.

Other members, however, considered that the problem before the group was not really one of altering the existing social matrix but of finding ways and means of providing credit facilities to the agriculturist, particularly the small farmer.

It was felt that the solution lay in two directions:

1. Provision of state aid in one form or another.
2. Development of a co-operative credit system.

It was suggested by some that governments should come forward with financial assistance for agriculture, particularly the small farmer. Part of the assistance might be given with the idea of eventual repayment and part of it without hoping to be reimbursed, being regarded more as a relief measure than an extension of credit.

This could be done in various ways:

1. Direct loans from the state as had been common in India.
2. Permanent land improvements, like irrigation and land reclamation, should be wholly financed by the State.
3. Government might finance agriculture by selling bonds to the public and guaranteeing a minimum return. This method had at some stage been employed in the British dependencies. The question, of course, arose as to whether the government would be able to collect a rate of interest as high as the

/one by

one by which the public had to be induced to take up the bonds. It was felt that the losses to the state should be regarded as an inevitable burden to be accepted on grounds of social justice - the small farmer was, almost by definition, not a good security but needed the loans as an indispensable part of economic improvement.

4. Provision of financial assistance for collective use, such as the provision of agricultural implements for every village of a certain size to be used collectively, with each farmer having the right of use. This, of course, could not strictly be regarded as falling within the category of a loan.

5. Indirect assistance in the form of loans or subsidies to private agricultural banks, co-operative credit societies, or other associations of farmers. This had been done in India and many of the Latin American countries. Experience had shown that state assistance to private banks was necessary because agricultural lending risks were particularly heavy and could not be taken by private banks.

As an alternative to government financing, it was suggested that there was one method by which the savings of the public could be utilized in dealing with the problem of agricultural credit, namely, the co-operative credit system. It helped to mobilize some of the savings of local communities themselves and made them available in the form of advances to other members of the co-operative society. In addition these agricultural credit societies could be assisted with government funds, but ideally and also quite often in practice they draw a substantial part of their funds from the savings and contributions of members.

The co-operative credit system had been established in many under-developed countries and it was generally felt that it was proving useful though the rate of progress was not everywhere all that could be desired because of certain inherent weaknesses of the system or particular local conditions.

In Puerto Rico, the co-operative credit movement yielded mixed results. In the case of the bigger farms, it was successful but in the case of the small farms, it did not work so well. Thus, the Production Credit Association, under the Farm Credit Administration Act, operated very well in respect of large cash crops. The Sugar Association was able to retire almost the entire amount given by the government and was in a sound position. The large size of the operations and the ability of the large farmers mainly accounted for the success. In the case of the

/small farmers,

small farmers, who cultivated three to ten or even twenty acres, profits were low and the contributions mobilized were meagre. The Farmers Home Administration, however, had certain types of loans for the under-privileged farm groups which could offer relatively little security. The programmes for the Farmers Home Administration and the Emergency Crops and Seeds loan scheme had been invariably successful. But despite these successes, it was still uncertain whether any small farmer was getting the amount of credit he needed.

Another outstanding feature of the Puerto Rican system was its combination of credit with advice and eductation. The Farmers Home Administration provided not only money but also guidance, and was supported by the resources of the government. The project had proved rather expensive because of the cost involved in the guidance, supervision and education of the recipients of the credits.

In Mexico, it was found that a system of co-operative agricultural credit had theoretically existed since 1926, but that it did not prove to be very successful except in certain cases like that of the cotton farmers where the system of land ownership system is different. A general lack of co-operative spirit was noticeable. The small farmer was usually unable to repay his debts unless he produced some profitable cash crop, such as cotton or sugar cane.

The tenancy situation was a particularly grave obstacle to the development of agricultural credit in the Philippines. The financial situation of the tenants had been progressively worsening from year to year and from generation to generation, and their indebtedness to their landlords had increased to such an extent that co-operatives were out of the question at the moment. Governmental assistance was imperative.

Indian experience of co-operative agricultural credit was, on the whole, favourable. The interest rate charged to small borrowers had come down from about 12 to 15 per cent and was now 6 per cent in the co-operatives as compared with 6-8 per cent outside the co-operatives. These co-operatives mainly served the small-scale farmers owning from five to ten acres. In the thirties, many provincial co-operatives had been hampered by unliquidated debts but delinquency in payments was more noticeable in the case of direct loans from the state. The co-operatives formed agricultural clubs, gave information on the services provided by the Department of Agriculture, and encouraged the agriculturists to invest their savings in co-operatives. The position of the small cultivator renting land for short periods was still unsatisfactory - the private money lenders continued to handle

/about 85

about 85 per cent of the business.

Great importance had been attached by the Indian government to the improvement of the land tenure system by reducing the fragmentation of holdings; it was expected that this was likely to improve the tenants' borrowing capacity. Some relief in respect of farmers' indebtedness had also been provided by legislative enactment whereby the right of money lenders had been limited, long-standing debts had been scaled down, and alienation of land was prohibited. The trend in India was in the direction of encouraging the growth of the system of small independent proprietors and permanent cultivators and not of eliminating them.

It was felt that the contrast in the experiences of India and the Philippines, although the feeling against the private money lender and the abuses of that system were equally strong in both countries, might have been due to the fact that in the latter country the co-operatives tried to advance too rapidly. The development of co-operatives was a slow and spontaneous process.

PART III: PAPERS PREPARED BY PARTICIPANTS IN MEETING OF EXPERTS: ANNOTATED GUIDE PREPARED BY THE SECRETARIAT

Prevailing Practices, Methods and Problems Involved in Obtaining Domestic Financial Assistance for Economic Development in Chile

Prepared by
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Chile

INTRODUCTION

Chile's financial problems are a direct consequence of the country's economic structure and the economic objectives it is attempting to attain.

The main problem being tackled by Chile - and by all the Latin American and other under-developed countries - is that of accelerating the rate of capitalization, with a view principally to industrial development.

An increase in the rate of net capitalization to national income, which is now approximately 5 per cent, is of two-fold importance: it will make possible an increase in the low real national income, thereby raising the standard of living, and will free the country from its extreme dependence on international markets, which in turn is expressed in two ways - in cyclical fluctuations due to the fact that one product, copper, constitutes more than 60 per cent of our exports, representing approximately 35 per cent of the budget of foreign exchange[1/] and in the country's urgent need - to obtain supplies of some raw materials and certain consumer and capital goods (machinery, tools, etc.) which are required for the very purpose of accelerating the rate of progress.

In addition to the low annual capitalization, due to the fact that the country is in the formative stage, and to the undue dependence on foreign markets, Chile exhibits the characteristics typical of under-developed countries, which react on the factors mentioned and are influenced by them: one-third of our working population, which in turn is one-third of the total population (approximately 1,800 million) is engaged in agriculture using outmoded methods (a position which is being slowly changed) with the result that productivity per worker is lower than in any other national industry. This is a factor determining the low general per capita income. Moreover, because of its low productivity and consequent low remuneration, the agricultural population stands

1/ For explanation of "budget of foreign exchange", see page 51 (of draft).

practically outside of the cash market, which weakens the consumer markets of industries seeking to expand.

In these circumstances and in view of certain defects of our financial system, to which reference will be made later, the State, under pressure from the circles most closely interested, has, in the course of the years, set up a series of development agencies, as required by circumstances, intended to function independently, and to satisfy the needs of individual industries. In this way agencies were set up to assist various productive industries by means of credit facilities or other measures to promote production. Owing to the way in which the agencies were established and have developed, our policy for the development of production naturally appears somewhat haphazard, in the sense that there is no organic, integrated plan.

The policy of each agency is controlled by its Board of Directors, in most cases without taking into account the possible effects of its action on other branches of the economy, since the expenditure of the funds available to these agencies has the practical effect of directing productive factors - manpower, raw materials, machinery etc. - into particular activities which nobody in Chile could at any given moment say are <u>the most useful activities</u>. Logically all that can be said is that they are <u>useful</u>. Later we shall see what attempts have been made to remedy this situation but we are bound to admit that the results have not been wholly satisfactory. Thus, we may conclude this rapid sketch of Chile's economic structure by saying that her institutional development is somewhat lacking in organization.

The following points mentioned in the agenda will be analyzed in as much detail as is compatible with clarity:

I. The various forms in which economic development is being promoted by domestic financial assistance; e.g. credits, direct investments, loans, commercial papers etc. and the criteria used in granting such assistance.

II. The facilities and institutions available for this purpose.

III. An appraisal of the methods employed; results achieved; major obstacles; unsolved problems; other possible (or planned) approaches.

IV. The effects on the volume of savings resulting from the development of particular sectors of branches of the economy with the help of this type of financial assistance.

I. THE VARIOUS FORMS IN WHICH ECONOMIC DEVELOPMENT IS BEING PROMOTED BY DOMESTIC FINANCIAL ASSISTANCE

In the first place, we must distinguish between methods of financial assistance for new industries and for the development and expansion of existing industries on the one hand, and current assistance to enable existing industries to operate normally on the other. In this connexion, it is understood that the study proposed by United Nations relates to the former, i.e. to the development of production and it is with this that we shall deal.

Nevertheless, it is of interest to note that the financial support given to existing firms to enable them to carry out normal operations is concentrated almost entirely in the hands of the banking system through short term loans and in certain circumstances, by the granting of over-drafts "up to a certain sum", which in practice amounts to an actual medium term loan for the amount of the over-draft. In Chile, existing firms have little opportunity of obtaining funds for the normal development of their operations in the securities market since the latter is very narrow; that is to say, the volume of savings offered is always less than the volume required; this is a phenomenon typical of the under-developed countries in which the securities market has to cope with an abundant supply - at least potential - of securities or, in other words, a large demand for funds.

Let us now go on to consider our financial capacity and the way in which Chile is tackling the problem of her economic development.

It is obvious that the acceleration of our development implies the diversion of a greater volume or productive resources to the production of capital goods, to the detriment of the production of consumer goods, and that the orientation of the productive factors depends on the manner in which the community is distributing its income between consumption and investment. As in all countries with a weak productive structure, our real national income is low, which means that savings (the source of investments) are small (approximately 10 per cent of the national income). Further, it has been observed that a large part of the initial savings capable of investment is earmarked for consumption (the net rate of capitalization is, as already stated, 5 per cent of the national income).

We can distinguish between three types of entity which have funds part of which may be applied to investment; the State, including governmental and semi-governmental agencies; firms; and individuals.

Savings in the hands of the State

The State has at its disposal substantial funds which it obtains under the tax laws in force and which it uses to cover normal consumption expenditures (wages, salaries etc.), capitalization schemes and schemes for the development of production. The institutions through which the State can operate to develop production are analyzed in the next section.

Savings of firms .

Firms also hold funds which can be invested. In fact, undistributed corporate profits are now the main source of national investment.

The investment of part of these profits is regulated by the provisions of Law No. 7747 (Economic Law) of 1943. Articles 9, 10 and 11 state:

"Article 9. Profits not exceeding 15 per cent of the capital (assets less current liabilities) of commercial, industrial and transport enterprises (excluding mining enterprises) shall bee deemed to be ordinary profits.

"Article 10. Profits exceeding 15 per cent, after deduction of the ordinary and special taxes established in Law No. 7144, shall be wholly invested by the taxpayers to whom this part refers in repayment of the firm's own bonds, in the expansion of its industrial or commercial activities, or in other enterprises or transactions likely to increase the physical volume of national production.

"The authorization of the President of the Republic, on the report of the technical authority concerned, shall be required for the investment of such profits in other businesses or enterprises.

"Article 11. Taxpayers who fail to comply with the obligations imposed in the previous article shall be required to purchase bonds of the Corporation for the Development of Production to an amount equivalent to the total of the investment not effected.

"For such purpose the Corporation for the Development of Production shall issue bonds which shall be sold at par and shall be taken up by the offenders. The maturity date, rate of interest and terms on which the said bonds are issued shall be determined by regulations to be made by the President of the Republic, but the interest may not be less than 3 or more than 5 per cent per annum."

/Private Savings

Private Savings

Private savings are generally placed with the institutions which make up the capital and money market analyzed in Chapter II.

To provide a clearer picture of the principles on which financial assistance is granted, we shall classify the enterprises and organizations receiving assistance into two groups according to their nature and organization. The classification will omit on the one hand companies wholly financed by foreign capital, since we are considering financing in Chilean currency; and, on the other, government services incorporated in the civil service and therefore financed directly by the State through the Ministry of Highways and Public Works, such as roads, ports and other public works.

Group A. Enterprises wholly owned or directly controlled by the State but administered independently. Among these are the State Railways, the National Electricity Undertaking (ENDESA), the Oil Services, the Paipote National Iron Works, etc.

Group B. Privately or individually controlled companies or corporations. Among these are the steel industry, including the Pacific Steel Co., mining companies (coal, small and middle-sized copper mines and other smaller mines), agriculture, manufactures, shipping, commerce, hotels, cold-storage plants etc.).

FINANCING - GROUP "A"

The process of capitalization implies a financial process since a price must be paid for the material and human resources in order to channel them towards investment. This is normally accomplished with that purchasing power which the nation does not consume from the national income, i.e. from its savings. The investment capacity of an economy is conditioned by the volume of savings, and this depends on the size of the national income and its distribution. In Chile, where the national income is low, savings are tiny and insufficient to support a rate of progress which would hold out hope of an effective and speedy improvement of living conditions.

The State has therefore been obliged to assume responsibility for promoting the capitalization of the Chilean economy, and to compel the country by various means to increase its rate of saving. It has therefore planned, initiated and maintained the type of activities classified in this paper as Group "A", which could not have been carried out by private enterprise for various reasons which will be explained briefly.

In the first place, the size of the investments is an insurmountable barrier to private enterprise, given the characteristics of our economy; in the second place, it is necessary to have an adequate supply of foreign exchange to purchase the machinery which were and are required, and this cannot be obtained through the normal channels of the balance of payments.

The State, on the other hand, acting through the Corporation for the Development of Production, has access to the capital market of the United States or other countries to obtain loans to enable it to carry out basic works.

Another factor which limits the interest of private enterprise in the development of such basic industries is the risk of investment. In Chile investors have a marked preference for immediate returns with little risk for the future. This is due to the tightness of the capital market, in other words, to the great demand for funds which enables investors to invest at high profits, for short terms and with very little risk.

Consequently, in Group "A" domestic assistance has had to come almost exclusively from the State, either directly from the Budget or through the development agencies mentioned in Chapter II.

The capital of enterprises in this group is either wholly contributed by the State (as in the case, for example, of the State Railways), or the enterprises are organized as limited-liability companies in which the State holds the majority of shares, as, for example, in the National Electricity Undertaking (Endesa). In such companies, by way of exception, there are small minority contributions of private capital when private groups have wished to be represented on the board of directors in order to be able to follow the course of business and to protect their own interests.

Loans for Group "A" have invariably been granted by State agencies. As usual, these loans may be divided into short-term loans i.e. up to five years for developments yielding a quick return; medium-term, from five to ten years, for works on which returns are slow; and long-term from ten to twenty-years, for basic works. Rates of interest have generally been lower than current market rates.

In addition to such State loans, the enterprises have received current commercial credits for very short-term operations from the commercial banks. Usually such credits have been documentary, since in practice there is no market for bonds or debentures.

/FINANCING

FINANCING - GROUP "B"

In Chile there are no investment banks as such, i.e. banking institutions whose main function it is to effect the initial investment and hold a certain percentage of the shares or bonds of companies formed in order to assist and facilitate construction or installation and initial operation, and to sell the shares when the company is in production, so that they can therefore claim the support of individual investors. On specific occasions and to a limited extent the commercial banks have performed this function subject to the furnishing of commercial guarantees.

As a result private companies are formed in Chile by groups of private capitalists prepared to wait two or three years before receiving the first returns on their investments. They do so because, in addition to the normal profit, they hope to be able to recover profit for the early years from the difference in the price of the shares (which they bought at face value), which they hope will cover the capitalized yield over and above the steady depreciation of our currency.

In the absence of State or private institutions to perform this function, this is obviously the only way in which companies can be formed. If commercial bank credit were used, the initial cost would be equal to 30 or 20 per cent of the investment, depending on whether there was a delay of three or of two years in obtaining the first returns, since the commercial rate of interest is now approximately 10 per cent.

These considerations confirm what was said earlier: only with great difficulty can private investors assume responsibility for the development of the major industrialization works required by the Chilean economy. In exceptional cases and to a limited extent, undertakings of this type may find favour with private groups, resulting in companies with mixed capital such as the Pacific Steel Company (CAP), the majority of whose shares are held by individuals. This was possible for CAP because it is an industry of great importance to the Chilean economy and the future hub of many allied industries. It is therefore obviously important that private enterprises and individual capitalists should be able to follow developments and influence decisions.

On the other hand, our securities market, like all securities markets, is an important centre for the secondary distribution of securities, but these must be already known and have some reputation.

/In short, and as

In short, and as a logical consequence of the great demand for money, which forces up the rate of interest, it can be said that the interest of private investors increases as the prospects of the undertaking are more immediate and attractive and also in relation to the benefit the new concern may bring to existing or future firms in which, generally, the same investors will participate. For these reasons the contribution of State capital has been necessary to provide such capital as private individuals are unable or unwilling to invest, thus forming corporations with mixed capital.

As in Group "A", credits may be divided into development and commercial credits.

Naturally the former are received exclusively from State agencies for terms and at rates of interest varying with the business concerned.

The latter arise only when the business is developed and are received almost invariably from commercial banks at commercial rates of interest, which in Chile are very high (approximately 10 per cent), and for a maximum term of one year. They are generally for 30, 60 or 90 days and are backed by drafts if the type of activity is such as to permit rediscounting by the Central Bank. Such credits may be renewable.

The issue of debentures or bonds by enterprises to raise the working capital they may require is somewhat unusual, for the reasons already given.

/II. FACILITIES AND

II. FACILITIES AND INSTITUTIONS AVAILABLE FOR DOMESTIC FINANCIAL ASSISTANCE

A. STATE AGENCIES

1. Ministry of Highways and Public Works (Ministerio de Vías y Obras Públicas)
2. Development agencies:
   (a) Agrarian Credit Bank (Caja de Crédito Agrario)
   (b) Mining Credit Bank (Caja de Crédito Minero)
   (c) Agricultural Colonization Bank (Caja de Colonización Agrícola)
   (d) Industrial Credit Institute (Instituto de Crédito Industrial)
   (e) Development Institute of Antofagasta (Instituto de Fomento de Antofagasta)
   (f) Development Institute of Tarapacá (Instituto de Fomento de Tarapacá)
   (g) Reconstruction and Assistance Corporation (Corporación de Reconstrucción y Auxilio)
   (h) People's Housing Fund (Caja de la Habitación Popular)
   (i) Corporation for the development of Production (Corporación de Fomento de la Producción)
3. Mortgage Credit Bank (Caja de Crédito Hipotecario)
4. Provident agencies:
   (a) Public Employees' and Journalists' Fund (Caja de Empleados Públicos y Periodistas)
   (b) Workers' Insurance Fund (Caja de Seguro Obrero)
   (c) other provident funds.
5. National Savings Bank (Caja Nacional de Ahorros)

1. As its name indicates, the Ministry of Highways and Public Works is charged with the execution of all public works of national interest. Its funds are obtained, naturally, from the national budget.

2. The development agencies are financed in the same way and are intended to develop the activities with which they are respectively concerned "principally" by means of credit.

The agencies have some revenue of their own made up of the interest and amortization payments on loans granted.

These are short, medium and long-term loans; their respective importance may be seen from the annual reports of the agencies concerned.

/Because of its

Because of its distinctive features, the most important of these agencies is undoubtedly the Corporation for the Development of Production, established in 1939, after an earthquake which devastated the southern part of the country, together with the Corporation for Reconstruction and Assistance. The purpose of the latter is to assume "responsibility for all matters relating to loans, expropriations, reconstruction and aid to victims in the provinces affected by the earthquake of 24 January 1939".

"The purposes of the Development Corporation (CORFO) are as follows:

(a) to draw up a general plan for the development of national production to raise the standard of living of the population by utilizing the natural resources of the country and reducing production costs, and to improve the international balance of payments position, and to maintain in the plan a proper balance between the development of mining, agriculture, industry and commerce and to endeavour to satisfy the needs of the various regions of the country;

(b) to carry out, in co-operation with official, semi-official or private development agencies, studies to discover better means of producing new commodities or increasing existing production, by improving the conditions under which these are developed with regard to quality, output and costs of production and facilitating the transport, storage and sale of products so that these may be marketed in the best condition and at advantageous prices;

(c) to effect, on the basis of the results of the studies to which the preceding paragraph refers, industrial or commercial experiments on such a scale and with such assistance as may be deemed necessary;

(d) to facilitate the manufacture in the country, or the importation, of machinery and other means of production;

(e) to propose and assist in the adoption of measures to increase the consumption of national products or to obtain greater participation of Chilean interests in industrial and commercial activities;

(f) to study methods for the general financing of the plan for the development of production or for the separate financing of the various works envisaged therein, and to grant loans;

(g) to receive appropriations or voluntary contributions;

(h) in general, to execute all documents and contracts necessary to carry out the purposes of the corporation."

/As was said in

As was said in the introduction in describing the main features of Chile's economic structure, our institutional development has been somewhat haphazard for lack of an integrated plan enabling the various organs taking part in the process to co-ordinate their activities. Thus the Corporation filled a gap when it was found to ensure that all development activities were balanced.

This is an important aspect of the part played by CORFO in the Chilean economy: it ensures that the development of all activities is integrated without producing imbalances which might affect the stability of a particular branch.

The general plan for the development of production which the corporation was directed to draw up has, however, still not been prepared because of the lack of accurate information, the need for certain preliminary experiments, and the exposure of the country to the dislocating effects of the last war.

The corporation has, however, carried out in Chile the work of capitalization which in other countries is performed freely through the capital market. Thus, for example, in the United States of America major works and major industries are created by and at the charge of private enterprise, by which they are planned, financed, executed and subsequently operated. Thus, if a group of business men or entrepreneurs plans to establish an industry requiring considerable investments and has insufficient funds, they apply to the capital market, where specialized private institutions study the economic prospects of the scheme and, if they regard them as favourable, undertake to issue the shares or other securities and to place them primarily with institutions possessing large accumulated savings, with a view to the later distribution of the issue on the market. Thus it remains in the hands of private investors. In this way investment is prefinanced by private agencies. In Chile, however, where we have not reached this degree of development and where national savings are small, it was inconceivable that investments on such a scale could be carried out by private enterprise. The Corporation has filled this gap by promoting basic industries such as electricity, steel, oil, mining, etc. Nevertheless, the work accomplished in evidently only a stage in the part played by the Corporation in the Chilean economy.

As our development proceeds, it becomes more necessary to draw up the general plan for the expansion of production, as consideration must still be given to "the proper balance between the development of mining, agriculture, industry, and commerce ... and to endeavour to satisfy the needs of the /various

various regions of the country". To this end, the Corporation has set on foot studies which will enable it to carry out the work expressly entrusted to it under the statute which set it up.

Research into national income, capital formation, population and economic geography is being carried out.

In the first stage of the development of basic industries the Corporation has accelerated the process of capitalization of the Chilean economy, thereby enabling, on the one hand, our people to expect a gradual raising of its standard of living and on the other freeing the country from its extreme cyclical dependence on foreign markets by reducing the great relative importance of copper and saltpetre in the national economy, mainly in foreign trade.

During what we have called its "first stage" the Corporation acted, in the absence of a general plan, on plans for immediate action in various branches of economic activity with the twofold purpose of planning basic and essential projects such as steel, oil and electricity and of co-operating in making up the shortage, produced in the domestic market by the decrease in supplies during the war. Thus, in the first stage, the Corporation is on the one hand supporting and developing industries providing substitutes for imported goods, through the purchase of shares in the companies or loans, and simultaneously carrying out the necessary research to ascertain what resources Chile has to set up key industries for its future development.

When the war emergency was over and the investigations had been completed, a second stage was begun, based on what might be called a policy of concentration of effort on four or five main branches, principally steel, electricity, oil, agricultural mechanization and irrigation. This is the stage which is now in progress and which is essential, as has been said above, to create the necessary conditions for greater national industrialization.

At present the Corporation is co-owner of approximately 60 undertakings in various sectors of economic activity. As regards the holding of shares, its policy is to sell them as soon as undertakings are consolidated economically and financially and can gain the support of private investors. In recent years, however, it has not considered it desirable to sell its shares because of the fall in stock market prices which has already lasted three years (1946-1949) and which in recent months has seemed to be ending in a recovery; this would mean that the Corporation would resume its sale of the shares of companies which are acceptable to private investors in order to keep its resources active.

/Loans are

Loans are made for an average of three years, or for five to ten years in the case of activities regarded as of national importance, whether commercial, industrial, agricultural or mining.

It should, I think, be pointed out that the work entrusted by law to the Corporation, namely, that of drawing up a general plan for the development of production, should not be confused with a general economic plan; the former is much more limited while the latter would embrace every aspect of the economic problem, such as the fixing of prices, wages, tax policy etc.

FINANCING OF THE CORPORATION

There are two sides to the financing of this undertaking - financing in national currency and financing in foreign currency (in practice in dollars). The financing in national currency took the form of treasury contributions derived from the tax on copper, plus certain sums derived from accumulated profits on its own investments and interest and amortization payments on its loans. This method of financing had the grave defect that the Corporation was made dependent on the revenue from a highly unstable activity like the copper industry. Under this system of financing, the corporation and the plans it was implementing were at the mercy of the fluctuations of copper exports. This is logically incompatible with the principle that the Corporation's work should be conducted on a stable and permanent basis.

At present, the possibilities of obtaining new funds from copper having been exhausted, the Corporation is financed by contributions from the national budget.

It is not, however, sufficient to provide the Development Corporation with funds in national currency if it is to carry through a plan for the establishment and development of basic industries. Chile is not in a position to provide the machinery, tools or some of the special raw materials required. The country also lacked some of the technical resources needed. Hence the Corporation's organic law envisages the obtaining of international loans guaranteed by the Chilean Government.

/RESOURCES OF

RESOURCES OF THE DEVELOPMENT CORPORATION IN NATIONAL CURRENCY

Year	Government Contribution	Own Income
1939	105,000,000.	--
1940	175,719,000.	4,145,233.
1941	239,216,691.	109,925,348.
1942	156,729,489.75	195,325,232.
1943	148,048,697.97	240,474,766.
1944	154,740,316.11	194,854,767.
1945	203,246,990.65	249,274,652.
1946	93,802,359.44	246,525,234.
1947	465,946,928.94	210,574,790.
1948	707,064,175.37	155,395,175.
	2,449,514,649.23	1,606,495,197.

CREDITS GRANTED TO CORPORATION BY EXIMBANK AND INTERNATIONAL BANK
(as of 31 December 1948)

		Granted	Utilized	Amortized
Steel Industry	US$	48,000,000.	13,000,000.	
Electric Plants		25,150,000.	9,037,962.37	
Agricultural Machinery		11,350,000.	7,625,936.09	
Cement Plants		4,500,000.	4,101,234.02	
Raw Materials		3,807,296.	3,807,296.46	21,120,500.00
Transport Equipment		3,546,260.	3,546,260.68	
Copper-Wire Plant		1,790,000.	1,670,729.27	
Tire Industry		419,000.	419,291.97	
Miscellaneous Industries		3,791,288.	4,041,289.14	
TOTAL		102,353,844.	47,250,000.00	21,120,500.00

(Note: Includes $20,000,000 credit obtained in early 1949.)

As we have seen above, the Corporation is an organization intended to operate on a long-term basis in a changing economic scene; its operations must therefore have sufficient elasticity and scope and it is therefore authorized by law to perform any acts and enter into any contracts which may be necessary to attain its purposes. The plans prepared by the Institution may therefore be carried out directly or through other organizations or in co-operation with private enterprise. Most of its work has been performed direct, but, in order to unify policies for the promotion of production and to take advantage of the /experience and experience and specialized knowledge of other agencies in particular fields, it has executed some works through other development agencies which have in those cases undertaken to make the investments direct. Briefly it may be said that the Corporation's operations have been carried out in the following manner:

(a) financial assistance in the form of loans, the terms as regards amortization, interest and collateral being determined by the Corporation;

(b) direct investments for the organization, establishment and development of new activities, such as oil, electricity etc.;

(c) investment of funds in trials and investigation of new sources of production including the necessary plans or installations;

(d) subscription of capital to established undertakings or undertakings about to be established, the terms being fixed in each particular case;

(e) technical assistance.

The Corporation's operations as a whole may be classified under two main heads: profit-yielding operations and operations which yield no profit, i.e. development operations or mere expenses. In its annual budget, the Corporation's funds are divided under two main heads: a Realization Fund and a Development Fund. The first covers all remunerative investments while the Development Fund finances all expenditure and research effected by the Corporation to discover new sources of wealth.

3. The Mortgage Credit Bank is another State institution for the provision of domestic financial assistance. The Bank is an intermediary between persons seeking funds and persons offering funds and operates by issuing mortgage bonds which the persons seeking funds sell on the securities market.

The purpose of the bank is "to facilitate loans on mortgages, preference being given to loans contributing to the development of agricultural production and construction".

This institution's operations will, I believe, decline in the future for two reasons:

(a) for the general reason that the stock market is falling and narrow and

(b) for the reason peculiar to these operations that the nominal yield of the bonds is 6 per cent since the law lays down that "in no case may the interest on drafts be in excess of 6 per cent per annum". This rate of interest is definitely lower than the current commercial rate, which means that holders can only sell their bonds at approximately 60 per cent of

/nominal value

nominal value with a consequent loss as they are obliged to service the debt in respect of the amount they received from the bank.

WELFARE INSTITUTIONS

4. These are financed by contributions from employers and from the State and the contributions of employees or workers, according to the fund concerned.

Their purpose is pre-eminently social and as such their activities have fairly important economic consequences. Their main efforts are directed towards supplying their members with free medical attention for which purpose they maintain preventive and curative medical services. A small part of their funds is invested in securities and the remainder is used to grant long-term loans to members for the purchase of real estate or the construction of houses, the purpose being social, namely, to enable workers to own the houses in which they live.

In order to co-ordinate the investment policies of the welfare funds and thus to avoid excessive competition among the various factors of production, Article 7 of Law 7200 of 1942 provides: "The President of the Republic shall direct and integrate the investment policy of the various welfare funds and shall enact the regulations required to ensure their compliance".

NATIONAL SAVINGS BANK

5. The bank is a legal entity operating under the sponsorship of the State for the purpose of encouraging thrift, offering a safe and remunerative investment for the savings of persons of modest means and performing other operations specified by law to which reference will be made later. It is self-financing and its accounts invariably show a profit. It is the only banking institution legally authorized to receive saving deposits, which are made in its Savings Department; the bank also has a Commercial Department which performs all the transactions normally carried out by commercial banks.

Funds received by the bank as savings deposits and funds of the Commercial Department, as well as its own capital, may only be invested in the manner and subject to the conditions stated below (Article 26 of the Law):

(a) Up to 50 per cent in readily marketable first-class securities, provided that securities issued in the country are listed on the Santiago or Valparaiso stock exchanges. For the purposes of this Law only the following shall be regarded as first-class securities:

1. bonds of the internal or external public debt, bonds of municipalities and public institutions guaranteed by the State;

/2. certificates of

2. certificates of the Mortgage Loan Bank and other institutions governed by the Law of 29 August 1855. (namely, the Mortgage Bank of Chile and the Mortgage Bank of Valparaiso);

3. shares of the Central Bank of Chile and the Chilean Nitrate Company.

The maximum percentage of the 50 per cent which may be invested in each type of security shall be established by regulation.

(b) in loans (it should be noted that no mention is made of the purpose of the loan) on collateral constituted by:

(1) the securities designated in paragraph (a) of this article;

(2) shares of commercial or mortgage banks and industrial, agricultural, commercial or mining companies having a capital of not less than 10 million pesos whose accounts for the last 3 years have shown regular progress, as certified by the Superintendent of Banks;

(3) deposits in the Bank itself or in other banking institutions. In the case of deposits in the bank, the collateral shall be constituted by delivery of the passbooks or certificates or in lieu thereof of the voucher relating thereto;

(4) mortgage loans, when the mortgage satisfied the requirements of paragraph (c) of the present article;

(5) the deposit receipts or warrants issued by general deposit warehouses in accordance with the law.

The amount of each loan on collateral may not exceed 100,000 pesos, except with the approval of three-quarters of the members of the Board of Directors, and may in no case exceed 200,000 pesos. The term of the loan may in no case exceed one year. The amount of the loan may not exceed 70 per cent of the market value of securities or shares or of the nominal value of deposits or mortgage loans or deposit receipts furnished as collateral. The bank may require, at any time, the reduction of the loan or added collateral if the prescribed margin has declined.

(c) In loans for a period not exceeding one year, up to a value of 100,000 pesos, secured by a mortgage, provided that the amount secured on the mortgage, including all encumbrances, does not exceed 50 per cent of the assessed commercial value of the property. Such loans may amount to 200,000 pesos with the consent of three-quarters of the members of the Board of Governors.

/(d) In the purchase of

(d) In the purchase of real estate if intended for the use of the Bank, which may let such part as it does not occupy; such unoccupied portion shall bear a fair and reasonable proportion to the part of the building intended by the Bank for its own use.

(e) In loans for a term not exceeding 25 years for the purchase of real estate for the use of persons who have for three years been regular contributors to the Savings Department of the Bank or to municipal social welfare institutions.

Loans for such purchases shall be secured by a first mortgage on the property concerned and may not exceed 100,000 pesos. They may in no case exceed 80 per cent of the purchase price of the property or 80 per cent of its assessed value. The Bank shall at all times require that the purchaser pays in cash the difference between the purchase price and the amount of the loan.

Such transactions may not be concluded with the same person more than once in a five-year period.

The total amount of the loans referred to in this paragraph may not exceed 30 per cent of the amount of the deposits in the Savings Department.

(f) In discounts or purchases of accepted bills derived from the sale, production, manufacture or transport of products, the maturity date of which, when they become the property of the bank, does not exceed 120 days and which are endorsed by at least two persons of known solvency.

The total of operations of this type which the Bank may transact with one person or firm, whether as endorser, drawer or accepter of such bills, shall be 250,000 pesos or up to 500,000 pesos provided such increase is approved by at least five members of the Board of Directors of the Bank (there are 7 directors).

(g) In loans without the guarantees prescribed above or in bills issued, accepted or endorsed by the debtor, up to a total of 20,000 pesos, for the promotion of small-scale manufacturing or agriculture **and retail trade.** The time remaining for such bills to run when the transaction takes place may not exceed six months. Transactions entered into by the bank in accordance with the provisions of paragraphs (f) and (g) of the present article may not exceed 20 per cent of the total deposits in the bank.

/In addition to the

In addition to the transactions mentioned, the National Saving Bank may, as has been said, carry out any of the transactions common to commercial banks.

As will be seen, the provisions of this law make it impossible for the National Savings Bank to support new enterprises requiring financial assistance. This is due to the requirement that first class securities should be readily marketable, which is impossible in the case of new securities, and also that they should be listed on the Santiago and Valparaiso Stock Exchanges, a condition which cannot be fulfilled in the case of undertakings in the process of formation.

All the statutory regulations limiting the co-operation which banking enterprises generally may afford to the process of capitalization are based on the lawmaker's desire to ensure that banks have a sufficient degree of liquidity to enable them to face any contingency.

On the other hand, as has already been remarked, in an under-developed country in full industrial development, the relative scarcity of savings leads to a high rate of interest while the opportunities to place capital for short terms without risk provide competition difficult to overcome by enterprises seeking funds on the capital market. This is one of the reasons we mentioned in connexion with the need which was felt in Chile for new institutions capable of carrying through major works of national industrialization; it is in our opinion the historical justification for the Corporation for the Development of Production.

B. EXISTING PRIVATE INSTITUTIONS ABLE TO PROVIDE DOMESTIC FINANCIAL ASSISTANCE

COMMERCIAL BANKS

Because of statutory and practical limitations the national banking system does not provide effective support for the process of capitalization. The commercial banks cannot legally grant medium or long-term loans. The general Bank Law states:

Article 75

Any commercial bank organized in accordance with this Law may:

1. Make loans whether secured or not by real or movable property for terms not exceeding one year.

2. Discount and negotiate bills of exchange, drafts, promissory notes and other documents representing payment obligations with maturities not exceeding one year from the date of discount or purchase.

There is, if not an exception to these provisions, at least a loop-hole which makes it possible in practice to evade the letter of the law. That is the custom by which banks grant overdrafts "up to a certain sum" which are prolonged for so long that the debtor can be said to be enjoying in substance, if not in form, a medium-term loan.

Nevertheless, in allocating loans, preference is given to commerce which offers the banks better security and higher profits, thus raising the general rate of interest on loans. The high profits from business activities are partly responsible for the tightness of the securities market, which, combined with the lack of confidence in new enterprises, is what prevents many recently-established industrial firms from obtaining finance either from the commercial banks or on the securities market. The foregoing emphasizes the function performed by the development agencies already studied in filling these gaps in the private financial system.

Further, the investment of the funds of commercial banks does not provide effective support for the process of industrialization. As confirmation, it is sufficient to quote a paragraph of the law:

"When, however, a commercial bank has completed its legal reserve fund and has also accumulated and indicated separately in its balance sheet additional reserves exceeding such fund in value, it may invest the excess of such additional reserves or such part thereof as is not invested in real estate, in shares or securities other than stock exchange

/securities

securities and may retain such shares or securities indefinitely; provided that it may not invest more than ten per cent of such excess fund in the same type of shares or securities.

The shares of other banks or of the bank itself shall not be included among such investments."

Insurance companies. In addition to the banks, the insurance companies hold a considerable volume of public savings received as premiums from their clients. They make large investments, the yield from which forms a part of their profits and is in turn invested.

Article 21 of the Law on insurance companies, limited liability companies and stock exchanges (statutory decree No. 251 of 20 May 1931) reads:

"Article 21. Accumulated funds corresponding to the technical reserves, capital and corporate reserves shall be invested by companies in Chile in the following manner:

1. In revenue-producing urban real property up to a limit of 60 per cent of the funds. Mortgage debts encumbering such property may not exceed 40 per cent of the assessed value thereof.

2. In State internal debt bonds or bonds guaranteed by the State, bonds of the Mortgage Credit Fund and mortgage credit banks, mortgage bonds of public utilities, or first debentures, the type and amount being approved by the Superintendency. (Similar to S.E.C. in U.S. - Translator).

3. In shares of domestic banks and in first-class shares of limited companies, the type and amount of which has been approved by the Superintendency, with the exception of the stock of allied companies, meaning to be companies operating in one or more identical risks.

4. In term deposits in domestic banks.

5. In loans secured by mortgage for terms not exceeding 10 years on revenue-producing urban real property, subject to such authorization and conditions as may be determined by the Superintendency.

6. Companies of the second group (life insurance) may also invest in loans to the holders of unmatured life policies.

At least 20 per cent of the capital, corporate and technical reserves shall be invested, with the approval of the Superintendency,

/in property

in property which can be easily liquidated at any time.

The 20 per cent aforesaid may never be less than 50 per cent of the technical reserves of companies in the first group (fire, marine, carriage overland and insurance against damage caused by events which may or may not occur); and 25 per cent of those of companies in the second group."

This clause shows that it was the intention of the legislature to secure safe and satisfactorily profitable investment for this type of institution. Nevertheless it cannot be stated that the investment of insurance companies, like that of the other institutions which make up the capital market, is governed by economically-sound rules. In our opinion, this is due not to any fault of the institutions themselves but to the lack of any uniform criterion to canalize investment in accordance with common interests without implying any loss of security or of profit from investments.

This does not mean that the investments of such institutions have been useless. Our contention is that the investments made by the institutions making up the capital market have not been the best possible having regard to the country's industrialization requirements. In fact, in a country like ours, with an under-developed and relatively undifferentiated economy and a low standard of living, any undertaking satisfies a need but some undertakings are obviously more important than others and there is a best way of doing things. This is why many circles in Chile believe that the State must guide the investment of public savings in such a way as to co-operate effectively in the policy of industrialization on which Chile is now embarked.

The legal enactments quoted also indicate a tendency typical of economically-under-developed countries - to favour investment in real estate. This is due to the belief that such investment best attains the object of ensuring the stability of returns and of the investment itself, which other types of investment will not do. As a result the employment of financial resources in real estate has been preferred by the institutions forming the Chilean capital market. In insurance companies, as we have seen, the accumulated funds "corresponding to the technical reserves, capital, and corporate reserves" must be employed up to a limit of 60 per cent in revenue-producing urban real property. It will be readily seen that this is a very high percentage considering the country's weak industrial structure.

/Moreover, mortgage

Moreover, mortgage loans and the acquisition of mortgage bonds must be added to this 60 per cent.

The legislature did not, however, merely direct that investments must be in real property; it specified "revenue-producing urban real property". Because of this provision the economic and social productivity of investments in real property is considerably limited and is in practice restricted to the construction of commercial buildings, chiefly in the capital, to the prejudice of the construction of low-cost housing and buildings for industrial development.

This, it must be stressed, does not mean that investments of the insurance companies and other institutions making up the capital market have been of no benefit to the country: the statement would be absurd, since the multiplier factor is probably greatest when savings are used in building. In other words, this leads to a series of allied, complementary activites. Nevertheless it is desirable that the savings accumulated by such institutions should be utilized increasingly effectively for the rapid capitalization of Chile.

III. AN APPRAISAL OF THE METHODS EMPLOYED; RESULT ACHIEVED; MAJOR OBSTACLES; UNSOLVED PROBLEMS, OTHER POSSIBLE (OR PLANNED) APPROACHES.

A great deal of this chapter has already been dealt with above. Nevertheless some further remarks may be made at this point.

As was pointed out earlier, Chile's financial problem is twofold: that of financing (1) in national currency and (2) in foreign currency.

1. Financing in national currency. The existing means for providing domestic finance have been discussed in the preceding chapter and mention has been made in passing of some of their more important shortcomings. Experience has also shown that any future institutional re-organization must provide for the solution of the following problems, in addition to those already mentioned:

(a) The present difficulty of carrying out reliable technical and economic studies regarding the prospects of businesses, for want of information regarding natural resources, shortage of trained staff, difficulty of estimating the market for the products and the cost of establishing businesses etc. On the other hand, one cannot expect to solve these preliminary problems completely, because of the time and cost of studies, so that many businesses must be started without the degree of certainty required in other more advanced countries;

(b) The cost of setting up new projects is almost always high in comparison with the great industrial countries. The high cost of studies, the higher freight and insurance charges on machinery and other materials which must be imported, the lack of Chilean technicians and the enormous cost of employing foreign technicians, the longer time required for construction and starting operations etc., all play a part.

One reform in the institutional field which would tend at least partly to solve the problems mentioned and would at the same time establish machinery to unify financial assistance for the development of production would be to set up an Investment Bank to be formed by the merger of the National Savings Bank with some of the development agencies already mentioned, such as the Agrarian Credit Bank, the Industrial Credit Institution and possibly others.

A draft law on these lines was prepared in 1947. The main clauses relating to this subject are summarized below.

The Bank would be formed by the merger of the National Savings Bank, the Agrarian Credit Bank and the Industrial Credit Institute. Among its objects

/would be:

would be: "4. To strengthen the securities market, by promoting the investment of capital in the organization, transformation or merger of any type of enterprises whose purpose is the development of production. 6. To act as a savings bank and to encourage the habit of saving by the people. The Bank will be divided into four departments: 1. Banking Department with commercial and savings departments; 2. Agricultural Credit Department; 3. Industrial Credit Department and 4. Investment Department. The Board of Directors will consist of the President of the Bank, who will be the Minister of Economic Affairs and Commerce; the Executive Vice-President, to be appointed by the President of the Republic and 18 directors representing the various sectors of the national economy. The Board will determine and direct the policy of the Bank with regard to both credit and investment operations; it will decide upon the issue of the Bank's own bonds and determine their terms etc."

Under Article 51, a Public Credit Commission is established consisting of the Executive Vice-President of the Bank, who will be Chairman, and six other members of the Board of Directors." "The Commission will meet in June and December of each year and its purpose will be the determination, based on a study of the conditions of the national capital market and its capacity of absorption, of maximum quotas for the issuing of Government municipal and mortgage bonds during the following six months": "such quotas will be determined for each of the bodies concerned individually and will be placed in force, with the approval of the President of the Republic, by decree of the Ministry of Finance."

The draft law then deals separately with the departments of which the institution would be composed.

A. <u>Banking Department, Commercial Section</u>: "The Bank may issue the following bonds: 1. promissory notes or special drafts for a term of twelve months, which may be prolonged twice for the same period. 2. Savings bonds which shall be repayable after not less than one year or more than five years. 3. Certificates of participation, the issue of which shall be recorded in a public instrument determining the nature of the security and the terms for its service, amortization and redemption."

In addition to passive, active and exchange operations, the Bank may (Article 75):

1. buy and sell,

1. buy and sell, on the order of and for the accounts of its clients, any type of securities, national and foreign.

B. Savings Section. This Section's function is to receive all sums as savings deposits. Other institutions or persons will be prohibited from receiving such deposits. The funds will be invested in: (1) Up to 30 per cent of the deposits in loans, for a maximum term of twenty-five years, for the acquisition of real estate; (2) Up to 30 per cent in internal public debt bonds, direct or indirect. (3) Up to 40 per cent through the Investment Department in (a) the purchase of stocks, industrial bonds or debentures or other financial securities, preferably securities guaranteed by the Corporation for the Development of Production. (b) the granting of loans to the Corporation, for periods and on terms to be established by mutual consent. (4) If the quotas mentioned in (1), (2) and (3) are not fully used, the balance of the savings deposits may be invested in first-class securities other than those mentioned in (2).

B and C. Agrarian Credit Department and Industrial Credit Department. The duration of loans varies with their object and may be as much as ten years. In other words short- and medium-term credits are given.

D. Investment Department (Article 95). The function of the Investment Department is: (1) to carry out all operations of the bank connected with long-term investments whether of funds from the Bank's own resources or from other sources; (2) to promote the investment of capital in the organization, transformation or merger of any type of enterprise whose aim is the development of production; (3) to ensure that the financial resources of the country are fully and rationally employed and channelled towards the development of national production.

Article 96

The Bank may carry out the following operations through the Department: (1) acquire shares, industrial bonds or debentures or other financial securities, preferably those guaranteed by the Development Corporation; (2) assume responsibility for the issue or placing of shares, industrial bonds or debentures or other obligations whether guaranteed by it or not; (3) grant loans, duly secured by first-class securities, to the Development Corporation for the additional financing of the development plans the Corporation is required to carry out for such period and on such conditions as

/shall be

shall be established by common consent; (4) assume responsibility for the investment of that part of the liquid resources of governmental or semi-governmental bodies which may be placed in first-class securities, whether or not the Department is able to offer an additional guarantee or to arrange with the bodies concerned to guarantee a minimum rate of interest and participation in profits in excess of the said minimum rate. To carry out such other operations as may be required to ensure the proper fulfilment of its purposes.

Article 97

The Bank shall not be responsible for the conduct of technical studies preliminary or subsequent to the establishment of new enterprises. The Bank shall only contribute to the financing of new or existing enterprises, directly through capital contributions or indirectly by providing its guarantee whenever, in the opinion of the Board of Governors, the record of the enterprise and studies in this connexion carried out by the Development Corporation or by individuals show that the enterprise is likely to succeed financially.

The Bank shall give priority to the financing of enterprises declared by the Development Corporation to be economically and technically sound and the promotion of which is in the national interest. Before participating in the financing of individual enterprises, the Bank may request the Corporation's guarantee if it deems fit.

Part VIII, Articles 105 and 106, deals with the financing of the Bank's operations by means of deposits in current accounts, savings deposits, savings bonds, certificates of participation, promissory notes or drafts and liquid funds placed at its disposal by governmental or semi-governmental agencies whether by law or voluntarily.

The above are the most important parts, for our purpose, of the draft law setting up the Bank; their provisions have indicated the manner in which it is proposed to co-ordinate credit and investment policies in Chile in such a way as to secure the complete utilization of national savings in those activities which will make it possible to accelerate the pace of the country's economic development.

2. Financing in foreign currency. In practice, this refers to the dollars available to the country to purchase, in the United States or elsewhere, any

/equipment it

equipment it requires to carry out its programme of industrialization, since Chile and the other Latin American countries generally lack the machinery, equipment and some of the raw materials essential to the development of industry.

At the beginning of this paper I mentioned as one of the characteristics of the Chilean economy its dependency on the economy of the United States in the sense that the latter determines our own cyclical stability and enables Chile to secure a normal and continuous supply of dollars, in other words, of the commodities produced by the United States productive system.

But Chile's prospect of receiving a steady flow of dollars in payment for her exports depends on the stability of the external demand for those exports, principally copper, salt and nitrates, and this in turn is directly dependent on the level of employment in the United States. At present, Chile is attempting to solve the problems created by the recent decline in the price of copper, which has serious consequences for Chile since it both creates unemployment within the country and reduces our normal supply of foreign currency. The latter in turn may be reflected in reduced imports of goods necessary to maintain our standard of living and the continuity of development of our industrialization plans. Indeed it may be said that one characteristic of our balance of payments structure is the fact that the demand for our exports is very elastic (sensitive) while our demand for imported products is highly inelastic (rigid), since the imports consist almost entirely of articles essential to maintain our standard of living and ensure the continuity of our industrialization plans. Chile has therefore a structural tendency towards an adverse balance of payments in the same way as the demand for domestic financial resources exceeds the country's normal savings: these characteristics are common to all under-developed countries which seek to accelerate their rate of progress.

For these reasons Chile controls the expenditure of her international purchasing power in a budget covering the importation of essential commodities necessary for the normal development of productive activities. The supply of and demand for foreign exchange is artificially adjusted year by year. This constitutes the foreign exchange budget which, as was said earlier, prohibits importation of less essential articles, as well as of luxury goods, as the only means of adjusting expenditure to our slender resources.

/For the reasons

For the reasons indicated, Chile has had to resort to foreign credit since with her normal supply of dollars it would have been unrealistic to contemplate a plan of industrialization. Then as now there were only two possibilities: to form mixed Chilean-United States corporations or simply to resort to credit. The latter has been the usual solution.

Although the subject is not strictly germane to this study, I shall make some brief remarks in this connexion, since in our countries it is impossible to speak of national capitalization without referring to the problems of financing in foreign currencies.

The more one studies economic developments capable of resulting in an increase of production, in the lowering of costs and, generally, in a real improvement of the living conditions of the people as a whole, the more one becomes convinced that in the under-developed countries it is impossible to make any progress with the systems employed in recent years whereby external aid is received only in the form of imports of machinery and other essentials, leaving all local expenditure to be covered with the internal resources of the country itself. The result is either that because the investment in national currency has to be financed from ordinary savings, development is so slow, especially in the early stages, that it does not represent an effective improvement sufficient to prevent the unrest and chronic political and social discontent common in our countries, with all their attendant dangers, or, if it is sought to make the rapid progress required by the circumstances, the economy of the under-developed countries must make an effort in excess of its normal capacity, which inevitably results because of the unduly large capital issues which have to be made, in an inflationary process of forced savings, and this neutralizes the beneficial effects of economic development for a comparatively long period.

For this reason we believe that the policy of external loans (received by the under-developed countries) should be broadened to enable these countries to obtain funds for the local spending necessary for schemes of economic improvement in order to avoid the situations indicated in the preceding paragraph, which are exceedingly dangerous from the economic, social and political points of view. In other words, we know that internally to accelerate the process of economic development, greater savings are required, i.e. a larger volume of the productive factors must be diverted from the

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production of consumer goods to the production of capital goods. This means reducing the standard of living of the population which in our countries is a difficult and dangerous matter. For this reason I believe that so far as possible, foreign loans must cover the financing of complete projects, that is, must provide the necessary funds, both in the national currency of the country receiving the assistance and in dollars or other foreign currency. This means that the money created and placed in circulation to finance the project in national currency will have its counterpart in an equivalent amount of imported goods.

At the same time, in view of the characteristics mentioned in connexion with our balance of payment, I believe that the cost of international assistance to under-developed regions must be made as low as possible in order that the debt service and additional expenses may exercise as little pressure as possible on their balance of payments. This is also in line with the spirit of President Truman's now famous Fourth Point of support for the economic progress of the under-developed countries. In this connexion I believe that the following would be of positive benefit to our countries, which would far outweigh the sacrifice they may entail for the United States:

1. Revising of means to provide more effective and cheaper technical assistance (free, if possible) in making the studies necessary to draw up development plans and industrial projects in such countries, and to import foreign technicians to assist in the construction, starting up and operation of economic development projects.

2. Revision of the rates of interest and amortization of credits granted. The present rates of interest of the Eximbank and the International Bank (4 per cent) and the period of amortization (5 to 10 years and exceptionally up to 15 and 20 years) result in high costs of production if one bears in mind the relatively greater cost of the installation and starting up of the development projects to which we have referred. It should also be borne in mind that the acceptance of credits by our countries is limited by our capacity to service them and that therefore longer periods of amortization would make it possible to speed up the rate of economic development. Further, as regards the revision of the interest rate, it may be pointed out that the risk is a small one and that great security is afforded to the investor or creditor, since the loans are guaranteed by the Governments of the American Republics.

/IV. EFFECTS ON THE

IV. EFFECTS ON THE VOLUME OF SAVINGS RESULTING FROM THE DEVELOPMENT OF PARTICULAR SECTORS OR BRANCHES OF THE ECONOMY WITH THE HELP OF THIS TYPE OF FINANCIAL ASSISTANCE

As the preceding pages have shown, Chile is passing through a stage of intensive industrial development and is anxious to speed up or at least maintain her rate of economic progress as the only means of rapidly raising her standard of living.

The reorganization of the country's internal finances, its traditional political stability and the rigorous foreign exchange budget by which the country economizes its supply of foreign currency are factors which make it possible to offer the foreign investor an attractive field for the development of activities of value to the country and the early remittance of profits or interest in foreign currency with the assurance that such remittances will have priority in the exchange budget over everything except payments for goods essential to the normal development of internal production, the term "essential goods" being kept within strictly defined limits.

As regards Point Four proper, it may be stated that the total volume of savings has been increased by the policy of developing production, which has required the creation of financial resources to supplement the shortfall of normal saving. The inflationary pressure implicit in this policy, which was adopted deliberately in 1938, was strongly reinforced and accelerated as a consequence of the recent war; in fact, Chile like the other Latin American countries, exported large quantities of goods to the United States of America but was unable to import, as the productive capacity of the United States was committed to war work. We can therefore say that to a great extent inflation in Chile is due also and initially to Chile's co-operation in the victory of the allied nations.

It was with this in mind that I asked earlier that foreign loans for our industrial development should cover the financing of complete projects since, as has been said, given the low level of normal savings, it is necessary in order to obtain internal financial resources for the country to make inflationary issues. The higher amortization and interest payments would be wholly covered since the development of major Chilean industries implies a marked saving of foreign currency.

/Prevailing

Prevailing Practices, Methods and Problems Involved in Obtaining Financial Assistance for Economic Development in Egypt

Prepared by
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Egypt

INTRODUCTION

1. The study of the prevailing practices, methods and problems involved in obtaining financial assistance for economic development in Egypt, necessitates a comprehensive analysis of the economic structure of the country. It is doubtless true, that, in spite of the unprecedented increase in industrial activity since 1940, agriculture remains the basis of Egyptian economic life. Available statistics - though undeniably incomplete - are sufficiently adequate to indicate the general character of the national economy and the predominance of agriculture therein. Returns of the last population Census of 1947 have not yet been published. The preceding Census of 1937 recorded that 5,228,600 persons or 70.5 per cent of the working population were wholly or partly engaged in agriculture. It is interesting to note that ten years earlier (in 1947) the number was 3,140,200 and percentage only 53.8. Again, the national income from all sources has been estimated at between L.E.450 millions and L.E.500 millions in 1947. More than half of this total is derived from agriculture. The Statistical and Research Department of the Ministry of Agriculture has recently, and for the first time, published the following details of its estimates of agricultural production during 1946-1947.

	1946-1947 (in millions of L.E.)
Principal Crops	196.0
Vegetables	10.8
Fruits	7.1
Live Stock	42.4
Dairy Products	10.8
	267.1

2. On the other hand, the Federation of Egyptian Industries has, on the basis of a recent investigation of the position of its members, calculated that the total value of goods and services produced and disposed of by industrial establishments in 1947, was approximately 165 million Pounds. The methods employed in making such calculation have been criticized on technical grounds, but in absence of

/better

better information, it is reasonable to accept the figure as a probable indication of the present state of industrial development. It is, however, essential to bear in mind - as will be explained later on - that the importance which industry has attained within the frame-work of national economy is essentially a recent phenomenon.

PART I. AGRICULTURAL DEVELOPMENT

3. The present structure of the national economy is, indeed, the consequence of so many environmental factors that have shaped or influenced the economic development. Neither the development nor the structure can be well understood without proper analysis of those factors and appreciation of their significance. If the purpose of study is to attempt, or at least to recommend reform or improvements, then to neglect the influence of those factors - inasmuch as they continue to operate - is to heighten the risk of avoidable errors, both in recommending and in executing the reform programme.

4. The predominance of agriculture in Egyptian Economy is neither entirely the result of natural advantages, nor is it wholly due to extraneous conditions. The proverbial fertility of the land and the temperate climate are powerful natural agents, but they have been supported by other factors, in making agriculture the most important economic pursuit in Egypt. The collapse in financial administration during the seventies of last century had had far-reaching economic consequences, which, it is claimed, determined the course of economic development to the present day. That collapse has, not only greatly impoverished the resources of the country and arrested the march of its progress, but also destroyed the remnant of an industrial activity that began to flourish early last century. The economic circumstances of the Egyptian people were very much reduced and their spirit for enterprise almost completely broken. The working population were literally driven to agriculture as the only safe and suitable employment. Trade and industrial ventures were, for all practical purposes, monopolized by foreigners who were especially protected by the regime of Capitulations that were only recently abolished.

5. Agricultural practices and methods of cultivation remained very primitive, accompanied, as it were, by reduced productivity and low living standard among the agricultural communities. The population of Egypt has more than doubled itself during the last fifty years, whereas the estimated increase in the total yield of agricultural production does not exceed one third and the estimated extension of

/the area

the area under cultivation one-tenth. To this unfavourable state, a number of factors have made contribution. In the first place, the steady increase in population helped to make the supply of unskilled labourers at once abundant and cheap. Secondly, the prevailing system of land tenure (of letting land in very small lots on yearly or three-yearly contract) and the prevalence of small holdings - so much encouraged and acclaimed by politicians and social reformers - had made unprofitable the introduction of improved practices and methods. Last, but by no means least, credit facilities were conspicuous by their absence.

6. But if private enterprise was lacking in the development of agriculture, the Egyptian Government assumed responsibility; and through its initiative and by help of public funds effected considerable improvements. Its efforts consisted largely of public works designed to control or regulate the flow of the Nile, to reclaim marsh lands and to rehabilitate exhausted terrain through land drainage and to raise crop value by seed selection. The cultivated area of Egypt is now almost entirely served by perennial irrigation, and a net work of drainage projects have or are being completed. It can, therefore, be said that most of the development in agriculture is due to Government initiative and direct public expenditure. Indeed, expenditure on irrigation and land drainage always constituted a principal item in the national budget; and notwithstanding the severe limitations imposed on State Revenue by the Regime of Capitulations, that item was progressively increased from year to year, since the turn of the century. The Aswan Dam, and the Isna, Assint and new Mohamed Ali Barrages, are examples of the great undertakings which have been entirely financed from the proceeds of taxation and which have exercised enormous influence on the type and volume of agricultural production in Egypt. It is often argued that such practice has an obvious disadvantage inasmuch as it caused land proprietors to rely unduly on government initiative and efforts in regard to effecting land improvements, be it through irrigation, reclamation, selection of seeds or drainage.

PART II. FINANCIAL MECHANISM AND FACILITIES

7. The lack of private enterprise in agricultural development and the excessive dependence on Government initiative and expenditure in respect to land and crop improvements, may not be satisfactorily explained by reference to the absence - until comparatively recently - of organized facilities for obtaining financial assistance. But it is note-worthy that these circumstances existed, and were most likely casually connected. The institution of village money-lender though

/important,

important, cannot be treated as a proper method of obtaining financial assistance for economic development. The village money-lender has ever been active. His activity has more often reflected the distress and failure of his clients than their hope and enterprise. The Egyptian Government had at the close of last century attempted to establish a system of direct lending to small cultivators. In spite of its success, it was discontinued on the ground that it was not a proper function of the Government to undertake the services of credit institutions.

8. The foregoing statements should not be interpreted as a denial of the existence of all types of organized credit facilities for economic development. Indeed, such interpretation cannot be true. Organized banking existed since the middle of last century, although its growth was attended by circumstances that had at once limited its scope and usefulness. In the field of commercial banking, the credit institutions developed a high degree of efficiency comparable to that obtainable in much more advanced countries. They were branches of foreign banks, and kept very closely to the policy and practices of highly specialized deposit banks. They accepted deposits; but their principal activities consisted in the finance of foreign trade and particularly cotton exports. These activities were no doubt profitable and entailed very little risk. The number of the banks grew rather more rapidly than the business available. Keen competition - often amounting to unsound rivalry - characterized their relations. They could not be in any way controlled nor their individual policies directed and co-ordinated. They had little or no interest to influence the flow of local savings into local investment. They contributed little to the promotion of banking habits among Egyptian people. Their financial requirements were obtained from the money markets of Europe. All these circumstances naturally led to a disproportionate growth of short-term lending as compared with long-term credit facilities. That was the apparent deficiency of the credit structure - a deficiency for which the banks were often blamed, and such blame was as often unjustified. It cannot be too greatly emphasized that the most essential consideration for the deposit bank is to develop such credit facilities or to engage in such business as not to impair its liquidity. It is very dangerous to call upon deposit banks to extend their services outside that limited sphere; and certainly it is better that these services are performed by other specialized institutions.

9. Mortgage banks and companies had operated in Egypt for a long time past. They were almost entirely foreign-owned institutions. The first to be established was the

/Crédit

Crédit Foncier Egyptien, which began operations in 1880. The business of mortgage was largely that of providing big land owners with loans that were mostly employed for purposes other than land improvement. This practice had proved more harmful than useful. It was evident that the type of agricultural credit mechanism thus evolved, was unsuitable or inadequate for a reasonable development in agriculture. That much was acknowledged by the Government whose express policy was to encourage small-holdings, especially after the breaking up of the State Domains and the Daira-el-Saneya. To give practical support to that policy, and in response to popular demand, it was decided in 1902 to form the Agricultural Bank of Egypt under the auspices of the National Bank. The experience of this new Bank was never a happy one. Soon after its formation a speculative era began and culminated in the crisis of 1907. This was followed by a period of distress among the small farmers, only to be aggravated by the failure of a number of newly formed land companies. The position of the small landowners became so bad that a Law, known as the Five-Feddan-Law was enacted in 1912 forbidding foreclosure in case of the defaulting owner of less than five feddans. That was a retrogressive step in so far as it rendered impossible, up to the present moment, the formation in the ordinary way of any banking concern, that would finance the little man who had nothing but his small holding to offer as security for loans. Thus the Five-Feddan-Law put an end to the Agricultural Bank of Egypt and with it any similar attempt.

10. The pre-war credit institutions were severely tested by the crisis of 1907 which was preceded by feverish land speculation. The Administration's policy of encouraging small holdings by the breaking up of big Government estates, caused foreign financiers, who were further induced by the fall in the rate of interest in the money markets in Europe, to foresee prospects of enormous profits through land speculation. The trading banks - contrary to their practices - helped those financiers by providing them with working capital. The large crop of land-companies that sprang up during the first few years of the present century, became primarily engaged in buying land in comparatively large areas and selling it in small lots, or in lending to prospective buyers of land. The aggregate capital of companies registered in Egypt which amounted to 14 millions in 1897, exceeded 87 millions in 1907.

11. One of the results of the crisis of 1907 was a rise in the capital and debentures of mortgage Banks and Companies from 39.7 millions to 59.6 millions.

/The corresponding

The corresponding increase in their loans was notable because it implied that land which was formerly free from indebtedness became now mortgaged. The fall in the price of land and the disappearance of the speculative type of land companies, meant that those who had purchased at inflated prices, had to resort to mortgage banks and companies in order to meet their commitments. Not only did they mortgage their new possessions, but also their old properties. Five new mortgage banks were formed after the crisis namely: The MORTGAGE COMPANY OF EGYPT LTD., CAISSE AUXILIAIRE FONCIERE, CREDIT FONCIER D'ORIENT, CREDIT HYPOTHECAIRE AGRICOLE & URBAIN D'EGYPTE and AEGYPTISCHE HYPOTHEKEN BANK.

12. The farming community prospered during the first World War. It was an era of inflation and rising prices. The burden of fixed charges was diminished and indebtedness reduced. Thus, loans of the seven principal mortgage banks, which amounted to L.E.46 millions in 1914, declined by almost one half in 1919. The prosperity of the fallah was, however, brought to an end by the collapse of prices in the spring of 1920. Land Banks and Mortgage Companies began to get busy. The CREDIT FONCIER EGYPTIEN, for example, increased its loans during the year from 0.7 millions in 1919 to 2.6 millions in 1920 and 2.1 millions in 1921.

13. The conditions of agriculture during the few years that followed the World War I, could not be regarded as comfortable. The Government had to intervene and provide farmers with financial assistance in the form of buying cotton at higher prices than would be secured in a free market. Such assistance was never intended as a measure of encouraging agricultural development, but as a means of restoring the solvency of the fallah. This policy was continued, almost uninterruptedly until the beginning of the 1930-31 season, when it became evident that the support of cotton prices threatened disaster to State finances. Nearly half of the Reserve Fund (L.E.19,378,000 out of L.E.40,599,000) was immobilized in cotton purchases. The Administration realized, at long last, that its intervention in the cotton market had grave consequences; for, first, it confused the issue of organizing agricultural credit with that of stabilizing cotton prices and, secondly, it encouraged greater dependence on cotton, whose advantages were doubtful. It was abundantly clear that the situation called for immediate action. Properly organized methods of financial assistance to promote agricultural development were urgently needed. It was decided to form an agricultural bank under Government auspices i.e., the CREDIT AGRICOLE D'EGYPTE.

/14. The CREDIT

14. The CREDIT AGRICOLE D'EGYPTE began operation in 1931. It was set up "for the purpose of meeting agricultural needs which are not at present catered for by the credit institutions in existence." In other words, it was expected to organize medium and short-term loans for small agriculturalists, and thus assist the development of diversified agricultural production. In particular, it was charged with the following main functions:

I. SHORT-TERM CREDIT (duration not exceeding 14 months)

(a) Advances to co-operative societies, and small cultivators on the security of the land itself, to enable them to acquire seeds, fertilizers and to cover the expenses of cultivation and harvesting.

(b) Advances to co-operative societies and small cultivators on the security of the crops.

(c) Sale of fertilizers and seeds to all cultivators with facilities for repayment.

II. INTERMEDIATE CREDIT (duration not exceeding 10 years)

(a) Advances to co-operative societies, and small cultivators, (on the security of mortgage in the case of the latter), to enable them to acquire agricultural implements and cattle, and to effect such urgent improvement as they might deem necessary to cultivable land.

15. Most of the loans given by the Credit Agricole were for the benefit of small cultivators either individually or collectively, in the form of a co-operative society. The unpracticability of the Five-Feddan-Law was recognized and therefore loans from the new Bank were exempted from its provision. In order to show the importance of the classes of agriculturists, whom the Bank is intended to serve, the distribution of land-ownership in 1930, which has altered little since then, is given here-below:

Land Owned	Number of Owners	Area Owned
1 feddan or less	1,920,641	785,372
from 1 - 10 feddans	667,519	1,760,290
" 10 - 20 "	41,558	564,096
" 20 - 30 "	11,483	318,006
" 30 - 50 "	9,236	351,217
over 50 "	11,916	2,200,375
Total	2,662,353	5,979,356

/16. There is

16. There is little doubt that the Bank has been very successful in the performance of the principal task assigned to it. It has secured the confidence of the cultivators, on whom it has conferred real benefits. It has branches and stores all over the country and thus is in a position to serve the entire rural population. Its business has progressively been extended until its total loans had last year reached L.E.7,400,000 as compared with barely L.E.2,000,000 in 1932. The returns of the loans granted in the course of 1948 give an interesting summary of the type of services the Bank provides. The total number of short-term loans (duration not exceeding 14 months) was 372,954, amounting in value to L.E.7,342,942 giving an average of just over L.E.19-1/2 per loan, and suggesting that the majority of the Bank's clients are composed of small cultivators. The distribution of the short-term loans was L.E.2,421,733 as advances to buy seeds and fertilizers, L.E.4,229,124 advances to cover the cost of cultivation and harvesting, and L.E.692,085 advances on crops stored. On the other hand, medium term loans reached only L.E.52,884 of which L.E.37,085 were loans to acquire agricultural implements and cattle, and L.E.15,000 to effect land improvement. The working capital needed by the Bank to finance its loans, has always been supplied by means of direct Treasury advances. The existence of a large Reserve Fund on which the Treasury can draw - with the consent of Parliament - has certainly facilitated that practice. Yet the possibility of the Credit Agricole having recourse to borrowing from the money market is not ruled out. Its Charter provides it with adequate powers to borrow. The necessity to make use of these powers has not arisen, nor is it likely to arise in the near future.

17. An analysis of the aggregate loans accorded by the Bank to its clients since its formation, will give an interesting summary of the extent of its services.

I. SHORT-TERM LOANS (duration not exceeding 14 months)

(a) Advances on securities of the land totalled L.E.51,460,179.

(b) Advances on crops stored totalled L.E.26,279,715.

II. MEDIUM-TERM LOANS: The sum total of these loans since the formation of the Bank amounted to L.E.540,758 as advances to acquire agricultural implements and cattle, and only L.E.107,024 as advances to effect land improvement.

18. It is to be noted that since its inception the CREDIT AGRICOLE was intended as an instrument for encouraging the formation and the extension of activities of agricultural co-operative societies, by offering them special treatment in the form of a reduction of the interest rate on loans, and every possible facilities

/compatible

compatible with its security. The total number of agricultural co-operative societies during the year the Bank was formed, was 554, borrowing from the Bank L.E.122,000 or 5.6 per cent of its total loans. In 1948 the number reached 1,657 and their borrowing L.E.1,881,000 or 25.4 per cent of the total loans of the Bank.

19. It is certainly reasonable to argue that the CREDIT AGRICOLE has been successful in providing short-term loans to cultivators, although it has often been said that the resultant benefits are not as real as they are apparent in so far as the short-term loans enabled cultivators to maintain the practice of anticipating income one year ahead of receipt. The Bank has also through its country-wide organization materially assisted in the proper distribution of seeds and fertilizers, and in the collection and storage of that part of the crop which the Government, throughout the war years, called upon cultivators, to surrender. It is generally held that the Bank is an instance of the success of a specialized credit institution. It is worthy of note that although the security it requires is easily provided, the repayment of its loans, when falling due, is very regular. The Bank's losses on doubtful debts are extraordinarily small.

20. On the other hand, the growth of mortgage banking had received a set-back in consequence of the measures taken in 1933 to protect the land-owners from dispossession as a result of defaulting or falling into arrear on mortgage. The effect of these measures was practically to stop the issue of all new loans. In order to arrange for repayment of existing loans, the following procedure was adopted:

1. A renewal of loans on the basis of a consolidation of capital still due and accumulated arrears.
2. An extension of the duration of all loans to 30 or 40 years instead of an average of 15 or 16 years for the old ones.
3. A reduction of the rate of interest on debts to 6.5 per cent on debts that have not fallen due.
4. A reduction of the rate of interest to 5 per cent on the 2/3 of the amount and 6 per cent on the remaining 1/3 of the debts that have fallen due.
5. The Government to pay to the Banks 2/3 of the arrears due, partly in cash and partly in five-year bonds bearing interest at 4 per cent.

21. At the same time, the Government encouraged by the success of the CREDIT AGRICOLE, decided to form a new Bank called CREDIT HYPOTHECAIRE AGRICOLE, whose object was to make long-term loans to land-owners on the security of land, provided

/these

these land-owners do not pay as land-tax more than L.E.50.- per year i.e., owners of between 30 and 40 feddans. The importance of this Bank was largely diminished as a result of the war-time prosperity of agriculturists and land-owners. Long-term agricultural indebtedness has been greatly reduced in recent years. An indication of the repayment of the mortgage loans, may be taken from the returns of the CREDIT FONCIER EGYPTIEN which reported that the total of its loans outstanding, diminished through excess repayment over newly contracted loans, as follows:

1934/44	L.E.1,215,000	1944/5	L.E.1,432,000
1945/46	L.E. 910,000	1946/7	L.E. 428,000

PART III. INDUSTRIAL DEVELOPMENT

22. Economic development in its industrial aspect has, during the last twenty years, been most spectacular. It is true that prior to 1914, Egypt could show little that might be called industrial activity. There were, indeed, a few public utility undertakings, a few factories and a large number of independent artisans. The country, relied for the supply of the bulk of its requiremnts of industrial products on foreign sources. The outbreak of hostilities caused immediate supply difficulties and brought home to people and government the danger of complete dependence on external sources of supply.

23. It was in 1916 that the Government formed a commission of enquiry to investigate and report on the possibilities of industrial development. The commission made a thorough investigation of all relevant circumstances and finally produced a report that was remarkable both for its factual analysis and its practical recommendations. This report remains a valuable work of reference to the present day. In reviewing past history, the commission has refuted, once and for all, the fallacy that for natural and historical reasons no industrial development was possible in Egypt. Furthermore, the commission examined carefully the circumstances of existing industries such as the textile, the sugar, alcohol and oil extraction, and was able to expose the avoidable obstacles which prevented the growth of those and other industries. Among the recommendations of the commission were, Tariff reform (a measure that proved impossible until 1930), reduction of railway and water transport fares, preference in Government adjudications, provision of technical and expert assistance (including recruitment of experts from abroad and the reform of technical education) and finally the promotion of credit facilities for industrial development.

/24. Unfortunately,

24. Unfortunately, very little could be done immediately to implement these recommendations. It is true that during the first World War, and encouraged by supply shortage and high prices, some enterprising persons were able to extend their industrial activities on a reasonable scale. But as soon as war ended and foreign imports entered in abundance, many, if not all of the newly established industrial concerns disappeared. Again, the Government in 1920 formed a special department called the Department of Commerce and Industry (becoming a Ministry in 1935) whose object was to help the promotion of Egyptian industry through technical advice and assistance. The Department was able to send missions of study abroad and to establish local institutes to train workers specially in such industries as the manufacture of glass, spinning and weaving of cotton and wool, and carpet making. It has also recruited a number of experts from abroad who gave valuable asistance to local industry.

25. Meanwhile, no important steps were taken to promote credit facilities for industrial development by private enterprises, except perhaps the efforts which Bank Misr made - subsequent to its formation in 1920 - by directly participating in the capital of a few industrial concerns. It should be remembered that the founders of Bank Misr intended that one of its main objects would be the promotion of industrial undertaking that had good chance to succeed. They were careful, however, to indicate that adequate precaution would be taken to minimize the risk of direct participation. It was hoped that in participating with a majority holding in an industrial enterprise, Bank Misr would give the general public a lead and should thereby be able to withdraw or greatly reduce its financial commitments. Such was a pious hope. The policy of the Bank has sometimes been criticized on the ground that to combine the business of direct industrial participation with that of an extensive deposit banking, involves a departure from sound practices. The dangers involved in such departure are by no means imaginary. Painful experience in many countries - including that of the Bank itself - has demonstrated with unmistakable certainty the grave consequences for a deposit Bank, of industrial entanglements particularly when the participation is of a speculative character. Bank Misr still controls and provides direct assistance to a number of very important industrial concerns. Its last effort had been the formation of a new enterprise to manufacture rayon yarn in Egypt. None the less, the fact remains that the efforts of Bank Misr constituted the first, and certainly thus far the most important institutional organization for the mobilization

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of local savings into industrial investment.

26. The beginning of the conspicuous development of Egyptian industry may be dated from 1930, when a new Tariff System was adopted. Prior to that year, Egypt was under Treaty obligation to refrain from imposing any custom duties on imports which would discriminate against a foreign-made article in favour of a similar article locally made. The new Tariff System was prepared by a team of foreign experts, and while it afforded some protection for local industries, it had, through marked reduction of duties on raw materials also encouraged those industries. Its very adoption seemed to have afforded investors sufficient encouragement to induce them to direct their savings into industrial investment rather than land and urban estate purchases. Both Egyptian and foreign capitalists participated in the industrial evolution that became apparent during the period up to the outbreak of the last war. It is true, however, to say that although existing commercial Banks (other than Bank Misr) did not offer the facilities of industrial loans, they were no doubt willing and able to provide industrial concerns with funds on reasonable guarantee, personal or collateral. The Government itself, recognizing the inability of small industrialists to obtain necessary capital through direct investment or bank advances, established a fund that was utilized in providing loans for approved Egyptian industrialists. This fund was first administered directly by a government department and subsequently by Bank Misr acting on behalf of that department. The experience gained and the results achieved do not warrant a repetition of this form of furnishing financial assistance for industrial development. They have revealed the inadequacy of the scheme of a government department administering such services as may best be entrusted to a specialized credit agency.

27. When the last war began in 1939, Egypt had reason to be grateful for the notable extension of its industrial activity compared with what it was ten years earlier. It is interesting to recall as an illustration of industrial progress that in a number of cases local industry produced the whole or the bulk of the country's requirements. The following percentages indicate the degree in which local production covered local requirements at the outbreak of war:

/1. Sugar

1.	Sugar	100 per cent
2.	Methlated spirit	100 " "
3.	Cigarettes	100 " "
4.	Edible salt	100 " "
5.	Flour milling	99 " "
6.	Cotton yarns	96 " "
7.	Shoe-making	90 " "
8.	Cement	90 " "
9.	Soap	90 " "
10.	Furniture	80 " "
11.	Matches	80 " "
12.	Beer Brewery	65 " "
13.	Vegetable Oils	60 " "
14.	Caustic Soda	50 " "
15.	Cotton Textiles	40 " "

PART IV. FINANCE OF INDUSTRY

28. The last ten years have witnessed an industrial revolution in Egypt. The country had been used as a principal base of operations for allied armed forces. Encouraged and induced by supply shortage of industrial products, local industry expanded extremely rapidly. Large profits were made, not only in providing articles for civilian use, no longer obtainable from abroad in sufficient quantities, but also on army contracts. It was the express policy of the authorities charged with import control to encourage local production by facilitating imports of raw material, machinery, spare parts etc. Similarly army authorities either through direct control or in co-operation with existing management, gave very valuable technical and material assistance to local industry, to enable it to meet the requirements of the armed forces. Furthermore, the army workshops were valuable training schools for young Egyptians who became skilled workers.

29. The prevailing practices of obtaining financial assistance for industrial development have been almost exclusively those of direct investment either by the promoter or promoters themselves or with the participation of members of the public. During the war the general public was not usually called upon to invest. Every industrial activity was profitable and such profit was large enough for the extension. Since the conclusion of hostilities, however, the practice has been to promote industrial enterprises through the floatation of joint stock companies. Egyptian public has become investment minded, as witnessed by the fact that most companies floated since the war, were greatly over-subscribed. In this connexion, reference must be made to the highly developed Stock Exchange Houses of Cairo and

/Alexandria.

Alexandria. They have attracted many a new saver, in spite of the considerable limitation on the listing of shares. Such limitation is ostensibly for the protection of investors. It is doubtful whether it has really afforded that protection. It is certain that the restrictive conditions - such as minimum nominal value of L.E.4 and only shares of Sociétés Anonymes may be quoted - are not conducive to attracting savings into new investment. Nevertheless, the Egyptian stock exchanges have through dealings in the stocks and shares of old established companies, enabled their holders to dispose of them easily to new savers, and thereby acquire funds for new investment.

30. It remains as yet true that in spite of the enormous development in industrial activity, the existing credit institutions offer little or no facilities for industrialists to obtain financial assistance - excepting of course Bank Misr in respect of its own companies. Such assistance was perhaps not needed during the very prosperous years in industry up to 1947. The position has now markedly changed and Egyptian industry has to face very difficult conditions consequential upon the decline in spendable income and the emergence of foreign competition. Industrial reorganization or rationalization of industry will need technical skill and financial assistance. The Egyptian Government has recognized the problem in its two-fold aspects and in enlisting the services of international experts, has attempted to give a lead to private enterprise to effect the necessary technical reorganization. On the other hand, it has sought to provide a means of obtaining financial assistance by creating a new industrial bank with a capital of L.E.1,500,000 of which 51 per cent has been subscribed by the State. Although incorporated last May, the Bank has not yet started operations. It is interesting, however, to note the objects which the Bank is intended to serve. They are summarized as follows:

1. Direct participation in promoting or extending Egyptian industrial concerns on the security of personal or collateral guarantees.
2. Offering advances on personal or collateral security, in the following manner:
   (a) Short-term advances - duration not exceeding 12 months - on the security of raw material, manufactured articles, merchandise, stocks and shares, personal guarantee, or any such security.
   (b) Medium-term advances - duration not to exceed 10 years - to assist existing industries on the security of mortgage.

/(c) Long-term

(c) Long-term advances - duration not to exceed 20 years - to promote new industries or extensions of existing industries, on the security of mortgage.

3. To assist graduates of technical schools and institutes to undertake industrial activities by offering them advances on personal security or mortgage or collateral.

4. To invest its funds when available in acquiring shares and bonds of industrial companies.

PART V. SUMMARY AND CONCLUSIONS

31. It is hoped that the foregoing analysis brings out the salient features of the present state of economic development in Egypt, and the prevailing methods, practices and problems involved in obtaining financial assistance. If the relevant circumstances are known and properly assessed, the problems of reform will be the more easily handled. That economic development in Egypt needs wholehearted encouragement amounting to a deliberate drive, is undoubted. Witness the average money income per capita of less than L.E.25. In every field of economic activity there is room for development. Perhaps some are easier to achieve or will yield quicker results. It must be immediately acknowledged that the Egyptian Government has traditionally assumed responsibility for initiating public works that have either formed essential part of economic development or greatly aided the course of that development. Reference has already been made to irrigation and land drainage. We should add other public undertakings and services. Railways, telephones, telegraph, radio and postal administration are state departments. Roads, hospitals, schools and universities are founded and financed from the proceeds of taxation. It is a characteristic of the Egyptian Government budget that it contains annually a considerable part devoted to new public works that possess economic and social significance. This practice is likely to continue - perhaps more progressively because of the marked increase in the social conscience and a strong realization that economic and social improvements must be speeded up to avoid social disturbances. After all, it is true that the Government has a Reserve Fund of over eighty million pounds.

32. In agriculture, development must have two-fold objective:

1. to increase the yield of the already cultivated area.

2. to bring under cultivation land which, for lack of irrigation and drainage is not yet reclaimed.

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It is estimated that the cultivated area is 5,978,000 feddans and the additional area that can be cultivated 1,200,000 feddans. An increase in the average yield of the land is no doubt possible with improved processes of cultivation and greater diffusion of knowledge of modern methods among the fellaheen, as well as better seed selection, more adequate fertilization and prevention of plant diseases. The course is likely to be slow and will largely depend on individual efforts, and it is here that the problem of obtaining financial assistance for such efforts becomes very important. It has been noted that agricultural credit is almost non-existent, apart from the services of the CREDIT AGRICOLE, whose advances, though considerable, are practically confined to short-term loans. Its medium-term loans - obviously the more suitable type of advances for agricultural development - are very small, and cannot be considered adequate for the purpose. It is difficult to determine why progress in this field has been so slow. It is generally explained that the Bank's clients are invariably reluctant or disinterested to take advantage of the facilities offered to them. Strong hope is entertained that an intensification of Government efforts, to educate the fellaheen in improved processes of cultivation, will soon cause their attitude to change.

33. In any case, the problem of improved agricultural methods and processes is closely connected with the problem of small holdings. As a system, small-holdings may be supported on social grounds, but its economic advantages in Egypt are very doubtful. Be it as it may, the system of small-holdings and that of land tenure are likely to continue, and therefore the problem of providing financial assistance for agricultural development will remain one in which the state must play an active role. Spontaneous private enterprise is not likely to grow unaided. With improved administrative procedure, the CREDIT AGRICOLE may prove adequate.

34. There are also land reclamation schemes already prepared and some put into execution. The cost of irrigation works alone is estimated at between 50 and 60 million Pounds, but the total cost of complete reclamation of cultivable land is likely to exceed 250 million Pounds. Irrigation works are obviously the responsibility of the Government, but the supplementary or complementary works can be entrusted to private enterprise. Big capital expenditure is herein involved. It is doubtful if Government finances and domestic resources will be sufficient. To call on foreign capital seems necessary if those projects are to be successfully completed. Government borrowing abroad is unlikely to be countenanced in view of the unfortunate experiences of the past. The alternative is to offer reasonably

/favourable

favourable conditions of investment to private foreign capital.

35. Whilst the schemes for agricultural development and land reclamation, may take some years to complete and yield the desired advantages of greater agricultural production, there are other projects of economic development whose fulfilment is very pressing for political and social reasons. Among these projects, the electrification of the Asswan Dam takes precedence. It is unfortunate, however, that after twenty years of discussion, and after preliminary measures were taken and work started, the authorities discovered that original estimates voted by Parliament, of L.E.11 million Pounds, must be increased to L.E.18 million Pounds. This substantial increase has been explained by the rise in the price of supplies and the added cost of improvements introduced into the plans of construction. It is to be remembered, however, that to finance this project, Parliament authorized the Government to float a domestic loan. It is to be presumed that the increase in estimates will also be financed in the same way.

36. As and when the electrification scheme is completed - and apart from the establishment of the fertilizer and steel works - it is hoped that the power so generated will be utilized in developing light industries north of Asswan. These industries will need financial assistance. It may be that the new Industrial Bank will be able to offer the needed assistance. It may be that private enterprise - Egyptian and foreign - will be attracted by offering it reasonable security and encouragement.

37. It is to be remembered that the progress achieved by Egyptian industry has hitherto been financed largely if not wholly through direct investment. Circumstances were favourable to that type of evolution. Savings were being accumulated at an increasing rate. Statistical data are lacking, but the returns of the principal banks regarding movement of their deposits may offer an indication.

Bank Deposits
(in million L.E.)

Year	30 June	31 December
1939	34.2	40.6
1940	36.4	54.7
1941	64.8	81.0
1942	78.6	107.6
1943	148.6	181.1
1944	211.6	236.9
1945	278.7	280.6
1946	275.2	280.7
1947	268.1	275.7
1948	269.6	261.8
1949	268.5	-

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38. The unquestionably large increase in the volume of savings has not only enabled industrial progress to materialize, but also has left an annual surplus for investment. It is also important to remember that the bulk of savings is represented by balances held abroad, principally sterling balances. The importance of this fact can best be appreciated, if one recalls that before the war Egypt was a debtor country. When war came to an end the estimated total of sterling balances was approximately L.E.450,000,000. In addition, Egyptian cotton and other products have since then been sold at very remunerative prices abroad. These circumstances seem to lend support to the view, widely expressed in Egypt, that the existing volume of savings and the expected annual increments - given the state of income and wealth inequality - will be sufficient to provide the necessary capital for economic development. That may be so, and will probably prove correct if the agencies of directing savings to investment are adequately equipped for the purpose - at best a doubtful assumption.

39. It has already been explained how the credit structure proved inadequate for full economic development. Commercial banking has reached a very advanced stage. It is often said that the commercial community has at its disposal too much rather than too little credit facilities. Again, commercial banks do not always follow a common policy. There is no special banking legislation to apply. A legally constituted Central Bank is conspicuous by its absence. The National Bank of Egypt which was formed in 1898 by private capital, was intended to function as a state bank and was given the monopoly of note-issue. It has remained a privately-owned bank and continued its private banking business alongside of those tasks entrusted to it by the government. It had exercised little or no control over other commercial banks, until the outbreak of the last war and the introduction of a mild form of exchange control in which it played an important role. Negotiations to convert the National Bank into a central bank were started as early as 1904. The renewal of its charter in 1940 was the occasion to introduce certain changes in its administration and working so as to facilitate the task of eventual conversion into a legally-constituted central bank. Efforts were lately made to accord the National Bank the legal status of a central bank, but an introduction of the issue of its nationalization retarded the results hoped for. In any case, it is true to say that the Bank now performs most of the functions which it would have performed were it in possession of the legal status of a central bank.

40. The inadequacy of the credit structure in providing credit facilities for economic development, is matched by the deficiency of existing credit institutions in respect of canalizing savings into investment. The effects of such deficiency have lost their practical significance for the time being and as long as the volume of the forced savings accumulated during and after the last war, remains unutilized. This is not a healthy state of affairs. It is essential that measures be taken to promote individual as well as institutional savings and to direct them to investment. It is suggested that members of the public be encouraged to effect their savings through Post Office Savings Bank and other savings departments of commercial banks. The deposits of these agencies can be - within the limits of safety or prudence - mobilized into industrial or agricultural investment. In regard to institutional savings, it is observed that the practice of most commercial companies is to transfer a determined percentage of their profits into reserve. This is a sound practice that should be encouraged. The Government has, however, obtained parliamentary consent to impose a double tax on the undistributed profits of corporations if the amount of reserve exceeds twenty-five per cent of the capital. Although the unwisdom of this measure is apparent, its evasion will be easily achieved.

41. It is conceivable that the Government through taxation and public borrowing will compensate for the deficiency of private credit institutions to mobilize private savings. It is observed, however, that the tax system - in regard to both direct and indirect taxes - needs reform. Egypt is now among the most highly taxed countries. Taxation on income is a recent scheme, whose application has been attended by many administrative difficulties. Indirect taxes seem to have become excessive. The yield of import duties last year amounted to more than fifty per cent of the total c.i.f. value of imports. No wonder official attempts to reduce the cost of living have proved fruitless.

42. Borrowing has become - after so many years of restraint - an important feature of State finance. In spite of the existence of a large Reserve Fund amounting to over eighty million pounds, Parliament has authorized the government to float internal loans for specific purposes; for instance, to cover the cost of the electrification of the Aswan Dam, or the Cairo Electricity Scheme. This seemingly contradictory practice cannot be explained by reference to the fact that about thirty million pounds of the Reserve Fund are earmarked. The truth is that the scheme of government finance or the system of national financial

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administration has become confused under the stress of recent events. The newly established Audit Department has revealed anomalies and irregularities, which call for immediate and serious attention if grave consequences are to be avoided. It will thus appear advisable that the government must confine its efforts for economic development to those projects that are normally or preferably carried out at a loss or without profits and the essential undertakings which private enterprise has not attempted to promote.

43. Be it as it may, Egyptian capital, unaided, will not suffice to finance all forms of economic development. The co-operation of foreign capital - both monetary and technical - must be sought. Such co-operation will undoubtedly be forthcoming if reasonably favourable conditions are offered. It is unfortunate that certain recent events have tended to create an impression among foreign residents that the present Egyptian temperament is unco-operative. It is said that the abolition of privileges enjoyed by foreigners under the regime of Capitulations had produced an unfriendly reaction against foreign nationals. At the same time, it is agreed that foreigners who have been so long privileged, may experience some difficulty in readjusting their personal status. But a more serious obstacle is said to be the situation created by the recent promulgation of the new Company Law, which stipulates that at least 90 per cent of the workers and 75 per cent of the employees of limited liability companies shall be Egyptian nationals, and that the majority capital of all new limited liability companies must be Egyptian-held. It is observed that, as this law only applies to limited liability companies it constitutes a strong discrimination against them, and thus has unfortunate results at a time when it is hoped that that form of enterprise will exercise increasing influence on economic development.

44. In conclusion it will be readily agreed that the services of foreign capital and foreign technicians must be enlisted for the economic development of Egypt. Liberal conditions must be offered to encourage private enterprise, especially in the field of providing financial assistance for the different forms of economic development. The projected Government schemes are likely to prove more than enough for its endeavours. It will be unreasonable, and may in fact prove harmful, to expect or to call upon the Government to undertake further direct measures to promote economic development.

/Prevailing Practices

Prevailing Practices, Methods and Problems Involved in the Domestic Financing of Economic Development in India

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To some, perhaps to a considerable extent, the problem of the domestic financing of economic development would vary from country to country with the state and character of economic development attained by a country. It will, therefore, be in order to set out briefly the broad elements of the economic pattern of the country, which should form the necessary background for a fuller consideration of the problems of domestic financing of economic development. The size and complexity of the problems involved for a country as large as the whole of Western Europe together or well over one-third the size of the United States, inhabited by one-sixth of the human race, make of even the financing of economic development too large a subject to be compressed so easily within a few pages. One must, however, resist the temptation to stray into giving an account of economic development as such, and content oneself with a very brief description of the present stage and type of economic development and structure of the country only to set the problem of financing in perspective.

I. The Present Pattern of Economic Development and Economic Prospects

With a population of 340 million and a density per square mile of 246 as against 4.8 in the United States and 703 in England and Wales, India is predominantly an agricultural country, with over four-fifths of the population dependent for their means of livelihood on agriculture, mostly small-scale, and associated employments; a little over 10 per cent of the population is employed in industry, of which only 1 per cent of the population is dependent upon large-scale industry; transport and trade between them account for a little over 7 per cent of the occupied workers, while public administration and liberal arts employ less than 3 per cent of the working population. The preponderance of agriculture and small-scale industries, using only a small amount of capital over and above the bare human and animal labour - the population of cattle and domestic animals in the country is the largest in the world - emerges as the outstanding fact in a broad survey of the economy. The size of the average agricultural holding varies from 2.5 to 12.2 acres per cultivator against 148 acres per cultivator in the United States, 62 in England, 40 in Denmark, 26 in the Netherlands and 14.5 in Belgium.

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With a small holding, the yield of agriculture per unit of area is also low. In consequence, the per capita income is among the lowest in the world.

Yet withal, the country has a fairly well-developed and functioning system of basic public services and some of her large-scale industries represent huge aggregations of financial and material capital, as well as among the largest units of industry, for example, in steel, operating outside the United States. The country has also a large economic potential with fairly extensive areas of cultural waste lands which could be pressed into economic use with more mechanical assistance and better water supplies as well as good possibilities of increasing the output of agricultural crops on existing lands through more intensive cultivation on the basis of larger supplies of fertilizers, manures and water; there is a fair abundance of hydro-electric resources in the waters of her great rivers, very large deposits of coal, though not of the highest grade, and ample deposits of iron ore, manganese, mica, bauxite and other minerals. About the most promising part of Government's economic plans relates to the several great river valley projects and irrigation schemes that are in train and are not only expected to bring large new areas of land under cultivation but to assure regular water supplies for considerable areas which have hitherto depended on precarious rainfall, and thereby to increase their productivity; better waterways communications and the generation of hydro-electric power for the diversification of economic activity also hinge upon the successful completion of these schemes. It is not the purpose of this note to describe either the potentialities of economic development or the country's plans in that direction. But it will be of interest to illustrate the various gradations of planning with reference to the number and cost of irrigation cum hydro-electric projects which are in prospect and under execution. The overall plan of the Government embraces 160 projects estimated to cost the equivalent of 2.7 billion dollars (mostly in local currency), while a seven-year plan comprises 50 projects costing the equivalent of 1.7 billion dollars. Of these 28 estimated to cost .8 billion dollars are already in the process of execution. Other plans of the Government relate to the expansion of transport and improvement of communications and increase in the capacity of existing industry as well as the building of new and additional industrial capacity notably in steel and chemicals.

At this stage, it is perhaps useful to refer to the broad framework within which future industrial development is expected to evolve, under the Government of India's declaration of industrial policy of 6 April 1948. This divided industries into three categories, namely those that would be the monopoly of the state, those left to private enterprise and those over which the Government exercises control. The manufacture of arms and ammunitions, the production and control of atomic energy and ownership and railway transport will be the exclusive monopoly of the Central Government. In regard to the following six industries, the state will be exclusively responsible for new undertakings but may receive the co-operation of private enterprise, viz., coal, iron and steel, aircraft manufacture, ship-building, manufacture of telephone, telegraph and wireless apparatus, excluding radio receiving sets, and mineral oils. Management of state enterprise will generally be through public corporations. The Government have decided to let existing undertakings in these fields to develop for a period of ten years (According to pronouncements of policy issued since the prospects of nationalization of existing enterprises seem to have receded into more distant future for the time being.) As regards generation and distribution of electric power, the industry will be regulated in terms of the Electricity Supply Act of 1948, which represents a compromise between full-fledged State enterprise and unregulated private enterprise. The following 18 basic industries will, subject to regulation and control, be in the sphere of private enterprise: salt, automobiles, tractors, prime movers, electric engineering, other heavy machinery, machine tools, heavy chemicals and fertilizers, pharmaceuticals and drugs, electricity, chemical industries, non-ferrous metals, rubber manufactures, power and industrial alcohol, cotton and woolen textiles, cement, sugar, paper and newsprint, air and sea transport, minerals and industries related to defence. The rest of the industrial field which constitutes the fourth category, will normally be left to private enterprise, individual, co-operative and corporative. The declared policy of the Government, therefore, clearly reflects the need to develop certain industries through Governmental initiative, which otherwise would not develop and to leave the field free where private enterprise is likely to be attracted.

All this relates, for the most part, to the sphere of large-scale industry and other development programmes involving heavy capital investment and potentially a significant sector of the country's economic activity, but it is well to remember - in relation to the problem under consideration - that the mainstream of economic life in the country derives for the time being only an insignificant portion of its sustenance from these new, potentially productive but in the main prospective sources of wealth. And, at any rate, the expansive possibilities of these

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spectacular new sources of economic strength and prosperity have to be accompanied by a great deal of complementary action, carefully worked out and executed, and, at least in part, translated into practical terms of greater efficiency and higher productivity of the labour of the man behind the plough or the pair of hands on the loom.

II. Financing of Economic Development

It is to the aspect of financing of these developments that it is necessary here to address ourselves in particular. The following pages deal with the more significant sources and methods of finance for economic development in the main sectors of the country's economic activity, and indicate the rough order of relative importance of domestic and foreign financing in the main branches of modern economic development where foreign financing has played an important role.

Agriculture

Agriculture in India is primarily conducted by small-scale peasant proprietors and occupancy tenants (viz., tenants on a long-term basis), while a small proportion of the land is also cultivated by temporary tenants or by labour under the direct supervision of the owner. The land tenure systems of India are diverse and complex, but the trend is toward simplification in the direction of enhancement of the status of the actual cultivator of the land, and the elimination of the hosts of intermediaries who under some of the systems intercept a good deal of the profits of cultivation. The reform of land tenures during the last ten years or so, ever since the popular Governments assumed charge of the provinces, has been an outstanding development in the agrarian sphere (comparable to another development which is also not without considerable significance for economic development, namely, the absorption and integration of the Indian states with their divergent economic and fiscal systems into the common economic and fiscal structure of India). But agriculture in India remains small-scale, individualistic and comparatively primitive in the methods of cultivation, in the implements used and in the organization of the supply of the farmer's requirements and the sale of his produce.

It follows that the amount of capital employed in agriculture is relatively small, the main objects of capital investment being the farm buildings and any embankments, wells and irrigational channels, draft bullocks and implements and seed, apart from shelter, clothing and food for the farmer and his family. The farmer relies for such financing partly upon his own resources and savings, which in recent years of high prices have been large enough to look after his normal

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needs as well as to repay his debts. Arrangements for the proper financing of agricultural production and development cannot, however, assume an indefinite continuance of this exceptional run of good fortune, and, indeed, the more normal pattern for a consideration of the problem of agricultural finance is indicated by the traditional cycle of good and bad years, taking output and prices together. In this normal pattern of recurring economic adversity, the agriculturist found himself getting deeper and deeper into debt to the private money-lender, who has for a long time formed an integral part of the rural economy of the country. The illiterate farmer who was slow to learn the virtues of thrift traditionally relied upon this more intelligent and thrifty member of society, who had always an eye upon his opportunities for profit in a situation where the high risks of money-lending were associated with high interest rates. The situation in this respect worsened particularly after the growth of protection for individual property rights during the British regime. The attention of Governments in India has been powerfully focused upon the evils of private money-lending, and the liquidation of agricultural indebtedness, the reform of private money-lending and the introduction of improved systems of rural credit and finance has had a high place among the economic reforms effected more particularly by the democratic Governments which took over the administration of the provinces after the partial transference of political power in 1937.

The growth of the co-operative credit movement, limited though it has been in range and effect, has been a principal positive factor in the suppression of the worst evils of private usury and has opened up the most promising line of solution not only of the agriculturist's problems of credit and finance, but also of the general rural economic problem. The dimensions of the co-operative credit movement, as it is called, are not large relatively to the traditional sources of financing in agriculture: its resources would comprise about 15 per cent of the total financing requirements for agriculture, which are still predominantly met by the now somewhat reformed private money-lending class. It covers the supply of short-term finance for the small working capital needs of the farmer as well as, in some provinces more than in others, the supply of long-term finance through co-operative land-mortgage banks for land improvements which yield return over a longer period. But the influence of the co-operative movement is wider than in the sphere of credit, and in many ways the most hopeful kind of co-operation is stated to relate to the multiple-purpose co-operative society. A conclusion which

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has impressed the student of rural reconstruction efforts during the last few decades is that the problems of finance in relation to economic development in agriculture are subsidiary to the problems of over-all organization of the economic efforts of the cultivator with a view to promoting greater efficiency and larger productivity in the business of farming. Cheap and easy credit has often enough been the ruin of the thriftless individual farmer, who has used this double-edged sword to his own undoing. What he requires is cheap but controlled credit, and the better organization of the purchase of his agricultural requirements as well as of the sale and marketing of his produce, in short more efficient conduct of farming, which is not only a business, but a way of life. The co-operative movement with its net work of Provincial Co-operative Banks, District Co-operative Banks and primary co-operative societies furnishes the base for broader attention to these problems. We may conclude the brief treatment of this phase of the survey of financing of economic development by stating that a proposal to set up an Agricultural Finance Corporation is under consideration at present to complete the apex of the financial structure in this sphere. So far the Agricultural Credit Department of the Reserve Bank of India has acted as a clearing house of information, and has tried to explore ways and means of securing greater access on the part of the Provincial Co-operative Banks to the credit facilities of the Reserve Bank of India (the central bank of the country), the availability of which has so far been restricted by a deficiency of the instruments which are appropriate for discounts or loans by the Central Bank.

Attempts to bring the indigenous bankers, who act as bankers as well as sources of finance for the large body of private money-lenders and together with the latter, form the so-called indigenous banking system with country-wide ramifications, into the orbit of the central bank of the country, have also so far failed of accomplishment. So that, there continue, side by side, the indigenous banking system, itself somewhat loosely organized, and the modern banking system with the central bank at its head, with only a partial and ineffective link between the two.

Over and above the private agencies of financing, the State has had a long history in India of direct loans to the agriculturist, though these have been for relatively short-term requirements of working capital.

On the whole, there has been a considerable improvement in the machinery of providing the normal financial requirements of Indian agriculture - the rates of interest are lower, the credit provided through the co-operative banks is related to

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the needs of agriculture and it exercises a healthful influence on the practice of rural finance which is far wider than the direct range of its impact. More recently, with good prices for agricultural produce, there has been a plethora of funds with the co-operative banks and other rural credit agencies while the needs of the agriculturist for finance of his normal operations has significantly declined with the growth of his own resources.

It is, however, in relation to developmental activities proper, that the resources of the individual agriculturist as also his normal sources of finance have been inadequate. In the past, the biggest projects of economic development in the sphere of agriculture related to irrigation schemes involving huge sums of money and the mobilization of equipment and personnel on a scale which, in the conditions of India, the State alone could cope with. The State relied upon public borrowing by the Central Government and loans to Provincial Governments, which were in direct charge of schemes of agricultural development. Almost all the irrigation schemes have been productive and provincial Governments have found in additional taxation the means to repay the interest and principal of the loans they raised from the Centre for their initial financing. Broadly, the position remains the same: the biggest developmental projects in the field of agriculture relate to the large river valley schemes for expanding the irrigational facilities for new and old lands and the generation of hydro-electric energy. The financing of these has to be arranged for by the State. The State would depend upon borrowing in the domestic market to secure the funds necessary to carry forward the execution of these projects.

Another important category of projects for the improvement of land has related to the consolidation of fragmented holdings so as to give the farmer an economic unit for his agricultural operations. Under the inheritance laws of the country, the agricultural holding is divided and passes at the death of the holder equally to all his male heirs. This practice has not only led to a reduction in the size of the individual holding below what is necessary for a good subsistence, but has resulted in a holding consisting of widely scattered and fragmented parcels of land, which raises the costs and reduces the efficiency of cultivation. One of the important lines of economic improvement in agriculture is to give the agriculturist a compact economic holding. Progess has been made in this direction but much more remains to be done. Apart from a great deal of other preparatory work that has to be done in connexion with such projects, they remain beyond the

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individual agriculturist's resources or the competence of his normal agencies of short-term finance. Long-term loans from Land Mortgage banks and special co-operative societies for Consolidation of Holdings can be of help in the matter, particularly since a considerable increase in the facilities of financing the long-term improvements which become possible once a holding is consolidated, is necessary if the process is to yield results in better agriculture and increased productivity.

Projects of land reclamation and the regularization of water supplies through schemes of tube-well irrigation which are expected to have quicker results than the big long-term irrigation projects, are other phases of economic development in agriculture for which special financing would be necessary. In view of the nature of the projects, in respect of which the main initiative is being assumed by the State, the internal financing of such economic development will depend upon the machinery of borrowing by the provincial governments, either directly from the market, or indirectly through the Central Government.

Small-scale Industry

Cottage industries of the handicraft type have always had, and will have, an important place in the economic development of the country. These industries require relatively small capital investment and are managed and operated by the individual artisan often with the assistance of his family. They are numerous and varied in character, some ancillary to agriculture, others independent but based on simple raw materials available in the country-side and catering to the diverse wants of the community. Such, for example, are the making and repair of implements, sheep-rearing, dairy-farming, bee-keeping, brown-sugar making, weaving, dyeing, seri-culture, utensil-making (brass and copper smithery), metal and cutlery, gold and silver thread industries, furniture, embroidery, pottery, soap-making, statuette-making, etc., etc. The problems of the financing of the development of small-scale industries are in many ways similar to those of the financing of agriculture, alike in respect of the present dependence on the private money-lender, who also acts as the trader supplying the worker with his raw material and taking over the finished product for sale, and in respect of the more recent growth of institutions - co-operative or state-sponsored - which seek to improve the status and increase the income of the worker and reduce the middleman's charges that act as a brake on production as well as on the expansion of demand. By its very nature, financing of this large sphere of economic activity, is entirely domestic, and

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the problems of economic development in the sector are as much of organization as of finance.

Large-scale Industry and Trade

We turn now to consider the sector of modern economic development, which is potentially perhaps the most significant. Modern economic development in India, apart from expansion of the facilities of basic public utilities, can be conveniently classified into the main categories of (i) transport - (a) rail, road and other inland, and (b) shipping, (ii) large-scale agricultural plantations, (iii) mining (iv) manufacturing (v) trading and (vi) banking, insurance and finance.

The relative extent of domestic and foreign financing varies widely between these different categories, and has been undergoing important changes recently. The railways of India represented before the war about the largest concentration in any single line of economic activity of foreign capital, mostly British. This position has now been completely changed, the entire railway debt has been repaid and Indian railways - entirely state-owned and mostly state-operated - are probably about the largest state enterprise outside the Union of Soviet Socialist Republics. The financing of further development raises more important problems in the sphere of foreign financing, owing to the very heavy proportion of imports to the total requirements of additional equipment for expansion, than of domestic financing. Such domestic financing of railway expansion, has, in the past, been provided out of the profits of the working of railways which are a productive asset.

The further development of road transport, which provides a considerable field for private initiative, involves important problems of integration of state effort in the construction of new and maintenance of existing roads, with private enterprise which is largely entrusted with the operation of road transport systems. Here, too, the sphere of state operation has grown steadily owing to the need for co-ordinated expansion and working of rail and road transport facilities and systems. The problems of financing, therefore, lie in the sphere both of State and private financing. The private finances for road operation companies are raised on an individual and partnership basis or from a wider group of subscribers through the corporation device.

Indian shipping has only recently come to acquire a substantial share of the coastal trade and is just beginning to participate in the long-distance foreign trade of the country. The larger shipping companies are joint-stock concerns which

/have had little

have had little difficulty in raising the necessary capital through subscription to their shares. Individual shippers also operate in the coastal trade of the country.

The large-scale agricultural plantations comprise the tea, coffee and rubber estates which have had a very high proportion of foreign (British) investments. During the war, the process of transfer of the ownership of these concerns into Indian hands has been going on apace, but no quantitative estimates of the relative share of Indian and foreign participation are forthcoming. The Reserve Bank of India recently undertook a census of foreign investments in the country, and when the results of this census are forthcoming, much interesting and valuable information in this field should come to light.

In mining, again, particularly in the mining of coal, gold, manganese, petroleum and mica which represent a large portion of the investment in this field, the majority of the important mining companies were, until the beginning of war, controlled by foreign capital. Here, too, the process of transfer from foreign to Indian ownership has been going on.

Manufacturing includes the important groups of enterprises like jute mills, cotton mills, sugar factories, paper, matches, cement and glass factories. These are preponderantly financed by domestic capital, and their capital requirements are met, in some cases, by the peculiar institution of long-term deposits by individuals (e.g., in cotton mills), by the Managing Agency System, or by the many and considerable banking institutions, again predominantly Indian-owned, which have come up rapidly in the last two or three decades. Although foreign capital still has a significant share in manufacturing activities, e.g., the jute mills, and in trading, particularly in houses conducting the country's foreign trade, domestic financing and management are increasingly replacing foreign sources of finance as well as management in the sphere of the country's modern economic development. The capital and deposits of Indian joint-stock banks now greatly exceed those of foreign exchange banks, which are branches of banks incorporated abroad and operating in India. Indian insurance companies now form an important channel for the mobilization of the savings of the people and dominate the domestic field, though in the sphere of foreign trade insurance, foreign companies still predominate.

The requirements of private enterprise in industries as far as capital is concerned fall, broadly, into two classes: block capital and working capital, but there is a third category of intermediate or medium term requirements, since a portion of the working capital is of a semi-permanent nature. As far as block

/capital is

capital is concerned, industry in India has raised it generally through common stock or occasionally through debentures. Some Indian industries have followed a system of accepting private deposits, part of which they have used towards block capital. The working capital is generally provided by the banking system, the resources of which have rapidly grown. Banks either make loans or give short-term credits through current account over-drafts to meet the current finance needs of industries. It is in respect of the medium-term requirements of industry that commercial banks could play a larger part. Although the resources of commercial banks are short-term in character and could not be committed for very long periods, a moderate fraction of the resources of the larger banks could, without undue risk, be devoted to the requirements of industry which are neither very short-term nor very long-term.

As far as the provision of block capital is concerned, in May 1943, Government instituted control of floatation of new issues of capital (though small amounts were exempted from such restriction) first with a view to directing savings into war loans, and, latterly, with a view to preventing the mushroom growth of industries and excessive competition for scarce resources. The policy has, however, been fairly liberally administered.

Generally, larger enterprises meet with less difficulty in raising block capital than smaller ones, and an objective of Government policy has been to aid the small enterprises, where they deserve help, through the provincial Industries Departments and Industrial Loans Acts.

For the rest, the financial institutions which play a prominent part in providing long-term and short-term capital are mainly banks, investment trusts and the financial corporations. At the end of 1947 the total number of banks (affiliated to the Reserve Bank) was 639 with paid-up capital of Rs. 450 million, and with 4,949 offices. The advances made by these banks as of that date amounted to Rs. 4,250 million and their deposits totalled Rs. 10,720 million. The advances of these banks were made either to industry against stocks or goods in process and to trade against stocks. Banks in India generally do not finance block capital although they do carry small portfolios of industrial securities. The bulk of the block capital of industries, therefore, is raised through public issues or private placements. Public issues are made generally through invitation to the public to subscribe to capital. Private placements are made with influential capitalists. But in either case the stock exchanges in India, particularly the important ones like those in Bombay, Calcutta and Madras provide the facility of transfer of capital, and the existence of a chain of stock exchanges facilitates the floatation of new capital.

Altogether, these institutions have been very helpful in raising capital for enterprises which are promoted by known industrialists or which carry limited risk. Where the enterprises are promoted by men who possess the necessary know-how but who do not enjoy established reputation with investors or where the enterprise though essentially sound carries greater risk and resort to the market is not so easy, special assistance facilities are necessary. Partly to remedy a lacuna of this kind and to help finance industrial enterprises which would have some difficulty in obtaining the necessary finance through established institutions, the Government of India established in 1948 an Industrial Finance Corporation with an authorized capital of Rs. 10 crores. The capital of this corporation is partly held by the Government and partly by the Reserve Bank of India, scheduled banks and insurance companies, investment trusts and other like institutions and co-operative banks. The capital of the corporation has been guaranteed by the Central Government as to the repayment of the principal and the payment of the annual dividend. The corporation is permitted to guarantee loans raised by industrial concerns or to current loans or advances to industrial concerns. During the last year the Corporation extended loans amounting to Rs. 14 million. An attempt is being made to establish similar corporations though on a smaller scale in the Provinces.

No account of the methods of financing economic development in India would be complete without a reference to the commercial organization peculiar to India known as the Managing Agency System. First developed in the middle of the last century, its influence steadily grew until it extended deep into the country's industrial, agricultural, banking and commercial life. Managing Agencies can best be described as partnerships or private limited companies, formed by a group of individuals with strong financial [illegible] and considerable business enterprise. They handle the pioneering and research work, promote joint stock companies, employ their own funds and arrange for widespread financing by acting as guarantors. They also provide the management, and act as agents for marketing the produce of their manufacturing interests, and for the purchase of raw materials, stores, machinery and equipment. The financial assistance rendered by Managing Agents is usually either in the form of direct loans, or as guarantors for advances made by Joint Stock Companies. The motive activating these diverse functions has been the "shyness" of capital, the lack of investment trusts and industrial banks, and the lack of enterprise and experience in management in the earlier stages of development. The Managing Agency system was confined to European firms originally, but its use was gradually adopted

/by Indian concerns.

by Indian concerns. Today it is in general use throughout the country, though the most important examples are found in the leading commercial centres of Calcutta, Bombay and Madras. Some of the Managing Agencies control up to 80 different organizations; and the activities of affiliated companies under one agency may include such diversified lines as tea estates, railroads, collieries, banks, insurance, shipping and others. The Managing Agency type of organization filled a real need in the country's economic life at the time it developed. However, today the growth and increasing specialization of the country's Commerce are reducing the usefulness of the Managing Agency system, and its influence will gradually decline. Government has sought to control some of the evil features of the system through legislation, and the development of alternative sources of finance has also acted as a healthful influence on the more questionable practices of the system.

III. Broad Appraisal of Methods of Financing

In a broad appraisal of the results achieved from the method employed, one is struck by the fact that just as the degree and character of economic development has to be adapted to the economic environment and the economic resources available, so the methods of financing have to be adjusted to the nature of the development for which such financing is sought. A reformed and renovated indigenous banking system which has the advantages of personal touch with and interest in the borrower's problems, a co-operative credit system which encourages the best traits in the farmer's character and restrains the worst elements of individual money-lending, land banks for long-term finance, co-operative sale and purchase societies, commercial banks for the finance of trade and short-term requirements of industry, industrial banks for the longer-term finance of industry, the stock exchanges and investments trusts - each of these institutions and methods has its peculiar contribution to make to the financing of economic development in a complex community. More important than the methods employed, which must continue to be variegated and specialized to fit the requirements of different situations, are the broad underlying factors which condition the level of savings and capital formation in a community. The inadequacy of facilities of financing is fundamentally traceable to the low level of savings and the shyness of capital (or the propensity for hoarding), while insufficient economic development may be due to deficiencies of initiative, enterprise, technical ingenuity and industrial leadership or limitations of economic resources. Generally the situation will be found to be characterized by a vicious

/(or virtuous

(or virtuous circle) of low incomes, low savings, low capital formation, low rate of economic development and low incomes again.

More concretely, the shortcomings of the existing situation in regard to domestic financing of development may be thus summarized: (i) Relatively high rates of interest; (ii) Difficulty for the small entrepreneur in the matter of obtaining credit; (iii) In the case of the Managing Agency system, the provision of finance is accompanied by too much control over enterprise and too high a share of profits; (iv) More fundamentally, however, difficulties of financing may also be due to low productivity and profitability of industry, in the present state of industrial techniques and technical efficiency.

High rates of interest are partly due to the lack of banking facilities and the resulting immobility of funds and partly to the risks attached to some forms of financing: the spread of banking facilities has been fairly rapid during the last few years, but it is doubtful if investing habits are being inculcated among the masses of the population to anything like the same extent. This remains one of the unsolved problems, and will, it is expected, only yield to education and propaganda over a long-term of years.

Difficulties of the small entrepreneur are being attended to more assiduously by direct Governmental assistance through the Industries Departments, but in this as in other spheres, finance by itself is not the "open sesame" to new frontiers of economic development. A pervasive improvement in technical ability and the multiplication of technical contrivances peculiarly suited for operation by the small worker are a sine qua non of successful industrial development through the small unit.

The evils of the Managing Agency system arose primarily out of the shortcomings of the environment in which it worked. No legislation can completely cure institutional defects or act as a substitute for a higher general level of ability and enterprise in the population. This, then - an improvement in the general ability and technical capacity and efficiency of the population is an essential prerequisite to a more satisfactory rate of economic development. The mere prolification of the machinery of financing will not achieve durable results in the direction.

The improvement of the machinery of financing does, however, remain important, and in this respect different countries may profit by the example and experience of other countries with a different or more complete institutional set-up for the domestic financing of economic development. In general, it will be found that a complex economic community requires a diversity of institutions, specially adapted to suit the requirements of different types and sectors of economic development. In the conditions of India it has been found in general that the co-operative solution is more suitable for relatively backward and small individual enterprises which require a certain paternal and protective care, and the wide extension of commercial financing facilities is better adapted to meet the requirements of larger and well-managed enterprises.

The above observations concerning improvements in the machinery of finance relate to the private sector of economic development. The foregoing brief survey, however, indicates that a good deal of the initiative for economic development, particularly in economically under-developed countries, comes today, and probably has to come, if the process is to be deliberately accelerated, from the State. No assessment of the efficacy and adequacy of domestic financing facilities in a country would, therefore, be complete without reference to the role of the State therein and to the policies which are most conducive to the encouragement of savings and capital formation, which ultimately condition the capacity of private and public (or Governmental) agencies together to promote the better financing of economic development. In this connexion it is of high importance to under-developed countries to scotch a current fallacy which retards a more speedy and rational development of the economies of under-developed countries. This is that "forced" saving is necessary to supplement the low level of voluntary savings in a poor community, and deficit financing can be the means of inducing such forced savings in the interest of a more rapid development than the rate of voluntary savings makes possible. Now, given the fact that a certain rate of development expenditure is incurred by the State, the use of resources on developmental purposes incidental to such expenditure must be secured by deduction from other uses (mostly consumption), and to that extent a forced saving of resources to finance development does take place. But, given the rate of development expenditure, this forced saving takes place whether the budget is in deficit, or it is in balance. If the budget is in deficit, i.e., if the State does not withdraw through taxation the amount of financial resources it expends on development as well as other purposes, inflationary forces are set up in the economy which enforce savings on different sectors of the community than if the budget were in balance. In the latter case, the enforcement of savings is in accord with a considered and well-thought-out

/pattern

pattern according to which the State withdraws resources from private consumption. A deficit, however, is rather an acknowledgment of failure to enforce the desired volume of savings, than of success in securing forced savings. A deficit does not merely mean that savings are imposed on different sections of the community than if the finance of development were procured through higher taxation or borrowing from the genuine investor: in so far as its inflationary effects result in a general marking up of values and levelling up of the cost structure, it may set up pressures which may make the necessary development extremely difficult of achievement. Apart, therefore, from the necessity of promoting conditions of economic stability in the economies of under-developed countries to enhance the incentives to foreign investment, the normally suitable objective of policy for the domestic financing of economic development is for the State to pay for its developmental expenditures through taxation and borrowing from the genuine investor, particularly under current inflationary conditions. The necessary expansion of the means of payment to sustain the expanding volume of activity in an economy undergoing development will in any case come about through the expansion of credit facilities on the basis of some enlargement of the cash base of the banking system through a degree of additional government borrowing from the banks, and it should be unnecessary to set up an objective of monetary policy different from that referred to above, in any programme of economic development or any plan of the means of its financing. In this connexion, the parallel sometimes drawn between the effects of pump-priming methods to lift an economy from the bottom of a depression, with large unemployed resources and unused capacity, and of inflationary finance to promote development is deceptive and incomplete. The capacity of an under-developed economy to expand production is small compared with the recuperative powers of a developed economy which is temporarily stricken with depression.

/Practices,

Practices, Methods and Problems Involved in the Domestic Financing of Economic Development in Mexico

Prepared by
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Mexico

Contents

/Oil and its derivatives

INTRODUCTION

This paper deals with the economic development of Mexico in recent years.

Because of the limitations of the statistics and of the available information in general, the investigation necessarily followed a special pattern and has been confined, at many points, to a statement of problems and trends without any detailed quantitative evaluation.

The paper is divided into four chapters:

I. Economic development of Mexico

II. The capital market

III. Repercussions of economic development on the Mexican economy

IV. Conclusions

The first chapter attempts to provide a quantitative evaluation, to the extent permitted by the incomplete statistical data, of the degree of development which Mexico has achieved and the various fields in which this development has taken place.

In the second chapter, the capital market is studied with special reference to existing institutions and current operations.

The third chapter attempts to assess the repercussions of the policy of public works and industrial development on the Mexican economy. Unfortunately, for lack of statistics, it was impossible to make a more detailed or exact evaluation.

The fourth chapter summarizes the conclusions drawn from the first three chapters.

CHAPTER I

The Economic Development of Mexico

I. General

The economic development of Mexico by the construction of public works, the modernization of agriculture and industrialization forms part of the economic policy of the Mexican Government.

Public works were initiated in Mexico in 1925 under the presidency of General Calles and intensified under subsequent administrations. They reached their peak during the presidencies of General Cardenas and General Avila Camacho and more especially under the Miguel Alemán administration. They have consisted mainly of roads, railways and electrification and irrigation works.

The policy of agricultural modernization was started about 15 years ago and has continued without a break until the present day. Modernization consists principally of the mechanization of field work, the employment of more advanced techniques, the use of fertilizers, etc.

Finally the industrial development of the country was really launched in 1940, when, as a result of the outbreak of war in 1939, a shortage of various industrial products began to be felt. As we shall see in a special chapter, the industrial development achieved by Mexico has resulted in the creation of openings for the employment of thousands of new workers and technicians, the modernization of various branches of industry, the self-sufficiency of Mexico in various industrial products, and, generally speaking, in a sounder basis for industrialization.

The economic development of Mexico has been particularly marked since the outbreak of the war. Between 1940 and 1948 the population of Mexico increased from 19,663,552 to 24,010,567 - i.e. by 4.3 millions with an average mean annual increment of 2.8% - while the national income rose by 32.9% and national investment by 48.2% annually. In dollars the increase is slightly less - 39.5%. If monetary influences are eliminated - in other words if the investment is calculated at 1940 prices - the increase is 11.4%

/Table 1

Table 1

MEXICO: NATIONAL INCOME AND GROSS INVESTMENT

YEAR	NATIONAL INCOME (millions of pesos)	GROSS INVESTMENT[1/] At prices for year (millions of pesos)	(millions of dollars)	Calculated at 1940 prices (millions of pesos)
1940	6,200	685	141	685
1941	6,900	851	175	798
1942	8,300	976	201	829
1943	10,500	1,114	230	784
1944	13,400	1,472	303	845
1945	16,000	1,942	400	1,002
1946	19,200	2,734	564	1,225
1947	20,300	2,802	579	1,185
1948	22,500	3,300	583	1,299

The available information is insufficient to furnish a quantitative evaluation of the various types of investment. It is known, however, that approximately 30% of the total investment corresponds to public works and that a substantial portion of the remainder is accounted for by Mexican industrial development. It is also impossible to determine the origin of the funds used to finance these investments, although it can be stated that the greater part was derived from Mexican resources. For purposes of comparison it should be noted that the loans obtained by Mexico from three foreign financial instituions - the Export-Import Bank in Washington, the International Bank for Reconstruction and Development and the Bank of America - between 1941 and early 1949 amount to 135,000,000 dollars, i.e. only 4.4% of national investment during the period.

1/ In these calculations inventory changes, variations in the monetary reserve and depreciation of existing capital are not taken into account. The discrepancy between the gross investment figures now presented and those contained in an earlier study (Antonio Carrillo Flores, "Financial Resources for the Economic Development of Mexico") is due to the fact that the figures published in that study include all durable goods, whereas durable consumer goods other than houses have been excluded from the present estimate.

All figures in the table are provisional and therefore subject to correction.

/II. Public works

II. Public works

The quantitative assessment of public works and the evaluation of their effects on the economy of a country are difficult tasks in themselves, and in Mexico they are further complicated by difficulties due to insufficient statistical data. In fact, our statistics still do not give sufficient prominence to figures relating to public works or make them easily determinable. As a result it is frequently necessary to make approximate calculations and to offer highly tentative conclusions. These circumstances must be borne in mind in appreciating the significance of the following figures and observations.

Before any figures are given, it should be pointed out that in Mexico public works are to be regarded fundamentally as an instrument of capitalization and not as a weapon against depression.

It is estimated that total spending on public works in the ten-year period 1939-1948 amounted to 5,062,000,000 pesos, distributed as follows:

Federation........................		4,266
Roads........................	1,562	
Irrigation....................	1,144	
Electric Power................	900	
Railways......................	260	
Other works...................	400	
Government of Federal District......		370
Other federative bodies............		341
Municipalities.....................		85

Assuming that gross investment during the same period amounted to approximately 16,500 million pesos, it follows that spending on public works amounts to 30.7 per cent of the total.

By providing the country with new capital goods, public works have undeniably raised the productivity of the economy. Further, because of the multiplier effect of the investments, they have increased the national income.

During this decade 86 per cent of the funds allocated to public works of all types were derived from domestic sources, 58 per cent from funds provided in ordinary official budgets, 28 per cent from domestic loans, and 14 per cent from foreign loans.

Total spending, and spending on public works. Table 2 shows the importance of spending on public works as compared with total spending by the various types of authorities during the most recent years for which information was available.

/Two things

Two things are striking, although not surprising: the great volume of spending on Federal public works as compared with other works, and in the case of other public works, the relative volume of spending by the Government of the Federal District, which is practically equal to that of all the remaining federative organs put together.

In this connexion the estimates made by the Bank of Mexico may be quoted. Figures published in the Bank's Annual Report for 1946 (pages 34 and 35) show that total spending on public works represented 23.8 per cent of the Federal budget in 1944 and 28.8 per cent in 1945.

Table No. 2

TOTAL GOVERNMENT SPENDING, AND SPENDING ON PUBLIC WORKS

(millions of pesos)

AUTHORITY	YEAR	TOTAL	PUBLIC WORKS		%
		(1)	(2)	%	(2)/(1)
TOTAL..........		3,244.0	762.1	100.0	23.5
Federation..............	1948	2,681.3 (a)	670.0 (b)	87.9	25.0
Federal District.........	1948	213.3 (c)	41.2 (c)	5.4	19.3
Other Federative organs..	1947	267.5 (d)	38.9 (d)	5.1	14.5
Municipalities..........	1946	81.9 (d)	12.0 (d)	1.6	14.6

Sources: (a) Bank of Mexico, Annual Report for 1949, page 103.

(b) Estimated.

(c) Department of the Federal District, Official Gazette, 10 May 1949, page 7.

(d) Directorate General of Statistics.

Principal Federal public works.- As it is impossible to analyze all public works, even those carried out by the Federation, we shall discuss only the most important Federal works, i.e. those connected with roads, railways, irrigation and electric power. The estimates of the Bank of Mexico, previously referred to, show that spending on such works - excluding electric plants, which are not taken into account - represented 86.4 per cent of the total spending by the Federation on public works in 1944 and 89.2 per cent in 1945. The remainder was spent on port works - dredging, shipyards, wharves and sea walls - and the construction of

/schools,

schools, barracks, airports, etc.

Roads.- With the establishment of the National Road Commission in 1925, the construction of highways in Mexico was started "in a formal and definitive manner". In 1941 the Commission was replaced by the National Directorate of Roads, which continued and gave fresh impetus to its work.

On 31 December 1948 the state of the road system for which the National Directorate of Roads was responsible was as follows:

	Total	Dirt Roads	Surfaced	Paved
		(kilometres)		
TOTAL	21,571	2,432	7,000	12,139
Under				
Maintenance Dept.	6,871	77	464	6,330
Construction Dept.	5,490	679	2,555	2,256
Co-operation Dept.	9,210	1,676	3,981	3,553

SOURCE: Secretariat of Communications and Public Works. Office of Information and Propaganda.

The National Directorate of Roads spent 1,872.6 million pesos between 1925 and 1948.

/Table No. 3

Table No. 3

EXPENDITURE ON ROAD CONSTRUCTION AND MAINTENANCE

(Millions of pesos)

YEAR	TOTAL	FEDERAL CONTRIBUTION			FROM STATES
		Total	Treasury Funds	Funds from Road Bonds	
1934	19.5	15.8	8.9	6.9	3.7
1935	30.0	25.3	13.3	12.0	4.7
1936	37.5	41.7	18.9	22.8	5.8
1937	59.7	49.7	24.4	25.3	10.0
1938	57.5	47.4	19.3	28.1	10.1
1939	48.8	39.2	6.7	32.5	9.6
1940	54.5	46.4	10.1	36.3	8.1
1941	86.1	76.5	12.6	63.9	9.6
1942	150.9	130.5	15.7	114.8	20.4
1943	173.7	157.9	44.1	113.8	15.8
1944	158.0	139.3	139.3	---	18.7
1945	169.7	151.9	50.9	101.0	17.8
1946	211.5	193.3	42.1	151.2	18.2
1947	202.0 (a)				
1948	306.8 (a)				

(a) Subject to correction.

SOURCE: Secretariat of Communications and Public Works. National Directorate of Roads.

/The figures

The figures for annual expenditure under this head from 1934 are given in Table No. 3, the contributions made by the Federation and by the states and the origin of the various funds being shown. Examination of the table shows the steadily increasing importance acquired by road construction. The size of the Federal contribution is obvious, as is the fact that, except in 1934 and 1935, funds derived from the sale of road bonds exceeded the sums supplied by the Federal Treasury from budget appropriations.

The total revenue from the tax on petrol consumption, from its establishment in 1925 until 1948, amounted to approximately 1,050 million pesos. Since 1933 the federative organs have shared in this tax, which was established with the intention that the revenue should be used for the construction of highways; but, as the revenue was insufficient, recourse had to be made in 1934 to public loans and road bonds were issued.

The construction of highways has implied a high level of spending in Mexico. It has been estimated that only 6.4 per cent has been spent abroad - principally for the purchase of construction machinery, spare parts for maintenance, structural steel for bridges etc. It is impossible to give exact figures for sums spent in the country under various heads; however, remuneration of the labour force is obviously large and may be estimated to represent two-thirds of the domestic cost. In this connexion the National Directorate of Roads, in its progress report for 1941 (page 29), states: "In the execution of all the works already described use was made of a great number of workers, since experience acquired during the seventeen years in which such work has been carried on in Mexico shows that in most cases, especially in the construction of dirt roads, is more economical to use labour than machinery. This does not mean, of course, that on many occasions, particularly for specific operations, use is not made of the most modern machinery manufactured, or of the most advanced construction techniques".

Railways. - It is common knowledge that most of the Mexican railways were constructed between 1880 and 1910, during which period 18,640 kilometres of track were laid, which, added to the 1,079 kilometres already constructed in 1880, give a total of 19,719 kilometres. During the next thirty years (1910-1939), however, only 729 kilometres of main line were constructed.

During the 1934-1940 presidential term work was started on the construction of some railway lines; the situation on 31 December 1948 is shown in Table No. 4.

/Table No. 4

Table No. 4

STATE OF CONSTRUCTION OF PRINCIPAL RAILWAYS
ON 31 DECEMBER 1948

LINE	KILOMETRES CONSTRUCTED	AMOUNT SPENT (Millions of pesos)
Total	1,374	313.9
South-Eastern	724	224.5
Sonora-Lower California	523	65.4
Caltzonzin - Apatzingan	127	24.0

SOURCE: Secretariat of Communications and Public Works, Office of Information and Propaganda.

In railway construction relatively little of the spending was covered by domestic loans. According to the Public Accounts of the Federation, this type of spending amounted in 1949 to 9.7 million pesos, in 1942 to 16.2 million pesos, and in 1943 to 15.2 million pesos, giving a total for the three years of 41.1 million pesos.

Spending and purchases in Mexico in respect of material and labour are estimated at approximately 80 per cent of the total investment in railways. The remainder was spent on the importation of material and equipment.

Beginning in 1945, the Export-Import Bank granted credits to the amount of US $26,000,000 for the purchase of locomotives, trucks, rails and all types of permanent-way equipment and rolling-stock for the Mexican National Railways. All these credits have now been wholly utilized and additional credits to the amount of US $17,900,000 have recently been obtained from the same bank for the rehabilitation and development of the country's railway system: US $12,900,000 for the National Railways and US $5,000,000 for the South Pacific Railway.

Irrigation. - Irrigation works are second in importance only to road works. Between 1926 and 1948 the total investment amounted to 1,310 million pesos.

In 1941 and 1942 irrigation bonds were issued and, according to the Federal Public Accounts, the funds raised were used to finance the spending of 38.7 and 57.6 million pesos in 1941 and 1942 respectively, making a total of 96.3 million pesos.

It is estimated that 10 per cent of the investment in irrigation works is

/spent abroad

spent abroad for construction machinery and equipment. As regards other costs, it is calculated that wages absorb 45 per cent, construction materials 35 per cent and engineering, administration and miscellaneous expenditures 10 per cent. In the report of the Bank of Mexico to the Bank of Reconstruction and Development, in which this analysis of costs is given, it is pointed out that the figures "may be regarded as estimates and therefore accepted with considerable reserve".

Electric power. - The capacity installed between 1939 and 1948 by the Federal Electricity Commission - established in the earlier year to accelerate the electrification of the country and to supplement private investment - was 115,992 kW, or 11 per cent of the country's total capacity. The Chapala Electric Company, owned by the Federal Government, produces 42,500 kW or 5 per cent of the national total.

Up to October 1948 investments by or through the Federal Government amounted to 874.1 million pesos, distributed as follows:

National		380.0
10 per cent tax	90.2	
Federal budget	99.8	
Electrical industry bonds	130.0	
Nacional Financiera	60.0	
Foreign		494.1
Export-Import Bank	164.5	
Bank of Reconstruction and Development	238.7	
Other Sources	90.9	

In August 1949 the Federal Electricity Commission had under construction plants with a total capacity of 301,696 kW and plans for plants with a total capacity of 406,472 kW.

III. Agriculture

No figures for investment in Mexican agriculture are available. Nevertheless, the data given below are sufficient to give an idea of the degree of agricultural development in Mexico. This development has arisen directly out of the radical changes enforced by the Agrarian Revolution and has affected the numerically largest section of the working population of the country. All the projects, experiments and changes have been transformed into a practical school for the peasant, who is educated in soil management, pest prevention, the use of water,

/fertilizers,

fertilizers, better seeds and modern machinery, and the responsibility he assumes in connexion with the loans he receives.

Agricultural production. - The acreage harvested and its production has increased significantly in 15 years, as can be seen from the following representative figures:

	1932	1938	1939	1945
Hectares harvested	5,189,372	5,346,696	5,652,257	6,313,979
Maize (tons)	1,973,469	1,692,666	1,976,731	2,186,194
Wheat (tons)	312,532	386,349	428,724	346,757
Beans (tons)	131,840	105,499	148,162	161,729
Rice (tons)	72,382	80,119	103,078	121,108
Sugar-cane (tons)	3,404,958	4,132,260	4,555,981	6,742,087
Cotton (tons)	22,015	66,494	67,645	97,586

Generally speaking, agricultural production as a whole has increased substantially during the last few decades, with a simultaneous increase in domestic and foreign sales.

Between 1938 and 1947, 96 main agricultural products were exported and 137 imported and the volume of both imports and exports increased: average annual exports and imports between 1938 and 1942 were $439,987,000 and $299,345,000 respectively, whereas in 1947 the figures were $1,064,532,000 and $754,917,000 respectively. The principal exports are cotton, coffee, sisal, chili, tomatoes, oleagineous pastes, groundnuts, vegetable waxes, ixtle, bananas, oils, fats, linseed, canned meat and timber. The principal imports are: wheat, artificial fibres of vegetable origin, lard, wool, crude rubber, powdered milk, malt, copra and coconuts, eggs, resins, timber and flour.

Land tenure. - Between 1916 and the present day a large proportion of the productive lands have been placed in the hands of the peasants, with a consequent change in the area, organization and ownership of holdings and in working conditions. The bulk of the lands handed over to the peasants came from the large estates typical of the pre-revolutionary regimes. As a result of the restoration and allocation of these lands, and of their extension when found inadequate, the situation of land tenure, according to the census of 1940, was as follows:

/Table No. 5

Table No. 5

PRIVATELY-OWNED AND COMMON LANDS

(Hectares)

TYPE	TOTAL	PRIVATELY OWNED	COMMON
Arable	14,954,167	7,908,950	7,045,217
Pasture	56,179,177	45,520,261	10,658,916
Woods	38,655,219	31,782,795	6,872,424
Uncultivated productive	8,808,456	7,111,979	1,696,477
Agriculturally unproductive	10,813,054	8,164,829	2,648,225
Total	129,410,073	100,488,814	28,921,259

In 33 years of agrarian re-distribution half of the arable lands have passed from private ownership to common ownership, i.e. from the latifundio worked by wage labour - the hacienda - to the minifundio a common holding averaging 4 hectares and worked by holders of commons (ejidatarios).

Agricultural workers. - The number of inhabitants engaged in agriculture, stockraising, forestry, hunting and fishing was as follows:

CENSUS	NUMBER OF PERSONS	ABSOLUTE INCREMENT	ECONOMICALLY ACTIVE POPULATION, AS PERCENTAGE OF TOTAL
1921	3,488,102	---	71.4
1930	3,626,278	138,176	70.2
1940	3,830,871	204,593	65.4

In spite of the absolute increases, the relative decline in the population engaged in agriculture during the last twenty years is significant and is due principally to the industrialization of the country and to technical progress in agriculture.

Climate and irrigation. - The most serious obstacle encountered by Mexican agriculture has always been the inadequacy of the rainfall, which is insufficient, irregular and torrential. As a result, from pre-colonial times the irrigation of his lands has been a principal concern of the Mexican farmer. According to the 1940 census, up to that year water had been brought to 1,899,211 hectares, or 12.6 per cent of the total arable land. The most substantial effort to offset the

/disadvantages of

disadvantages of aridity by means of irrigation has in fact, however, been made during recent years. The National Irrigation Commission, which gave rise to the present Secretariat of Hydraulic Resources, was established to irrigate new areas and to improve existing irrigation systems. The execution of this policy brought water to 816,224 hectares up to 1946, to 120,307 in 1947 and to more than 200,000 in 1948. This means that, in the last-mentioned two years alone, more than one-third of the land irrigated before 1946 and more than one-sixth of the land irrigated since the arrival of the Spaniards more than 400 years ago was irrigated and improved. The total land capable of irrigation is approximately 7 million hectares.

Soil management and the use of fertilizers. - Soil management and conservation and the maintenance of fertility have always been unsatisfactory. During the last twenty years increasingly effective steps have been taken to prevent soil erosion and exhaustion. An attempt has been made to reduce the haphazard cutting of forests, excessive grazing, inadequate irrigation and single-cropping, combined with a campaign in favour of contour ploughing, terracing, crop rotation and the use of fertilizers.

As the result of poor management, unirrigated lands have been exhausted to such a point that they are no longer capable of yielding a crop each year; as a result only half of the land available for cultivation is sown each year, the rest being left fallow to be sown the next year. Apart from animal manure, which is used only on a small scale, fertilizers have not been used in significant quantities. The production and importation of fertilizers has always been scanty. There was, however, an increase over a period of twelve years, from 9,259 tons imported in 1934 to 20,763 tons in 1945. The imports consist principally of Chilean saltpetre, sulphate of ammonia, potassium chloride, superphosphates, and other chemical, organic and mixed fertilizers.

During recent years serious consideration has for the first time been given to the solution of the fertilizer problem, and 50,000 tons of superphosphate of lime are now being produced with imported raw material, 2,500 tons of seabird guano and 3,500 tons of bonemeal. A sulphate of ammonia plant will be completed in 1950 and will produce 70,000 tons a year, which, when used for the manufacture of complete fertilizers, will be capable of fertilizing 240,000 hectares. This area, although large, is roughly only one part in 62 of the area requiring fertilizers. The yield of maize, wheat, rice, beans and sugar-cane is at least doubled, if fertilizer is

/used, because

used, because of the present exhaustion of Mexican soils.

Genetic improvements and pest prevention. - Maize is the staple diet of rather more than three-quarters of the Mexican people, of all but infants and persons with a relatively high standard of living. Every year more than half the sown acreage in Mexico is under maize. Nevertheless, this crop has always been grown in a very primitive manner. Moreover, lack of planning and the vagaries of the climate have frequently resulted in alarming shortages.

To remedy this state of affairs the present Government set up the Maize Commission, by decree of 4 January 1947. This body has dealt in a methodical way with the various problems connected with maize. One of the most successful aspects of its work has been the improvement of seeds by genetic methods carried out by the Rockefeller Foundation. The varieties and hybrids obtained have resulted in increased yield and resistance to acame, drought and diseases, and in some cases have shortened the growing cycle. Efforts are also being made to improve the dietary use of the cereal.

The Maize Commission has set up a large plant near Selaya, Guanajuato, where genetically-improved seed is selected for size and shape. Excess moisture is dried off and the seed is put up in bags and distributed to the farmers for use.

The Commission has 1,350 trial fields where the seeds are tested. In 1947 it supplied seed for 3,000 hectares and in 1948 for 250,000 hectares. This year it is supplying seed for 300,000 hectares. The hybrid maize has been divided into three types according to the proper altitude for its cultivation: the first is for areas between sea-level and 1,000 metres, the second for altitudes between 1,000 and 1,900 metres, and the third for altitudes over 1,900 metres.

Important improvements from the genetic point of view have also been made in wheat, beans, sesame and rice. For wheat the objects - to obtain greater yield and resistance to chahuixtle and acame - have been achieved with reasonable success. There are sufficient seeds possessing these qualities to sow 50,000 hectares of wheat next spring.

The prevention of pests and agricultural diseases has been undertaken in a systematic and intensive way only very recently. During the last few years large sums have been invested in this work and a new directorate has been set up in the Secretariat of Agriculture.

Agricultural machinery and other investments. - Techniques of using agricultural labour, like agricultural techniques generally, have made little

/progress.

progress. The Mexican farmer still produces largely for his own consumption and as a result his crops and his work are highly diversified. The predominance of smallholdings also helps to strengthen this tendency. The machinery, agricultural implements and vehicles employed are generally antiquated: there are still more native than mouldboard ploughs; although the number of mouldboard ploughs is increasing and displacing the old ploughs. The number of mechanical seed-drills is also increasing, as is the number of iron harrows, cultivators, reapers and threshers which replace animal power; rails are giving ground to motor-threshers; the number of fodder cutters and balers is also increasing. Primitive carts and wagons are being largely replaced by motor-lorries as quickly as roads permit, as are draught animals by tractors where the topography, climate and size of fields are suitable. The number of stationary engines has also greatly increased.

At the time of the 1940 census the numbers of machines and agricultural implements in Mexico were 729,727 mouldboard ploughs, 925,407 native ploughs, 27,125 mechanical seed drills, 32,530 iron harrows, 69,079 mechanical cultivators, 5,037 mechanical reapers, 1,989 threshers, 1,503 motor-threshers, 3,742 hand-thresher hand-threshers, 2,216 fodder cutters, 2,095 fodder balers, 130,628 carts and wagons, 5,980 motor-lorries, 4,604 tractors and 8,913 stationary engines. In 1940 the average annual cultivated acreage of 8 million hectares was tilled with this equipment assisted by primitive tools and implements such as spades, mattocks, hoes, forks, wooden harrows, machetes, sickles and scythes.

There has been a substantial increase in all the figures given in the previous paragraph. Between 1941 and 1948, 202,573 ploughs, 24,670 tractors, 40,835 machines of other types, and 31,198 tons of spare parts and miscellaneous agricultural equipment were added to the nation's stock of agricultural machinery by import alone.

Agricultural installations generally and buildings in particular are not highly specialized but are mostly suitable for various uses or easily adaptable to them. Special barns, silos, stables, cold stores and processing plants for agricultural products are rare and small, with the exception of sugar mills, coffee-processing plants, cotton gins, a few fruit and fruit-juice packing plants, and others of less importance.

Agricultural credit. - During the revolutionary period agricultural credit was taken over by the Government. It is provided for holders of commons by the Banco Nacional de Crédito Ejidal, and for smallholders and stock-farmers by the

/Banco Nacional

Banco Nacional de Crédito, Agrícola y Ganadero. The sums provided as loans for holders of commons have increased year by year. In 1936 the amount lent was 23,277,692.43 pesos, and in 1947 it was 179,312,238.92 pesos. In the period between 1936 and 1947 the total amount lent amounted to $1,052,319,433.61 and repayments to $782,647,862.58, indicating that 25.5 per cent of the amount lent was not repaid. The numbers of associations and of their members, organized and in operation, have also increased steadily. In 1936 there were 3,679 associations organized and 3,002 in operation, with 308,729 and 257,363 members respectively. By 1947 the organized associations had increased to 6,359 and those in operation to 3,912, with 480,661 and 254,176 members respectively. The operations of the Banco Nacional de Crédito Agrícola have also increased. In 1943 it lent $13,972,868 and in 1947 $33,794,970. During that five-year period it lent $121,002,030, of which $86,937,375 was repaid, leaving 28 per cent of the amount lent outstanding. The number of associations in operation increased from 304 in 1943 to 454 in 1947, and the number of members from 8,292 to 13,758.

The loans made by both banks consisted of installation loans, repair loans, real-estate loans, pledge loans and direct loans, and were used specifically for the cultivation of maize, cotton, wheat, beans, rice, potatoes, chili, tomatoes, sesame, goundnuts, sugar-cane, coconut, small coconuts, castor oil, tobacco, lucerne, Bananas, coffee, etc.

Efforts have been made to ensure that the loans should be increasingly timely, adequate and cheap ant to increase the certainty of their repayment.

Forestry. - Most of the cultivable land in Mexico was once covered by forest. The forests have steadily decreased and have not been rationally exploited. In 1939 there were 38,655,219 hectares classed as "forest" (19.7 per cent of the national territory). Of this area 36,869,173 hectares were unexploited and 1,786,046 hectares were being cut (4.6 per cent of the total forest area). During recent years energetic measures have been taken to prevent the irrational exploitation of forests. In the twelve years between 1934 and 1945 the value of forest production amounted to $1,137,218,000, with a maximum value of $195,001,000 in 1944 and a minimum of $21,031,000 in 1940. The most important species in the tropical forests of Mexico are red cedar, mahogany, primavera, and rose morada, which produce cabinet woods, and approximately 100 species producing hard and soft woods. In the high woods of the temperate and cold region the most important species are pine, fir, white cedar and oak. In the semi-arid regions guayule,

/candelilla,

candelilla, ixtles of palm and lechuguilla and guapilla are exploited. Charcoal is obtained chiefly from oak, mesquite and huizache. In general, wood is not distilled. The forests also yield rubber, guayule, chicle, resins, dyewoods, waxes, oilnuts, fibres, etc.

Pasture land and stock-raising. - The area of pasture land is tending to increase, largely at the expense of the forests, which are being destroyed. According to the 1940 census Mexico then had 56,179,177 hectares of pasture land, occupying 28.5 per cent of the national territory. The pastures have not always been rationally used and in some areas have been destroyed by over-grazing.

According to the 1930 and 1940 censuses the numbers of livestock of the various types and the rate of increase of each type were as follows:

Table No. 6

INCREASE OF LIVESTOCK IN MEXICO

LIVESTOCK	NUMBER OF HEAD		INCREASES	
	1930	1940	Absolute	Relative %
Swine	3,698,233	5,105,946	1,407,713	37
Horses	1,887,478	2,509,398	621,920	33
Mules	751,343	938,688	187,345	25
Sheep	3,673,887	4,452,423	778,532	21
Cattle	10,082,958	11,590,964	1,508,006	14
Asses	2,159,734	2,318,722	158,988	7
Goats	6,544,129	6,843,903	299,774	6

The present livestock population has been calculated by extrapolation, and it is estimated that there has been a considerable and steady increase of each variety.

Foot-and-mouth disease broke out in a virulent form in 1946 in the State of Vera Cruz and infected the area bordered by 92° west and 22° north. A joint commission, using Mexican and United States experts and capital, was formed to combat it. The commission first decided in favour of the slaughtering of infected animals; from 27 March 1947 to 6 March 1948 the "rifle sanitario" gave the following results:

ANIMALS SLAUGHTERED AND COMPENSATION PAID IN THE AREA INFECTED WITH FOOT-AND-MOUTH DISEASE

LIVESTOCK	NUMBER OF HEAD	COMPENSATION PAID
Cattle	484,637	117,789,235.30
Swine	144,971	5,405,682.38
Sheep	63,063	1,336,291.66
Goats	244,442	5,403,686.69

The number of head of cattle slaughtered represents 3.4 per cent of the estimated cattle population for 1947, while the number of sheep, swine and goats slaughtered was 2.3 per cent of the total population. The prevention of foot-and-mouth disease by slaughtering was replaced by vaccination and strict quarantine. The production of vaccines has increased from 36,000 to 2.5 million doses a month. Nineteen million doses of vaccine have been administered, covering the whole livestock population of the infected zones and neighbouring regions.

One of the most serious economic consequences of the appearance of foot-and-mouth disease was the suspension of cattle exports, which in 1946 had reached a value in excess of 100 million pesos for cattle alone. This difficulty was circumvented by the establishment of meatpacking and canning plants, of which there are now 17, situated as follows: 5 in Sonora, 5 in Chihuahua, 3 in Coahuila, 1 in Nuevo Laredo, 1 in Durango and 2 in Tamaulipas. The establishment of these plants represents a capital investment of $55,300,000.00. Their output in 1948 was:

Gross exports of frozen meat	$ 23,226,374.50
Exports of canned meat and other canned products	330,880,551.89
Domestic sales	13,412,579.26
Stocks	17,842,033.80
TOTAL	$385,361,539.45

<u>Fisheries</u>. - Mexico has a coastline of 9,219 kilometres, 6,608 kilometres on the Pacific Ocean and 2,611 on the Gulf of Mexico and the Caribbean. It also possesses approximately half a million square kilometres of the continental platform and 6,500 square kilometres of inland waters (lakes, lagoons, reservoir ponds and rivers), the whole providing a wide area of rich fisheries.

Only in recent years has there been a significant increase in the number of fishermen. It is estimated that there are now in 1949, approximately 18,000 fishermen in Mexico, almost half of whom belong to co-operatives and one-quarter to

/syndicates,

syndicates, the remainder being unorganized.

In 1941 the fishing fleet consisted of 3,548 vessels displacing 7,881 tons. In 1945 the figures had risen to 4,910 vessels and 16,127 tons. Most of the vessels are of less than three tons. There has also been an increase in fishing gear.

The production of the fisheries rose by 70,519 tons in 1940 to 114,000 in 1946. The value was $34,434,116.00 in 1940 and $115,746,651.99 in 1946. Of the total catch during this period, 50.64 per cent was made by foreigners and 49.36 per cent by Mexicans.

In Mexico fish is not customarily a regular item of diet. Between 1940 and 1946 only one-quarter of the fish caught in Mexican waters was consumed in Mexico. Nevertheless, consumption has increased from 0.75 kilogrammes a head in 1940 to 1.7 kilogrammes in 1946.

IV. Industry

The industrial development of Mexico has been most marked since the outbreak of the war, when a shortage of various articles for which Mexico depended on foreign sources began to be felt. As this shortage was likely to increase and many imported products were urgently needed, the Mexican Government, in collaboration with industrialists, gave an impetus to national industry. In the short period of one decade the industrial structure has changed greatly with the establishment of many factories throughout the country. The increase has been so marked in some areas that there are now new industrial centres of some size - like Tlalnepantla in the State of Mexico - where ten years ago none existed. However, the growth of the principal industrial towns, such as Mexico, Monterrey and Guadalajara has been accelerated by the establishment in them of a great variety of industries.

The Government policy of support for the industrialization of Mexico has been expressed in various ways. In 1941 the Manufacturing Industries Law was enacted, under which tax exemption was granted to industries regarded as new and necessary. Customs policy, the granting of subsidies, and the establishment of the Nacional Financiera, one of the most important of whose functions is the promotion of industry, are directed towards the same end.

In the absence of adequate statistics it is impossible to provide an accurate quantitative statement of the industrial development achieved by Mexico during recent years. The indices of industrial production and other information show, however, that it has been intense.

<u>Industrial production.</u> - According to the index of volume of production, the industrial production of Mexico increased by 35 per cent from 1939 to 1948, with a maximum increase of more than 5 per cent in 1945 and an average annual increase of a little under 4 per cent. The actual increase is, however, greater, since the industrial index does not include industries established during the last few years (Table No. 7).

/Table No. 7

Table No. 7

PHYSICAL VOLUME OF INDUSTRIAL PRODUCTION

1929 = 100

Year	General index	Mining and Metallurgy: Total	Mining and Metallurgy: Gold and silver	Mining and Metallurgy: Industrial materials	Crude Oil production	Refinery production	Electric power	Manufactures: Total	Manufactures: Textiles	Manufactures: Beer and cigarettes	Manufactures: Clothing and cosmetics	Manufactures: Miscl.
1939	119.95	76.97	80.77	74.30	96.00	181.07	151.42	144.37	127.05	191.92	136.03	120.55
1940	119.61	75.03	86.76	66.85	98.55	162.17	154.39	153.66	135.98	209.97	121.58	136.71
1941	124.94	76.27	81.49	72.63	96.35	176.67	154.11	163.72	149.85	213.66	126.00	152.53
1942	131.75	86.75	86.36	87.02	77.92	172.43	160.36	180.15	162.71	246.76	122.49	169.17
1943	137.54	87.43	82.68	90.75	78.69	186.47	167.33	189.88	164.53	287.46	91.33	185.95
1944	141.39	77.92	69.57	87.74	85.50	197.27	168.05	207.41	167.11	344.85	98.88	191.45
1945	150.69	79.24	59.98	92.67	97.46	214.66	187.49	219.10	162.69	356.78	110.34	237.56
1946	155.30	59.80	44.36	70.56	110.19	237.81	202.73	239.61	160.64	421.02	112.10	261.28
1947	161.70	78.03	57.31	92.49	125.97	273.74	219.85	210.25	147.40	341.99	97.08	258.03
1948	162.49	71.03	53.56	83:22	130.94	265.64	242.49	217.40	153.32	357.31	109.85	250.23

SOURCE: Bank of Mexico.

The following conclusions may be drawn from the movements of the various components of the index:

Mining and metallurgy hardly maintained the 1939 level, in spite of a slight and brief recovery in 1942-1943.

The production of oil and oil derivatives increased considerably, especially in 1945-1948. However, the intense industrial expansion characteristic of the whole period was felt by the manufacturing industries, which increased by 46 per cent according to the production indices. The real increase is certainly greater.

The branches of industry advancing most rapidly are: preserved foods, beer, soft drinks, sugar, rubber articles, cement and other construction industries, textiles and paper. The expansion of other industries not separately represented in the index, such as iron and steel, metal manufactures and chemical products, has been equally spectacular.

New industries. - Although there are not sufficient data for a statement of the number of firms established in this period of rapid development, the number benefiting by the Manufacturing Industries Law was 350 in 1945 and 585 in 1948.

Nor are there sufficient data for a quantitative estimate of the importance of the new industries in Mexico. Nevertheless, the following comparison indicates their significance.

The following figures relate to 27 major industries selected from the 172 assisted by the Nacional Financiera by investment in the securities of the firms concerned or the granting to them of loans. The total investment in the 27 industries is 910 million pesos, and the value of their production, based on plant capacity, is 785 million pesos.

The industrial census of 1940 reported a capital investment of 3,135 million pesos and a production of 3,077 million pesos for industries with a minimum annual production of 10,000 pesos. In other words, the 27 firms represent 29 per cent of the capital investment and 25.5 per cent of the production reported in the census returns.

Industrial workers. - No satisfactory figures are available for the present level of industrial employment, but the information contained in the census of 1940 and the 1944 sample show the rapid absorption of the labour force into secondary occupations.

/Employment in

Employment in Manufacturing Industries

	Number of persons	Increase
1935 Census	318,041	
1940 Census	389,953	71,912
1944 Sample*	559,168	169,215

* Includes establishments regardless of value of production, while the censuses include only firms with a minimum production of 10,000 pesos.

The increase in industrial population has resulted from the natural increase of the economically-active population and from migration from less productive activities, principally agriculture.

Electric power. - The new demand created by the expansion of industry and the higher level of personal income resulted in a shortage of electricity during the war. The Federal Electricity Commission and the companies intensified their efforts and in the course of eight years more than 350,000 kW were installed, raising the country's total capacity from 680,000 to rather more than 1,000,000 kW. The bulk of the installations were erected in the Central Zone; Ixtapantongo was built with 56,000 KW, Nonoalco was increased by 50,000 kW, and a ninth unit was installed at Necaxa with 16,000 kW. Thermo-electric stations of 25,000 kW capacity were built at Tacubaya, La Laguna and elsewhere.

The number of persons employed was almost doubled in ten years; capital investment, according to the figures of the Chamber of the Electrical Industry, increased to approximately 1,600 million pesos in 1948 and in the process the participation of national capital was increased; output increased between 1945 and 1948 by some 1,200 million kWh, and per capita consumption increased 30 per cent between 1939 and 1947. The process of growth is continuing and there are now 42 plants under construction with a capacity of approximately 400,000 kW.

Oil and its derivatives. - The principal sources of Mexican oil are the four traditional fields of Pánuco-Ebano, Faja de Oro, Zona del Istmo and Poza Rica, whose reserves represented 90 per cent of the country's total reserves. The prospecting carried out during the present decade, and more particularly during the last two years, is intended to provide a wider source of supply and thus to eliminate the various problems, chiefly of distribution, inherent in this excessive dependence on a single producing centre.

In spite of difficulties of various kinds, the results of the prospecting seem to have been satisfactory. The new fields of Moralillo, Reynosa, Moloacán,

/Baladeces,

Baladeces, etc., in the north-east of the country, which produce oil and gas, hold out hope of substantial production. The discovery of new reserves has moreover always more than kept pace with extraction, resulting in a net increase of reserves as follows: 1938, 825 million barrels; 1946, 850 million; and 1949, 1,270 million.

Production did not begin to rise until 1944. As a result of expropriation and the situation it created, the oil industry was somewhat late in joining the general movement of expansion. Its development has, however, been considerable during the last four years. The production of crude oil rose from 5 ½ million cubic metres in 1943 to approximately 9 million in 1948, while the production of derivatives rose from 7 to 10.5 million. It was also decided to initiate works for the utilization of natural gas, and the Poza-Rica-Atzcapotzalco pipeline has now been completed, with a maximum capacity of 100 million cubic feet a day.

There has been a notable change in the markets on which the oil industry relies. The foreign market, which in 1937 absorbed more than half the total sales, was reduced in 1948 to little more than 20 per cent of sales, while the domestic market increased to more than 75 per cent. This new development has led to the planning and construction of a network of pipelines into the interior of the country and the establishment there of large refinery centres.

Mining. - Mexico's position as one of the world's producers has varied during the period under review. There was a marked decline in the production of gold and silver; the production of minerals for industrial use increased, but the volume of mining production generally was barely maintained.

The principal development in this decade has been the reduced share of mining in Mexican exports (it fell from 68.4 per cent by value in 1939 to 25 per cent in 1946, and rose in 1947 to 40 per cent) and its increased contribution of raw material to national manufacturing industries. Whereas formerly, it gave rise to no industry, it is now the basis of numerous industries. Reference need be made only to the electrolytic refining of copper, which is now carried out in Mexico, and the various allied industries which have developed with it: rolling, alloys, casting, fungicides, electrical equipment etc.

Manufactures are the most important element in the national income of Mexico, although they employ little more than one-tenth of the economically-active population.

Their expansion has been intensive and continuous. It began during the early years of the war and subsequently gained increased impetus. The so-called basic

/industries -

industries - principally the iron and steel industry, which tripled its production between 1940 and 1947 and provided a sounder basis for the manufacturing industries; the metal industries, eager to replace foreign products no longer available on the market; the food industries (chiefly beverages, canned goods and sugar), stimulated not only by the foreign market but also by the increased consumption level of the population generally; the glass and tile industry, and the industries producing rubber articles, chemicals and fertilizers, were outstanding in this process of development.

As a result of this process of expansion there was an increase in the industrial unit, which had been typically small as regards both the number of workers employed and its capital. Technical resources also improved, with the use of new methods of production and up-to-date techniques. These were consolidated by the establishment of official industrial standards which ensure that the quality of products is uniform and satisfactory. The standards established for cement, the material used in the construction of our dams and irrigation works, are among the highest in the world.

At the same time industry has been modernized, not only by the establishment of new undertakings with up-to-date equipment and techniques in the chemical, fertilizer, refrigeration and textile industries, etc., but also by the replacement of equipment and the introduction of new production and marketing methods in existing enterprises, especially those producing glass and tiles and rubber articles.

The supply of raw materials, although still largely dependent on foreign sources in various branches, is now based chiefly on national products.

National self-sufficiency is increasing in various industrial products. It is completely assured in some, such as sugar and cement, and partly in others, such as canned foods, glass, and iron and steel.

Manufactured goods have occupied a more important place in Mexican exports, although they have declined in the last two years. The value of exported manufactures increased from 1 per cent of total exports in 1939 to 20.6 per cent in 1948, with a maximum of 35 per cent in 1945-46. Imports of consumption goods have been reduced, while there is a very active trade in production goods and equipment. For example, imports of generating plant and other machinery intended principally for industrial use rose from 38 million pesos in 1940 to 350 in 1947.

/CHAPTER II

CHAPTER II

The Capital Market in Mexico

I. General.

In the preceding pages we have mentioned some of the most significant aspects of economic development in Mexico achieved in recent years. We shall now examine some characteristics of the capital market, i.e., the institutions through which the economic activities have been financed, the operations used to this end, and the manner in which the financial resources have been distributed.

The capital market in Mexico is not, as might be supposed at first sight, a mechanism operating in accordance with traditional principles and capable of strict comparison with the financial markets of highly - industrialized countries such as the United States and England. Although its function is similar, there are some peculiarities in the form of its organization and even its structure to which attention will be drawn in this discussion.

One of the characteristics of the economic and social structure of Mexico is insufficient national income, both absolute and relative. Notwithstanding the considerable increase in the national income and the effort to continue to increase it by joint public and private activity, the per capita income of Mexicans continues to be low compared to that of the inhabitants of a country of average development.

To this must be added the fact that the distribution of the income results in a situation which has a marked influence on the structure of the capital market. There is on the one hand a small population group whose high income gives it a wide margin of saving, and on the other a mass million strong who can hardly satisfy their most pressing needs.

Considering the problem as a whole, there would appear to be no gainsaying that notwithstanding its increased importance in relation to income, voluntary saving in Mexico is insufficient to maintain a volume of investment capable of assuring maximum levels of employment and production. This explains why Mexican financial policy has been dominated, especially in recent years, by capitalization.

In a country like ours - as the Mexican Minister of Finance said in 1946 - with vast undeveloped resources, a low standard of living and a population mostly still practising agriculture by rudimentary techniques and with uncertain results, it seems undeniable that the need which will most require constant attention, and to which, when necessary, all others must be subordinated, is to achieve greater capitalization

/than we

than we have today and at a slower rate. Only in this way will it be reasonable to expect in the long run better and fuller utilization of our natural potentialities and a progressive raising of the standard of living of our people. 1/

During the last fifteen years there has been a remarkable expansion of the capital market, expressed in several factors, some of which we have examined:

1. Constantly increasing national income.

2. Increasing volume of savings.

3. Increasing volume of investment and higher industrial agricultural production.

4. Better utilization of savings.

5. Progress in the organization and operation of the State, of credit, and of economic activity in general; and

6. Expansion and strengthening of the securities market.

After these preliminary explanations we shall try to give an overall picture of the financial mechanism of Mexico, and shall begin by examining its most important bodies and institutions.

II. <u>The State and the capital market.</u>

The most important organ participating in the capital market is the Federal Government, not only because of its position as the authority which enacts laws and measures affecting the operation of the market, but also because of its active intervention in capital supply and demand.

Although the Federal revenue has increased year by year and rose between 1939 and 1948 alone from 564 to 2,331 million pesos, the financing of public works and other activities fundamental to the economic development of the country has necessitated a volume of spending which in recent years has exceeded revenue and resulted in the issuing of securities by the Federal authorities, thus increasing the size of the public debt. On a current basis, however, the Government has attempted to maintain a balanced budget by limiting its spending to revenue obtained from taxation. This balance was achieved last year.

Although the domestic public debt has grown rapidly during the last ten years and has become of primary importance to the securities market, it is relatively small compared to the annual revenue of the Federation and the national income. In December 1948, in fact, the Federal domestic debt equalled about 61 per cent of the Government revenue in that year and 6.4 per cent of the national income. On the

1/ Six Years of National Activity. Mexico, F.D. Page 327.

same date the funded domestic public debt of the United States amounted to $230,579,000,000, or 117 per cent of the national income.

The increase of public debt in Mexico has been possible because of the increasing support afforded to the Government by the Bank of Mexico, the Nacional Financiera and other national credit institutions. It is also due, although on a lesser scale, to the investments of insurance companies, the private banks and an ever-increasing number of private investors.

Various industrial activities have been financed in Mexico by public spending, although most of the funds have been used in the development of works of general utility which, because of their high cost, low profits, risks etc., have not been carried out by individuals or private enterprises. This is why about 80 per cent of the domestic funded debt consists of road bonds, public works bonds and electrical industry bonds. Investment in public works is so large that, as we saw in the preceding chapter, it is estimated to represent approximately 30 per cent of all investment.

The Mexican Government's policy regarding the public debt has for at least fifteen years been the punctilious fulfilment of its obligations, which are contracted in accordance with the country's capacity to pay and in order to provide investments of a productivity which will afford the best guarantee for the investor. New issues of Federal securities may now not exceed the total amortizations. Further, states and municipalities may float only loans which produce a direct increase in their revenue. Thanks to this policy there has been no increase in the amount of the Federal public debt since 1948.

III. Institutions.

As it is impossible to study in detail the development of the principal financial institutions of Mexico, we shall restrict ourselves to a short examination of their present position and recent history.

The following institutions will be examined:

1. Credit
2. Insurance
3. Others

The banking system. - It may be stated without fear of exaggeration that the development of the Mexican system in recent years has been extraordinary. This would be true whether the expansion of the system is compared to that of other countries similar in economic importance to Mexico, or to the various other

/activities of

activities of the Mexican economy itself.

At the end of 1934, for example, there were 102 commercial banks, including head and branch offices, operating in Mexico; in 1940 there was a total of 121; in December 1946 there were 273, and at the close of 1948 more than 340.

The total number of private mortgage banks, which from 1934 to 1940 was two, rose in 1948 to 21 head offices and three branch offices. What is more strking, the number of finance companies, of which eight were operating in 1934, had risen by 1940 to 38 head offices and one branch office, and in 1948 there were 104 head offices and two branch offices. These examples, indicative of an expansion unprecedented in the financial history of Mexico, might be multiplied.

Although the credit institutions perform a common general function, they can be classified in various groups. In Mexico the most generally applicable criterion by which they can be distinguished is the participation of the national government in their organization or operation.

Institutions in which the Government takes part are known as national credit institutions, while the remainder make up what is known as the private banking system.

The most outstanding of the group of national credit institutions is the Banco de Mexico or central bank, and mention should also be made of the Nacional Financiera, the Banco Hipotecario Urbano y de Obras Públicas, and the Banco de Comercio Exterior.

The Bank of Mexico. - The Bank of Mexico was established in 1925 and was largely reorganized in 1932, 1936 and 1941. Under the present system it is a limited-liability company with a paid-up capital of 50,000,000 pesos, 51 per cent of which is held by the Federal Government.

The company is controlled by a board of directors consisting of nine persons, five appointed by the Government. Its general functions are those of any central bank, but the nature and scope of the procedure are of course adapted to the needs of the country and the Bank's duties.

During the first few years of its existence the Bank of Mexico could not act as a central bank in practice; moreover it operated on orthodox lines which limited its sphere of influence and retarded its development.

When the period of intensified construction of public works began, the central bank commenced to grow in importance, and it has since been the centre of the Mexican banking system and the mainstay of the Government's financial policy,

/fostering the

fostering the development of credit institutions generally, the money market, the capital market and the industrialization of the nation.

The first of these aims has been achieved by the bank's systematic support of national and private credit institutions through the granting of re-discounts and credits and the purchase of securities.

The foregoing has also revealed the stimulus given by the central bank to the money market, the activities of which have been increased through the establishment of new deposit banks.

Finally, the assistance afforded by the Bank of Mexico to the economic development of the country has taken various forms. The Bank has helped to carry out Government programmes and has assisted agriculture and industry, thus filling the gaps due to the insufficiency of savings and of the resources of the other credit institutions. Besides contributing to the acceleration of economic development by acting as a lender or investor, the Bank has, as a central institution, promoted a monetary and credit policy tending to reduce the impact of inflation and to create conditions permitting an increasingly stable development of the national economy.

The Bank has therefore been actively concerned with the stimulation of the capital market, by issuing and negotiating securities and by granting loans for productive purposes. It has also attempted to persuade all the institutions of the credit system to give, in granting loans, priority to the development of productive activities. To restrain inflation and prevent speculation, the Bank has since the war imposed a quantitative restriction on the volume of credit and now requires its associated banks to maintain a cash reserve of 50 per cent of sight demands. Finally, during recent years the Bank has attempted to regulate credit qualitatively with a view to making the most efficient use possible of the financial resources in the hands of the banking system.

The following figures give a general idea of the importance of the Bank of Mexico in the national financial structure. In December 1948 its resources amounted to approximately 3,502 million pesos, representing 91.4 per cent of the total assets of private credit institutions. At the same time its investments amounted to 1,852 million pesos, mostly in Government securities. Credits amounted to 767 million pesos, including re-discounts under 6 months to the amount of 160 million pesos and re-discounts maturing between 110 and 360 days to the amount of 475 million pesos.

/The Nacional

The Nacional Financiera. - It would be difficult to deal with the development of the capital market and of the progress made in the industrialization of Mexico without considering the work of this body. Established in 1934, the Nacional Financiera - a body similar to the industrial development corporations of some other Latin-American countries - has grown rapidly and is now one of the most important institutions of the Mexican credit system and the greatest direct influence on the securities and capital market.

During its fifteen years of operation the Nacional Financiera has passed through three more or less well-defined stages. During the first stage, covering the period of 1934-1940, its functions were ill-defined and to some extent contradictory, since it was responsible for the development of the securities market as well as for that of domestic credit.

Acting under its organic law of December 1940, it began in 1941 to play a new role. Its legal structure was reorganized and it was given the following functions:

1. To supervise and regulate the national securities and long-term loan market.
2. To promote the investment of capital in the organization and development of enterprises.
3. To operate as a support agency for finance or investment companies granting credits guaranteed by securities.
4. To act as agent and adviser of the Federal Government, States, municipalities or official agencies in the issue, floating, conversion, etc. of public securities.
5. Other related functions.

To this end the Nacional Financiera was authorized to perform various investment or credit operations directly or as an agent, including the issue of certificates of participation and finance certificates.

The progress made by the Nacional Financiera in its second period of development was notable, as can be seen from the figures for resources, credits, investments etc., given below. At the end of 1940 the resources of the Nacional Financiera were 18,000,000 pesos; its investments in securities amounted to 3.4 million, its loans to rather more than 8 million, and its finance certificates in circulation to 303,000 pesos. Seven years later the figures were as follows: resources, 732 million, investments in securities 100 million, loans of various

/types 488 million,

types 488 million, and finance certificates in circulation approximately 43 million pesos. Certificates of participation in circulation, issued for the first time in 1941, already had a value of 266 million pesos.

Nevertheless, after 1940 some problems were still unsolved and it was again necessary to reconstruct the Nacional Financiera to cope with the difficult economic conditions created by post-war readjustment, both national and international.

To deal with these problems a law amending the organic law of the Nacional Financiera was passed in December 1947. The capital of the institution was increased from 20 to 100 million pesos, its status as agent of the Federal Government was reaffirmed, and it was charged with the negotiation of international loans for capitalization purposes. Further, in order to make its work more effective, the new law provided that the Nacional Financiera should, in carrying out its work of promoting industry, set up or strengthen enterprises of fundamental importance to the economy of the country, in order to:

1. make use of unused or insufficiently-used natural resources;
2. discover better techniques for increasing the production of important sectors of the national industry;
3. help to improve the balance-of-payments position, so as to enable the country to do without non-essential imports, to stimulate the production of exportable goods, or to develop industries to earn foreign currency for the national economy.

In December 1948 the institution's resources amounted to 1,052 million, its investments in securities to 126 million, its credits to 409 million, and its certificates in circulation to 395 million pesos. By that time it had assisted in the financing of 172 industrial enterprises, the most outstanding being 21 factories producing iron and steel and metal products, 18 sugar firms, 14 textile firms, 12 printing firms, 11 cement factories, 11 constructors of public works, 10 communication and transport enterprises, 9 packing and refrigerating enterprises, 6 electricity-generating enterprises, 5 food factories, 4 paper mills etc.

Sixty per cent of the credits and investments relate to enterprises operating in the centre of the Republic, 24.4 per cent to industries in the northern part of the country, 13 per cent to enterprises on the North Pacific coast, and approximately 3 per cent to industries in the Gulf and South Pacific regions.

The National Bank of Foreign Trade is another national credit institution

/whose activities

whose activities have steadily increased in importance. Founded in 1937, its object has always been to develop Mexico's external trade, especially the export of agricultural products, in order to help to stabilize the Mexican peso.

Its principal operations include the granting of short-term loans, the discounting of commercial paper in connexion with export operations, and the organization of small producers of export goods.

In this work the Bank has the assistance of the Mexican Export and Import Company, which in practice operates as a subsidiary.

The principal agricultural products with which the Bank has been concerned have been sisal, banana, groundnuts, cotton, chicle, candelilla wax, etc. It has helped to finance crops and rehabilitate some industries based on them, to prevent speculation, and to organize producers.

The National Bank of Foreign Trade has not been given its own financing machinery and has relied mainly on the Central Bank to carry out its operations.

The National Urban Mortgage and Public Works Bank was established in 1933, its organic law being first enacted in 1943 and amended in 1946 and 1949.

The principal function of the Bank as now organized is the financing of public works, public services and low-cost housing; it acts as a support agency for savings and family housing loan banks, and collaborates with the authorities in the examination and solution of problems related to its functions.

In view of its purposes, the Bank operates in close contact with Federal, state and municipal authorities, which it partly finances.

The Bank supplements its capital resources by the issue of mortgage bonds, which are taken up by corporate and individual investors and are generally issued for a term of ten years at 6 per cent interest annually.

At the end of 1948 the Bank had bonds in circulation to the value of 254 million pesos, equal to 81 per cent of its total assets.

Its present operations range from loans for direct investment to co-operation with specific authorities. Its loans, normally granted for short terms, amounted in December 1948 to 255 million pesos. Its authorized capital is 60 million pesos.

The Bank assists the treasury authorities in matters within its competence and reviews the savings plans of savings and loan institutions for family housing.

The Agricultural Credit Banks. - As early as 1926 the need to promote the development of agriculture and thus to improve the standard of living of a large

/sector of the

sector of the Mexican population, and the absence of private organization ready to assume the risks of agricultural loans, prompted the Mexican Government to set up an agency to operate with small landowners. Side by side with this institution - the National Bank of Agricultural Credit - the National Bank of Commons (Ejidal) Credit began to operate in 1936; as its name indicates, it was intended to operate with commons holders and their associations.

These two institutions will not be examined in detail; it may simply be stated that their existence, although criticized by the most conservative groups in Mexico, is full justified.

It has been a feature of their operations that:

1. Their funds have been insufficient.
2. As a result, the volume of funds distributed by them has been relatively small, especially in relation to the volume of money spent on industrial development in its various forms.
3. They have not had sources of funds of their own and have therefore relied principally on the Government and on loans of the central bank.

They have been active mainly in granting loans, especially for installation and repair.

Other Institutions. - In addition to those already mentioned, the National Cinematographic Bank, the National Bank of Co-operative Development, the Retail Trade Bank and the Army and Navy Bank are included in the group of national credit institutions.

To sum up, the national credit institutions, operating with increasing resources and increasingly efficient machinery, have afforded a sound basis for Government programmes and the industrialization of the country by assuming risks and taking part in activities of great social and economic importance which private investors would not have undertaken or would have undertaken on much more limited terms, thus holding up the general progress of the Republic.

The private banking system of Mexico comprises the following groups of institutions:

1. Commercial or deposit banks.
2. Savings societies.
3. Savings and loan societies for family housing.
4. Finance companies.
5. Mortgage loan companies.

/6. Capitalization

6. Capitalization companies.
7. Trust companies.

Side by side with these institutions, which are regarded as the most important, there are others which according to law constitute the group of "auxiliary credit organization." Among these are:

1. The stock exchanges
2. Price control boards
3. Credit unions
4. Produce warehouses

We shall now deal with the main features of the organization and operation of these institutions, and then examine the insurance system and some features of the securities market.

Commercial Banks - Because of the volume of their resources, the commercial banks are of extraordinary importance in the credit system. In December 1948 their resources amounted to 2,886 million pesos while the total resources of the banks of the private system were 4,615 million. In other words, the funds held by the commercial banks represented 62.5 per cent of the total resources available in the private credit system.

However, if their direct support to industrialization and the development of the capital market is taken as the criterion of their importance, very different conclusions must be reached.

At the close of 1948, for example, the resources of the commercial banks - 2,886 million pesos - were distributed as follows: investments in securities, 366 million pesos; loans, approximately 1,400 million pesos. Of the investments in securities approximately 115 million pesos were in Government bonds, the remainder being distributed between bank securities and, to a lesser extent, industrial securities. As regards loans, more than 90 per cent were for terms of less than one year, and less than 10 per cent were for terms of more than 360 days.

The foregoing indicates that while investment in securities has increased, it represents only approximately 13 per cent of the resources of the commercial banks. Investment in Government securities, in particular, represents little more than 7 per cent of the total of the public debt and less than 4 per cent of the assets of these banks.

The limited support given by the commercial banks to the development of the

/capital market

capital market is due principally to the following:

1. The profits of short-term operations, typical of the money market, are usually higher than those from investments in public and many private securities;

2. The former are less risky and the rapid repayment is an added incentive in their favour;

3. The legislation governing commercial banks has generally encouraged the maintenance of a degree of liquidity which makes it difficult for them to allot a substantial part of their resources to long-term operations intended to stimulate production. Consequently they have engaged principally in the supply of short-dated credit, principally to commerce but also on a substantial scale to some industrial activities, especially during the war years, when there was a great demand for such credit because of the continuous rise of prices and the profits offered by speculation.

Faced by the traditional attitude of the commercial banks, which under-estimated the need for financing activities of fundamental importance to the sound development of the country's economy, the Bank of Mexico has in various ways and on various occasions taken steps to induce them to re-distribute their investable assets, and in granting loans to exercise greater care and have greater regard to the general interest. Further, at the beginning of the present year the law on credit institutions was amended in order to secure increasing participation by the commercial banks in the development of the capital market. The most important amendments from this point of view were:

I. The minimum capital of a commercial bank was established at 3 million or 1 million pesos, according to whether it operated in Mexico City or elsewhere in the country. (The previous figures were 1 million and 250,000 pesos.)

II. The commercial banks were authorized to grant installation and repair loans for a maximum period of two or five years respectively, the loans being considered not as made from their own capital but as an investment of deposits.

III. To maintain the stability of the commercial banks it was provided, however, that the total of such loans plus investment in private securities for terms of over two years would not exceed 20 per cent of current liabilities; the amount of loans would not exceed half the capital and reserve of the granting institution; the debtor enterprise would not pay dividends while the loan was outstanding; and the amount of the loan would not exceed 50 per cent of the verified value of the property offered as security.

/Notwithstanding some

Notwithstanding some deficiencies and limitations, the commercial banks have contributed to the development of the financial organization of the country. They have extended credit to places where only a few years ago it did not exist; they have strengthened the money market and generalized the use of cheques, drafts, bankers' acceptances, letters of credit, and other insturments; and by means of sight and time accounts they have concentrated savings and funds which were formerly hoarded or merely handled on a very small scale.

Savings Banks.1/

As in other countries, the savings banks form a part of the investment machinery in Mexico although they distribute part of their funds on the money market.

Their growth has been considerable in recent years. Whereas in 1936 only four banks were in operation, ten years later there were thirty-six head and eighty-six branch offices, and in December 1948, eighty-one head offices and 170 branch offices were in operation. In 1939 their funds were 34 million pesos and in December 1948 they possessed 394.5 million, distributed as follows: investments in securities, 121 million; discounts 85 million; and loans of various types approximately 73 million pesos. In December 1948 the total of savings accounts was 334 million pesos.

Finance companies.

Of the extremely broad functions assigned by law to these societies, the chief may be described as follows:

1. To promote and organize enterprises;

2. To take part in other companies, principally for purposes of financing;

3. To facilitate the issue and distribution of public and private securities;

4. To grant long-and short-dated credits in the form of discounts, direct loans, pledge loans, and installation and repair loans.

The finance companies were converted to credit institutions by the Bank Law of 1941 - previously they had been auxiliary organizations - so that they could be used to further the development of the capital market.

1/ The savings and loan associations for family housing will not be dealt with although they form part of the private banking system, as they are a very recent innovation and their operations are still of little practical importance.

From 1941 onwards the finance companies were able to command more adequate sources of funds, which, in conjunction with favourable economic conditions for their expansion, resulted in an extraordinary increase in their numbers. Whereas in 1940 there were only twenty-eight head offices and one branch office, in 1948 140 head and two branch offices were in operation.

Their development has been no less remarkable as regards the volume of their funds and operations. In 1940 their resources amounted to little more than 67 million pesos, but in 1948 the value was 980 million. Their investment in securities rose during this period from 15 to 177 million pesos, mostly in private securities. The most important loans granted in 1948 were: direct, 143 million; pledge, to a value of 73 million; installation loans 87 million, and ordinary loans 42 million pesos.

Like the other institutions in the system, the finance companies were affected by the most recent reform of the general law on credit institutions. Their minimum capital was increased and general bonds were replaced by finance bonds backed by specific guarantees, while various general measures were taken to ensure a fuller contribution by the finance corporations in the economic development of the country.

Mortgage loan companies - The mortgage loan companies also form part of the banking system of Mexico. By law their minimum capital must be 500,000 pesos. Their funds accrue mainly from the sale of bonds and certificates, and in their active operations preference is given to mortgage loans.

In December 1948 there were twenty-one head and three branch offices in Mexico, most of them in the Federal District. Their total resources amounted to 205 million pesos of which more than 50 per cent were mortgage loans.

The loans granted by these companies have been used principally for purposes of urban development, which absorbs more than 95 per cent of all the loans made by private mortgage banks. In urban development, preference has been given to residential and commercial construction and the building of middle-class houses.

In December 1948 mortgage bonds in circulation amounted to 118 million and certificates to 225 million pesos. Unlike most of the institutions to which we have referred so far, the mortgage loan institutions do not maintain close contact with the money market, although some of their operations may affect it.

Capitalization companies - These are what are known as investment institutions, which from the economic point of view are the equivalent of savings banks. Their appearance in Mexico dates from recent years. The first bank of this type was in

/fact established

fact established in 1933.

These societies issue bonds known as capitalization bonds which have been increasingly accepted by the public.

Their most important operations are loans, investment taking a secondary place. The following figures serve to indicate, in general terms, the importance of the capitalization societies in the private credit system. At the end of 1948 there were sixteen head offices and one branch office, with funds of approximately 457 million pesos. Approximately 60 per cent of this sum was derived from bonds in circulation, and the most important single operation was represented by mortgage loans of more than 94 million pesos. Loans of other types amounted to approximately 36 million, and investments in public and private securities to approximately 84 million pesos.

While some of the operations of the capitalization banks develop production, others, like the pledge loans, are principally a stimulus to consumption.

Trust companies - The importance of the trust companies is determined not by the volume of their funds, which at the end of 1948 amounted only to 37 million pesos, but to the width of their functions, the services they render and the amount of the assets they concentrate and distribute through various trust operations.

Thus, for example, in December 1947 their assets amounted to little more than 30 million pesos, but the value of the property held by them on trust was more than 242 million.

There are now ninety-three trust companies in Mexico, ninety-one of them being head offices. All have helped to develop investment in real property, securities and other property, and to bring into general use operations and services of value in the financial development of the country.

Stock exchanges - Legally the stock markets are regarded in Mexico as auxiliary organizations of the credit system. Traditionally there has been only one stock market, the Stock Exchange of Mexico, but a new market was recently set up in Monterrey.

The Stock Exchange of Mexico was established as a limited company in 1933. Its capital is divided into shares which are taken up by the agents or brokers. In addition, however, it has other members known as subscribers, who contribute an initial subscription and monthly contributions of which the amount is determined by the company's board.

Although the area of influence of the Stock Exchange has been on the increase, most shares are negotiated outside it or on the open market.

A law relating to the securities market is now in preparation and will contribute to its development. It will also ensure that the Stock Exchange in particular plays a more important part in the canalization of savings towards investment in public and private, and especially industrial, securities.

Credit unions - As already noted, the credit unions are part of the group of auxiliary organizations. Generally speaking, they are organizations for the purpose of granting loans and guarantees, making investment, etc., exclusively with their members, of whom each union must have at least ten.

Of these agricultural, industrial and other credit unions, thirty-seven are now in operation throughout Mexico. In December 1948 their resources amounted to 171 million pesos, with discounts, loans and credits to the amount of 76 million pesos.

Price control boards and produce warehouses - Although these two groups of organizations have come to be of considerable importance in the credit system, they will not be examined in detail since, because of the nature of their functions, they have not a direct part in the financing of economic activity in Mexico.

The insurance system - Side by side with the credit system, mention must be made of the insurance companies, which also form part of the captial market and have come to acquire major importance as corporate investors.

For example, the resources of the insurance companies rose from approximately 88 million pesos in 1938 to 214 million in 1943 and 580 million in 1948. The same trend was followed by premiums collected, technical reserves, capital accounts etc.

During recent years investments in securities by insurance companies have represented between 25 and 30 per cent of the whole of their funds, except in 1948, when the ratio was slightly more than 40 per cent. At the end of that year, however, the principal accounts of the insurance companies were as follows: resources - as has been said - amounted to 580 million, investments in real estate to 112 million, mortgage loans to 32 million and policy loans to approximately 50 million pesos. Technical reserves, which in 1938 had amounted to 63 million pesos, were approximately 381 million pesos.

Other organizations - To give a more complete picture of the institutions and organizations of various kinds which contribute to the financing of economic development in Mexico, mention should at least be made of the social security system, the surety institutions, the non-commercial corporations, and the commercial

/foundations

foundations and companies - especially the limited companies - which on a different but important scale provide funds for various sectors of the capital market.

IV. Instruments, operations and methods of financing.

Although we have already referred to various securities and financing operations, some further remarks are required in this connexion. Naturally each of the financial institutions employs special instruments or specific operations to carry out its work. Thus, for example, the cheque, the bill of exchange and the banker's acceptance are specially connected with the operation of deposit banks. The savings banks have "savings bonds" which serve to document deposits for terms varying between six months and twenty years. The capitalization company issues bonds containing capitalization contracts, and the insurance company issues insurance policies.

There are some instruments, however, which must be dealt with separately because of their special importance and their highly individual features. These include certificates of participation, general or finance bonds, and mortgage bonds and certificates.

Certificates of participation - Although certificates of participation have been issued by various institutions, in their best-known form they have been used only by the Nacional Financiera.

The certificates issued by this institution are negotiable securities certifying the holder's co-ownership of a number of securities - principally industrial - constituting a common fund administered by the Nacional Financiera.

There have been major changes in the structure of the fund since 1941. Whereas at the end of that year the fund consisted wholly of government securities, in December 1947 these represented only 79.4 per cent, the remainder of the fund - 60.1 per cent - consisting of private securities. Moreover, subsequent to issue "M", some industrial loans were included as part of the common fund.

The acceptance by the public of these securities is without precedent, since many of the certificates in circulation are in the hands of individual investors. The success obtained in the sale of these certificates has been extraordinary. Whereas at the end of 1941 the certificates in circulation amounted to little more than 7 million pesos, in December 1948 the total was 276 million.

Among other peculiarities of the certificates of participation of the Nacional Financiera are the following:

1. Before 1945 issues matured after 2 1/2 to 10 years; since that year seven issues of no fixed maturity date have been issued and only one with a fixed

/maturity date.

maturity date.

2. The rate of interest has been stabilized at 6 per cent per annum, tax free to individual holders.

3. Heretofore the method of fixed-term retirement has been most commonly used, the common fund being liquidated and the face value of certificates being remitted to holders. In the issues with no fixed maturity date, however, it is established that if the Nacional Financiera retires the issue during the first year it will pay a 5 per cent bonus, if in the second year 4 per cent, in the third 3 per cent, in the fourth 2 per cent, and in the fifth 1 per cent.

4. In order to increase the stability of its certificates, the Nacional Financiera repurchases face or purchase-value securities submitted with 90 days' notice, together with interest. In practice, however, the Financiera has in most cases bought its certificates at sight.

The savings accumulated through the sale of certificates of participation have enabled the Nacional Financiera to broaden the scope of its activities and to finance enterprises of fundamental importance to the Mexican economy.

Other securities - The continuous progress of the securities market and of financing practices generally has also been shown by the trend of dealings with some private securities. For example, general bonds issued by finance companies, the circulation of which in December 1941 amounted to little more than 1 million pesos, reached 333 million pesos in 1948. The funds which have been accumulated through the sale of general bonds have served to finance various industries, the most outstanding being perhaps the sugar industry. As regards the terms of these securities, it should be mentioned that the public generally has not been able to acquire them on a sufficiently large scale, and as a result general bonds have usually been sold to corporate investors, largely to the central bank.

Since the reform of the credit system enacted in February 1949, general bonds have been replaced by "finance bonds", the principal feature of which is that they are issued with a specific guarantee. This reform was intended to facilitate the sale of these securities to increasingly large groups of individual investors.

Mortgage certificates are also important, since they have made it possible to canalize increasing volumes of individual savings. Their circulation, which in 1941 amounted to 96 million pesos and in 1944 to 111 million pesos, had reached a figure of 225 million pesos in 1948.

Unlike mortgage bonds, these certificates are securities with a real, direct

/guarantee.

guarantee. They are issued, at least formally, by the mortgagor and not by the mortgage loan corporation which issues bonds.

The following table gives an idea of the scale on which the fixed-interest security market has developed in recent years. The figures, expressed in millions of pesos, relate to the value of securities in circulation.

Table No. 8

CIRCULATION OF FIXED-INTEREST SECURITIES
(millions of pesos)

Year[1/]	Total	Govt. securities	Participation certificates	Finance securities	General bonds	Commercial bonds	Mortgage bonds	Mortgage certificates	Savings bonds
1939	208.4	168.5	--	0.2	--	--	11.0	28.7	--
1940	491.7	427.2	--	0.3	--	1.1	13.1	50.0	--
1941	665.5	528.3	7.4	1.5	1.2	12.8	17.8	96.5	--
1942	904.3	699.3	41.8	2.6	23.6	8.6	21.6	105.1	1.7
1943	1,211.9	822.1	142.6	4.6	76.2	3.2	48.4	102.5	12.3
1944	1,261.5	700.2	180.1	17.7	116.8	2.2	120.9	111.1	12.5
1945	1,626.1	822.9	222.4	16.7	181.1	2.8	203.5	162.9	13.8
1946	2,000.6	1,024.9	225.9	43.5	240.9	5.5	256.0	194.8	9.1
1947	2,295.1	1,129.0	250.4	42.8	346.1	9.6	306.0	204.8	6.4
1948	2,678.1	1,445.1	276.2	26.2	332.8	8.1	360.2	224.6	4.9

Operations. - A wide variety of financing operations are employed to promote the economic development of the nation. Classified in accordance with the traditional criteria for the study of credit activities, the principal passive operations would be deposits and the issue of securities, and the most important active operations would be loans and investment. The most important of the former are discounts and personal, direct, installation, repair and mortgage loans, while investments include securities, real property and other property.

1/ The figures represent the circulation at the end of each year. Only Federal and bank securities are included. Sources: Bank of Mexico, National Bank Commission and Nacional Financiera.

/As regards

As regards neutral operations in the credit system, the most important would be trust operations. The most recent practice is based principally on United States traditions.

As regards financing methods in general, Mexico has had to combine all the instruments at its disposal to intensify economic development, including public investment, private investment, mixed investment, and investment based on foreign capital in the form of direct acquisitions and the floating of inter-governmental loans.

CHAPTER III

Repercussions of economic development in Mexico

I. General

In previous chapters we have examined the level of economic development achieved by Mexico and the various sectors in which it has taken place. We have also regarded the problem of its financing, pointing out that only a very small part of it was based on foreign capital and that the remainder was financed through taxation and domestic credit, in some cases by the canalization of voluntary savings and in others by the formation of involuntary savings through the creation of money and its conversion into capital.

The first repercussion of the policy of economic development has been on employment. In fact, the construction of public works and industrialization have absorbed a population formerly engaged in principally agricultural activities, its mobilization being due to the higher wages offered. It would be untrue to say that in Mexico employment has increased as a result of such transfers: all that has happened is that the section of the population employed at higher wages or salaries has increased. The number of such transfers to more remunerative activities is unknown, but the phenomenon is clearly reflected in the rapid growth of the urban centres - principally industrial and commercial in recent years.

The process of forced saving would have led, if production had not risen at the same rate, to a decrease in consumption by the Mexican people because of the rise in prices and the consequent restraint on consumption. (Table 9).

/Table No. 9

Table No. 9

NATIONAL INCOME AND PRICES

NATIONAL INCOME[1/]

Years	At prices for year (millions of pesos)	At 1939 prices	Price index 1939 - 100
1939	6,000	6,000	100.0
1940	6,200	6,049	102.5
1941	6,900	6,313	109.3
1942	8,300	6,882	120.6
1943	10,500	7,207	145.7
1944	13,400	7,507	178.5
1945	16,000	8,052	198.7
1946	19,200	8,395	228.7
1947	20,300	8,378	242.3
1948	22,500	8,650	260.0

1/ Provisional figures subject to correction.

As production or real income increased 44 per cent between 1939 and 1948, the policy of economic development in Mexico has resulted in a raising of the standard of living of the population, as may be seen from Table No. 10.

Table No. 10

Per capita consumption of various agricultural products

(kilogrammes)

	1938	1941	1943	1945	1947	1948
Maize	89.91	105.11	87.41	100.51	107.46	117.94
Wheat	24.76	27.51	30.84	30.14	30.77	30.18
Beans	5.54	7.52	7.18	6.98	8.74	9.73
Rice	3.86	5.05	5.28	5.46	5.54	5.59
Coffee	1.16	1.15	0.84	0.85	0.96	0.90
Potatoes	3.85	4.59	5.89	5.87	5.72	--

A weighted index of the apparent consumption of these six agricultural products has been calculated and is given below: The index confirms the statement that

/there has been

there has been an increase in the food consumption of the Mexican people during the last decade, in other words during the period of most intense economic development.

Year	Index (1938 = 100)
1939	114.1
1941	117.4
1943	108.2
1945	115.9
1947	124.2
1948	131.6

If the rise of prices had not intervened, the policy of public works and industrialization would have resulted in a higher standard of living for the population; but the policy of forced savings transferred, so to speak, purchasing power to producers and traders in goods and articles which would be demanded to satisfy consumption, with a resulting increase in the wealth of those who were already rich. In other words, the policy of economic development raised the level of consumption of the great mass of the population and the volume of savings of a minority - public works contractors, industrialists and more especially business men.

No figures are available for a quantitative statement of the amount of savings nor accurate information regarding their use, but it can be stated that the bulk of savings has been largely canalized towards production and the remainder towards the purchase of durable consumer goods, inactive deposits in foreign banks, or the construction of urban properties. It is important to note in this connexion that the number of building licenses granted in the Federal District rose between 1942, a year in which the building industry was very active, and 1945, in which year the building industry reached its peak, from 3,250 to 6,358. The number of residences increased from 3,310 to 6,106. As regards value, the figures for all the buildings rose from 76 to 174 million pesos and for residences from 58 to 131 million pesos.

II. The Multiplier

An increase in the volume of investments creates an expansion of the national income greater than the initial increase in investment. The magnitude of the increase in national income as a result of new investments will depend in particular on the use made of the income generated by the investments. To the extent that the community spends its income on national articles, the repercussion of increased investment on the national income will be substantial. If the income generated by the increase in investment is devoted to an appreciable extent to savings or to the purchase of foreign goods, the effect of new investments on the national income will be limited.

In the specific case of Mexico, the effect of new investments on the national income is influenced essentially by the high marginal propensity to import which exists in our country. If this propensity were not so large, the repercussion of new investments on the national income would be very substantial, as the marginal propensity to save is very low.

It is estimated that the marginal propensity to save in Mexico is approximately 1/10; consequently, regarding saving only as a negative factor expressed as leakage of income, the effect of new investments on the national income would be very large, since the investment multiplier is ten, or the reciprocal of the marginal propensity to save, as shown below:

$$k = \frac{1}{1 - \frac{C}{Y}}$$

$$k = \frac{1}{1 - \frac{90}{100}}$$

$$k = \frac{1}{1/10}$$

$$k = 10$$

However, as a rise in the national income of Mexico derived from new investments or the expansion of exports leads to a considerable increase in imports, this factor must be considered in attempting to assess the effect of investments on our economy.

It is estimated that Mexico's marginal propensity to import is 0.20; in other words that any increase in investments expressed as a rise in income causes a rise in the level of imports of that magnitude.

/Considering both

Considering both the marginal propensity to save and the marginal propensity to import as negative factors giving rise to leakages of income, we may determine approximately the effect which new investments would have on the national income.

If the marginal propensity to save is 0.10 and the marginal propensity to import is 0.20, the two marginal propensities are expressed in a leakage, in the first period of generation, of 0.30 of each peso of income generated, and proportional leakages in the subsequent periods.

The foregoing means that, because of the public works and investments carried out in recent years, there has been a continuous increase of national saving which is difficult to estimate for lack of relevant statistical information. The volume of voluntary saving has continued to be an increasingly important factor in the financing of the economic development of Mexico but is still insufficient to finance such development by itself.

On the other hand, the high propensity to import immediately suggests the repercussion that any policy of investments has on the monetary reserve. As voluntary savings have been insufficient to finance the programme of economic development, recourse has been had, as we have seen, to spending financed by created money, with the result that 20 centavos of each peso issued seeks foreign articles and, consequently, also dollars. It is for this reason that a policy of investments, if carried out at an accelerated rate, leads to disturbance of the exchange market. The alternatives remain, however, either to retard the economic development of the country so as not to create difficulties with regard to the monetary reserve and the exchange rate of the national currency, or to continue economic development and material progress even at the cost of some exchange problems.

It would seem that the best policy, suggested by the experience of Mexico during recent years, is to limit economic development to the point where balance of payments is secured, so long as this is compatible with the continuation of that progress.

CHAPTER IV

Conclusions

1. The economic development of Mexico has been the objective of the economic policy of the Mexican Government during the last two decades.

2. Originally this development was basically directed towards the construction of public works, but in the last ten years a great stimulus has been given to industrialization and the modernization of agriculture, and especially, among public works, in communications and transport, irrigation and electrification; among basic industries to oil, coal and iron and steel; to agriculture and stock-raising, and to manufacturing industries such as those producing textiles, food, cement, paper, chemicals, copper, electrical goods and sugar, the cinema etc.

3. As a result of this policy the country has made constant progress. Its population has increased by 2.8 per cemt annually while the national income has risen 33 per cent and national gross investment 48 per cent annually, measured in pesos.

4. Approximately 30 per cent of Mexican investment represents public works; the remainder consists principally of industrial investments.

5. Approximately 86 per cent of the former is financed by domestic funds and 14 per cent by foreign loans. 58 per cent of spending on public works is provided by ordinary government budgets and 28 per cent by domestic loans.

6. Recently, spending on public works has constituted one-quarter of the total expenditure of the Federation, states and municipalities.

7. Public works undertaken by the Federation occupy the first place and represent 90 per cent of the total. The remainder is accounted for by the governments of the Federal District, the states and the municipalities.

8. In Mexico public works are instruments of capitalization rather than weapons against depression.

9. The public works carried out have created new centres of activity and the productivity of existing centres has increased.

10. Before the agrarian revolution no significant effort had been made to extend and modernize Mexican agriculture. The effort made during the revolutionary period has resulted in a general increase of agricultural production and constitutes a starting-point for greater achievement in the future.

11. The true success of the agrarian revolution is only just beginning to be achieved through the education of the peasant, the technical direction of agricultural work, the improvement of lands and the administration of loans.

12. The increase of production thus obtained benefits not only agriculture but the country in general, enabling it to be increasingly self-sufficient in essential articles.

13. The present tenure of productive lands by commons holders and smallholders can be regarded as legally and economically consolidated, a factor guaranteeing increasing agricultural production.

14. Any area irrigated is freed from the hazards and uncertainties of rainfall. The work already achieved in irrigation is most important, but there is still room for the irrigation and improvement of an area four times as great again; this work is being energetically continued.

15. The proper management of soils and the use of fertilizers offers a wide field of action, since the whole cultivable area urgently requires this treatment. The results obtained fully justify the efforts made to produce fertilizers and to educate the peasant in the conservation, management and fertilization of his soil.

16. The introduction of genetic improvements to increase the productivity of maize and other important crops has proved its effectiveness and is tending to become general, with excellent prospects for the future.

17. The prevention of pests, to which due importance is now beginning to be given, makes possible healthier and richer harvests. It is therefore tending to be improved and to be constantly extended.

18. Modern agricultural machinery has demonstrated in practice its economic advantage over traditional equipment and is now replacing this on a substantial scale.

19. In the field of agricultural credit valuable experience of administration has been obtained, and the increasing funds applied for this purpose are making it increasingly more effective.

20. The rational exploitation of forests has been applied only on a small scale and in recent years. An effort is being made to conserve the large forest area still available and to ensure the methodical and permanent utilization of forest resources in the future.

/21. Forest

21. Forest management policy is also directed towards the prevention of erosion, floods and aridity and towards the storage of surface and sub-surface water which is so necessary in the arid climate of Mexico.

22. There is ample scope in Mexico for scientific forest exploitation, and only one-twentieth part of the forest area is exploited.

23. Mexican pasture lands have been exploited unscientifically. Only in recent years has attention been given to their capacity and to methods of using this renewable resource which guarantee its permanence.

24. The improvement of native stock, the breeding of thoroughbreds, proper cross-breeding and the prevention of diseases have begun to bring about an increase of livestock.

25. Attention has also been paid to the important links which must exist between stock-breeding and agriculture proper. From his livestock the peasant obtains labour, milk, meat, wool, fat etc., in exchange for the waste products of his crops, secondary products of little value, and grazing on fallow lands, pasture-lands and suitable woods.

26. The campaign against foot-and-mouth disease has rejected the practice of slaughtering in favour of vaccination and strict quarantine. These are tending to wipe out this epizootic and to prevent it from becoming an enzootic. The area affected is steadily decreasing and the disease has not prevented the normal increase of the livestock population.

27. Little use is made by nationals of the rich fishery resources of Mexico, although there has been some increase during the last decade. Fishing, especially in deep waters, offers good prospects for the future.

28. Mexican fishermen have confined themselves to fishing part of the coastal lagoons, of the waters of the continental platform, and of the lakes and rivers. In these areas their activities are tending to be expanded and intensified.

29. The effort to make better use of the fishery resources of Mexico must be directed principally towards deep-sea fishing grounds, where more valuable species are found and which are now fished wholly by foreigners.

30. The most obvious measure of industrial progress is the volume of production, since progress must be expressed in the last resort by increased production. Nevertheless, the deficiencies of the available production indices make their use inadvisable as an exclusive indication of real production, and indirect methods should be used to supplement them.

/31. To judge

31. To judge by the indices of the volume of production, the country's employed industrial capacity increased by approximately 35 per cent between 1939 and 1948. As the statistics do not faithfully reflect this development, it may be assumed that the progress achieved is greater than 35 per cent.

32. Although the number of enterprises set up in recent years cannot be estimated, it is known that the number of enterprises accorded the privileges granted to new and necessary industries amounted to 350 in 1945 and 585 in 1948.

33. The various branches of industry have not developed uniformly.

Mining not only has not progressed but is losing ground. Judged either by production or by workers employed, it has hardly been able to maintain its 1939 levels, and before 1939 there had been many years of continuous decline

There was a fairly substantial increase in oil, natural gas and oil derivatives, greater in the last two products than in the first. However, the effect of the marked development characteristic of this decade has been felt most strongly by the manufacturing industries proper. The increase was greatest in some of the basic industries, the electrical industry, iron and steel, chemicals, and fertilizers. Electric power generation rose by more than 50 per cent, while the production of pig iron and steel billets tripled between 1940 and 1947; there was a simultaneous expansion in every branch of the metal industries.

In addition, there was a marked increase in the food industries (especially beverages, sugar and canned goods), glass and tiles, building, etc.

34. In 1944 our industry included few manufactures, added little or no value to the raw material during production, and had little or no national integration. As a result of this process of industrial expansion it achieved independence in supply, was modernized and became self-sufficient in many lines.

Its independence in supply has improved considerably in the case of some metal industries, whose raw material, formerly exported, is now processed in the country. Thus mining, although it has lost importance in itself, has regained importance for the economy in general since, in contrast to the situation a few years ago, it is now the basis of some native industries.

Modernization has affected various branches of industry, of which the metal industry, foods and textiles are outstanding, not to mention others, such as chemical products and fertilizers, which are practically new in Mexico and have been equipped in accordance with the most up-to-date techniques.

/Self-sufficiency

Self-sufficiency has been completely achieved in various branches (sugar, cement, etc.), and in others considerable progress has been made towards it (canned foods, iron and steel products, porcelain and glass, etc.).

35. The modifications in the structure of industry have entailed corresponding changes in our external trade.

As regards exports, manufactures have an increasing share in the total value and have risen from 1.03 per cent in 1939 to 20.6 per cent in 1948.

As regards imports, there seems to have been a reduction of imports of consumer goods and an increasingly active trade in production goods and equipment.

36. During the period under review the most significant sources of finance for the economic development of Mexico have been, in order of importance, (1) domestic resources and (2) foreign resources. Domestic funds have been raised increasingly from voluntary savings and have also resulted from the creation of means of payment. Foreign funds have entered the country in the form of private investments and loans of other types.

Lastly, financial resources have been canalized through (1) public spending, (2) investments and loans by banks, insurance companies and other organizations, and (3) individual and corporate investments in various branches of economic activity.

37. The expansion of the volume of resources applied to the economic development of the country has been outstanding. As a simple example, the following figures may be given: from 1939 to 1948 the spending of the Federal Government, applied largely to public works, rose from 611 to 2,681 million pesos. The internal public debt, which has contributed so much to the construction of roads and irrigation works, electrification and railway development, increased during the same period from 168 to 1,445 million pesos. Finally, the value of the certificates of participation of the Nacional Financiera in circulation and of general bonds, mortgage certificates and bonds rose from 123 to 1,194 million pesos between 1941 and 1948.

38. The economic development of recent years would have been impossible without a basically-adequate financial structure, i.e., without proper institutions and methods to canalize an increasing volume of savings towards capital formation. Realization of this fact resulted in efforts in a number of directions, among which the most important are: (1) enactment of new banking, fiscal and general financial laws; (2) creation of regulatory and supervisory bodies in various sectors of the capital market, such as the National Insurance, Investment and Securities

/Commissions;

Commissions; (3) support of the establishment of new credit institutions and encouragement of their productive operations; (4) introduction of new certificates, operations and practices in connexion with the development of the market, and (5) fiscal and administrative facilities for the establishment of new industries.

39. This progress has been achieved after overcoming innumerable obstacles, most of them inherent in an under-developed economic, social, and therefore financial structure. Moreover, as is to be expected, in the financial field there are deficiencies and obstacles to further progress. Thus, for example, there are still parts of Mexico where credit and its advantages are unknown; there are speculations which encourage instability and retard economic development; there are industrial and other activities which lack proper financing or have been financed only on excessively burdensome conditions; voluntary savings are exported, etc.

40. The last fifteen years, however, and particularly the years since the outbreak of the Second World War, are the period of the greatest and most rapid expansion of the capital market in Mexico.

41. The most outstanding aspects indicative of the development of the capital market have been: (1) the continuous increase of the volume of investment and of the national income; (2) the absolute and relative increment and increasingly productive utilization of savings; (3) better organization and more efficient operations of bodies and institutions participating in the market; (4) extension of such bodies and institutions to hitherto backward areas, deprived of the benefits of credit and even currency; (5) constant improvement of techniques employed to concentrate and distribute available financial resources for the development of production.

42. Independently of other factors which also have controlled the development of the capital market, the participation of the Bank of Mexico and of the Nacional Financiera have been decisive in achieving this progress. The accelerated rate of industrialization is partly due to their joint action, while the Nacional Financiera in particular is responsible for one of the most successful experiments in the securities market the sale of its certificates to increasingly-wide groups of individual and corporate investors.

43. Mexico's policy of economic development has had numerous repercussions on the country's economy. The first effect has been on employment to increase the employed population receiving higher wages or salaries. This has meant the transfer of populations from primary to secondary and tertiary activities and has considerably

/increased

increased the population of urban and industrial centres.

44. The policy of public works, national industrialization and the modernization of agriculture has resulted in an increase of production, an increase of consumption and, in the last analysis, an improvement of the standard of living of the people.

45. The investments policy of recent years has increased national saving.

46. Given Mexico's high propensity to import (0.20 per $1.00 spent), an investment policy has immediate repercussions on the exchange market. It is therefore necessary to regard repercussions on the exchange market as one of the limits to the investment policy and to attempt to spend at a rate which does not destroy the balance of payments. If, however, a choice has to be made, the choice is obvious: economic progress comes first.

Domestic Financial Assistance for Economic Development in the Philippines

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INTRODUCTION

The Philippine economy is essentially agricultural. In pre-war years, about 80 per cent of the total population depended for livelihood upon agriculture. Except for rice, only a minor portion of the agricultural products was destined for local consumption, the bulk being exported, providing the main source of the country's income and the foundation of the national economic structure.

The growth and expansion of overseas commerce of the Philippines therefore reflect not only the development of these agricultural industries, but also the economic progress of the country. Moreover, they demonstrate the dependency of the national prosperity upon overseas commerce.

The Philippines has been heavily dependent upon its trade with the United States. The existence of free trade between the two countries has undoubtedly created opportunities for the Philippines to sell in the United States much larger quantities of its agricultural products than it would have been able to sell in the absence of preferential trade relations. In consequence, the tendency has been for the Philippines to develop those industries which produce commodities for sale in the United States market. The resulting increase in the production of export commodities which are thus protected has operated to discourage the production both of export commodities not so protected and of commodities intended for Philippine consumption. On the other hand, the increased sale of goods in the preferential United States market has enabled the Philippines to buy more goods from the United States. In the pre-war period, the Philippines as a market ranked sixth in the overseas trade of the United States.

The Philippines today is faced simultaneously with two problems of gravity - the necessity for rehabilitation and reconstruction of the economy ravaged by the war and the slow but certain loss of the speical privileges in the American market. The Philippine Rehabilitation Act of 1946, the Philippine Trade Act of 1946, the gift of surplus military equipment, and other measures have provided for financial and technical assistance, access to supplies and equipment and, above all, time in which to achieve recovery and adjustment. The full utilization of the benefits under these measures in the harnessing of the country's resources should make possible the transition from economic dependence on the United States to a position of economic freedom and the ability to deal competitively and profitably in the world's markets. Basically, the immediate objective is to raise the domestic prodiction of all goods now imported for which the principal raw materials are now or could be made available locally, and sustain and expand the production of Philippine export commodities.

A BRIEF REVIEW OF POST-WAR DEVELOPMENT

Since the termination of the war, the Philippines has made substantial progress in the rebuilding of its economy. There is yet much to be done and the Philippines is determined to accomplish much. Its political independence having been finally settled, the full force of its determination to make that independence real and lasting, is being brought to bear in the fields of economic endeavour. Relatively young and inexperienced, the Philippines may not be expected to move very fast in the beginning in the accomplishment of this ideal. There are, and there will be, obstacles in the way, but patience coupled with earnestness of purpose will in due time surmount these obstacles. It is in this light that observers of Philippine affairs are invited to pass judgment.

For the post-war years 1946, 1947 and 1948, the progress of Philippine economic development may be summarized[1/] as follows:

1. Agricultural production had increased, by the end of 1948, about 68 per cent over that of the post-liberation year 1946. This level of total agricultural production is already about 93 per cent of the pre-war average of about 5.4 metric tons. The production of foodstuffs has been given the necessary emphasis and has shown an increase of about 31 per cent over the last three years. The production of rice alone has already exceeded by 54 per cent that of the pre-war average, although the production of this cereal has still to keep up with the increase in population. Livestock and fishery production has improved quite considerably, especially the latter which has already exceeded by about 14 per cent the pre-war output.

2. After three years of rehabilitation, the production of export crops has already shown marked improvement, increasing by about 395 per cent in the

1/ A record of Philippine Economic Progress, by the Technical Staff, National Economic Council.

/three-year period

three-year period beginning with 1946. In spite of the lack of machinery and equipment, high labour costs, dislocation of transportation and communication and other difficulties attendant upon a war-ravaged economy, the 1948 physical volume of export production has already reached 62 per cent of the pre-war export output. Greater progress is to be expected from the rehabilitation programme recently launched for the primary export industries.

3. Despite the difficulties of reconstruction and the attendant shortages and dislocations within individual industries, as already indicated, the volume and value of principal exports to all countries have shown remarkable revival since the liberation, as indicated by the export figures for the period 1946 up to the present. The total export volume has increased by 255 per cent compared with that of the early post-liberation period, whereas the value of total exports in terms of pre-war values has increased by 584 per cent. With the present plan of speeding up the rehabilitation of the primary export industries, it may reasonably be expected that the export volume will increase at a faster rate than that of the previous years.

4. The adverse trade balance of nearly P500 million in 1948, more than covered by United States Government dollar payments and expenditures in the Philippines, is not so much an indication of the inability of the Philippines to pay for its imports with its exports, but rather a natural reaction of an under-developed economy in meeting requirements for capital goods for internal development by imports from abroad, as well as by the highly developed wants of the people - wants which had been aggravated by a forced abstinence during enemy occupation. This is especially the case of the Philippines which almost overnight found itself with a greatly expanded purchasing power arising from huge dollar expenditures of the United States Government in this country. In the absence of any import controls or exchange restrictions, this high effective purchasing power would, as a matter of course, be reflected in expanded imports of the essentials and necessities of everyday living. This situation has been aggravated especially by the inability of the internal economy to meet essential domestic requirements from local production in the face of war devastation and the concomitant economic difficulties.

Such an adverse trade balance is, however, accompanied by an increasing proportion of the total imports in the form of machinery, equipment, and other capital goods for the development of local enterprises that will eventually

/result in higher

result in higher productivity and higher income for the country as a whole.

5. Contrary to the charge that no local investments have been made to develop local resources, private and public investment in productive enterprises has shown remarkable and steady growth since the post-liberation year 1946, as indicated by an increase of 354 per cent in the paid-up capital of corporations and partnerships, and an increase of 199 per cent in the net worth of public industrial and manufacturing enterprises. These figures clearly underline the working hand-in-hand of private and public investment in the development of the country's natural resources through the rehabilitation of old industries and the establishment of new development projects in both the private and public sectors of the economy.

6. The flow of bank credit within the economic system, which is an index of economic activity or productivity for the economy as a whole, has grown steadily in volume, reaching P540 million by December 1948, or an increase of 209 per cent over that of December 1945. Agricultural and industrial loans, particularly by the government banking instutitions, have kept pace with the increasing volume of bank credit for all purposes, reaching a total or P251 million by May 1949, of which P121 million are for agriculture, P61 million for industrial enterprises, and P68 million for commercial and residential housing.

7. The foregoing development activities of the economy are now being co-ordinated and strengthened under a short-term programme of rehabilitation and development approved by the President upon the recommendation of the National Economic Council. This economic programme calls for the co-ordination of private and public investment in all sectors of the economy, and for the implementation by the Government of projects and enterprises into which private enterprise is reluctant to venture and which by their very nature are not directly competitive with private undertakings. Government funds are being made available for the implementation of those sectors of the economic programme which are calculated to stimulate and strengthen private confidence in the investment of venture capital and the establishment of long-run development enterprises. All of these, of course, are conceived as effective means for (a) buttressing the economy over the next three or four years against the decline in United States Government expenditures in this country, (b) initiating the adjustments called for by the progressive reduction of the

/tariff

tariff preferences in the United States market, and (c) building up in the longer run increased productivity and higher income for the whole nation.

The economic progress so far attained has been accomplished practically without resort to external borrowing. It should be stated, however, that the huge expenditures of the United States Government in the Philippines since the war have been greatly instrumental in making it possible for the Philippines to accomplish much in the rebuilding of the economy, because such disbursements have placed to the credit of the Philippines substantial dollar balances that have enabled the Philippines to obtain from the United States urgently needed goods.

FACTORS INFLUENCING FUTURE ECONOMIC DEVELOPMENT

Immediate future progress in internal economic development of the Philippines depends on the further solution of certain problems and the adoption of definite measures regarding internal savings and the easing up of credit. Among the most important problems may be mentioned the following:

1. Increasing the production of essential consumer goods and other products that can be profitably produced in the Philippines.
2. Improvement of internal marketing and distribution, including the establishment of integrated marketing organizations.
3. Improvement and expansion of credit facilities, praticularly private banking facilities.
4. Strengthening and co-ordinating dollar-conservation measures.
5. Promoting and encouragement of savings and the channelling of such savings into productive investment outlets.
6. Planning and programming of national economic development with a view to a fuller and more economical use of all available resources and facilities.

In reality, the above problems may be grouped into two principal aspects, namely: the internal aspect and the external aspect. The internal aspect has mainly to do with increasing domestic production and providing the necessary marketing, distribution and other service facilities so as to reduce costs and enable the people to enjoy a growing volume of material goods and services. The external aspect is mainly concerned with the conservation of our foreign exchange by more stringent import controls, intensive prosecution of dollar savings and dollar-producing enterprises, and bilateral trading arrangements that will mean further dollar savings. Of course, the principal problem in the conservation of dollars is the channelling of these to capital goods purchases and their investment

/in domestic

in domestic enterprises.

This paper will attempt to confine itself to the problems of expanding domestic banking and credit facilities and of the development of a domestic money market that will encourage savings and promote domestic investment.

PLANNING FOR NATIONAL ECONOMIC DEVELOPMENT

There is hereunder indicated very briefly an outline of the planning that the Philippines has undertaken for the achievement of a sound economy. Almost immediately after the attainment of independence by the Philippines, intelligent planning for the rebuilding of Philippine economy was undertaken through the joint efforts of the United States Government and the Republic of the Philippines. This was done by the Joint Philippine-American Finance Commission, which completed its report in the middle of 1947. This report covers mainly the monetary and fiscal programmes that the Philippine Government has to undertake in the reconstruction and development of its economy.

The Philippine Government has also commissioned the Beyster Technical Group which prepared what is now known as the Beyster Industrial Plan, covering principally the technical aspects of a short-term industrial development programme for the Philippines. Although this is not an operational plan, it nevertheless presents in broad and dashing strokes the opportunities for investment in the Philippines as well as the projects for harnessing the abundant local natural resources. But this is not enough. In order that the technical and industrial plans might be co-ordinated with the fiscal and monetary policies conceived by the Joint Philippine-American Finance Commission, former Secretary of Finance Miguel Cuaderno submitted an economic programme covering the development of the national economy for the next five years, starting from 1949, and providing for development in food production, industrial production and the service industries, together with the necessary manpower requirements of these industries. Incidentally, this plan was presented to the International Bank in justification for a loan for the execution of the national power programme. This plan was recommended favourably by the National Economic Council and approved by the President of the Philippines for execution.

This plan calls for private and public financing of the projects contemplated and requires adherence to a list of priorities in the prosecution of the said projects.

With the establishment of the Central Bank, particularly under Section 137 of the enabling act (Republic Act. No. 265), an amount not exceeding P200,000,000

/is authorized

is authorized to be made available by the Central Bank in the form of direct advances to the Government for self-liquidating, income-producing projects. For 1949, the Monetary Board of the Central Bank had decided to make available to the Government the sum of P115,000,000 of which P60,000,000 is to be set aside for government development projects, P35,000,000 as an advance to the Rehabilitation Finance Corporation, for non-government and government-controlled projects, and P50,000,000 to amortize the budgetary loan of P120,000,000 from the United States Reconstruction Finance Corporation.

In order that the proceeds from the authorized P200,000,000 direct advance to the Government, particularly the P115,000,000 made available in 1949, might be utilized effectively and in an orderly manner, the Philippine Government, upon the recommendation of the National Economic Council, has established the following priorities for industries to be assisted:

1. <u>Top priority</u>

   Rice, corn, fishery, fruits and other products
   Sugar
   Abaca, maguey, ramie and other fibers
   Tobacco
   Peanuts
   Coconut
   Livestock and products
   Mining
   Land transportation
   Shipping and air transportation
   Waterpower development
   Small industries (nail plant, paper and pulp plants)
   Fertilizer plants
   Handicrafts

2. <u>Second priority</u>

   Water supply
   Port improvements
   Schools, hospitals, markets
   Highways
   Flood control and drainage
   Airports
   Drydock for large vessels
   Jute (saluyot)

The plan, in so far as domestic financial assistance to the national economy is concerned, would require (1) internal borrowing by the Government to absorb the excess money income and thus direct the flow of domestic capital toward increased productivity, and (2) the improvement and enlargement of the banking structure to ease up the credit facilities for domestic development needs.

/Destruction of

Destruction of capital equipment during the war

One of the chief problems confronting under-developed countries, such as the Philippines, since the war is the lack of capital to finance the reconstruction of their ravaged industries and the development of the national economy. Most of the industries that were destroyed during the war were using obsolete and greatly depreciated equipment and employing inefficient methods of production. The destruction of the outmoded equipment may be a blessing in disguise, for those engaged in these industries will now be compelled to modernize their plants and adopt more efficient methods of production. Even those industries whose equipment was not entirely destroyed but may still be repaired will have to utilize modern equipment if they are to reduce their costs of production and compete in the world markets.

However, the lack of capital to modernize industrial plants and agriculture has so far been the chief cause of the slow rehabilitation and development of the Philippines. Practically every under-developed country in the world today is clamouring for assistance abroad in order to acquire new capital goods, machinery and tools to develop their industries. The desire of many under-developed countries to decrease their dependence on a few agricultural products with an uncertain foreign market and to supplement their income by limited industrialization has increased the demand for loans from countries that could afford to extend them.

As one of those countries badly destroyed by the war, the Philippines is in need of capital to effectuate economic rehabilitation and development. Its relatively more favourable dollar position compared with that of other under-developed countries has enabled it to undertake a more rapid economic recovery than some countries. But the needs of our rehabilitation and development programme are by no means satisfied by the immediately available domestic capital at our disposal.

Lack of adequate banking facilities

Banking facilities in the Philippines are as yet very limited in scope. In the principal commercial centers, excluding the Government-owned Philippine National Bank, banking is handled mostly by branches of foreign banks or by domestically-incorporated banks owned by aliens. This accounts for the fact that most of the banks are more interested in the financing of foreign trade rather than in loans for production or development. Outside Manila, Cebu and Iloilo, the

/principal ports

principal ports of the Philippines, banking is almost wholly served by branches and agencies of the Philippine National Bank, whose board of directors is in Manila and the members of which are virtually appointees by the party in power in the Government. Since decisions in the case of the Philippine National Bank have to emanate from the head office located far away from the rural communities, the operation of such branches and agencies are greatly lacking in the speed and adaptability that are conducive to a healthy growth of rural banking.

As of 31 July 1949, there were only 14 principal banks, inclusive of the Postal Savings Bank, 33 branches and 51 agencies in operation in the Philippines, exclusive of the Central Bank, with total resources amounting to P991,063,333.98. Two years ago, the Rehabilitation Finance Corporation was organized with an authorized capital of P300,000,000 and with the power to acquire additional funds in the same amount by issuing bonds guaranteed by the Government of the Philippines. The pre-war Agricultural and Industrial Bank was absorbed by this institution. However, even with the resources of these institutions, the capital requirements of most industries are not fully satisfied and the larger part of the financing has to be done by the Government through Government-owned corporations directly engaged in various enterprises.

For lack of adequate banking facilities in the provinces, a large portion of the national income that is not devoted to the financing of consumption goods and which should be available for investment, is hoarded. Only a minor portion finds its way in the form of savings deposits into the banking institutions. The idle national savings could be profitably employed if a sufficient number of banks and a well developed money market could be established to channel this liquid capital into various industries.

While the large business enterprises have easy access to the banks for investment loans, most of the small businessmen have to depend upon their own savings, which are necessarily limited, to finance their enterprises. Mortgage loans among the great number of small businessmen are extended by private money lenders who charge for the use of their funds a price much higher than the borrowers can afford to pay.

The undeveloped banking system and money market has to a large extent limited the amount of available domestic capital and consequently, has retarded a more rapid economic recovery of the country. Inasmuch as all the banks, with the exception of two insitutitions, are commercial banks, their resources could be,

/and are largely,

and are largely, devoted to the granting of short-term credit, chiefly to finance the export and import trade. The great bulk of the banking resources of the country are therefore employed not in developmental projects but in foreign exchange business. Moreover, the absence of exchange control has facilitated the employment of bank resources in the financing of foreign trade.

Limitations to investment in local banking

Now as in the past, the entry of domestic capital into the field of banking is impeded by two main factors: first, the timidity of local capital to venture into fields which are unexplored by private Filipino business and where the normal return is far below that which private capital would earn if invested in the business of money-lending; and second, the scarcity of trained men who have had previous experience in the business of banking.

Revision of the domestic banking system

The most important step taken by the Republic of the Philippines after its inauguration was to revise the banking system of the country in order to take care of the credit needs for economic rehabilitation and development. Accordingly, the Central Bank of the Philippines was organized to integrate and direct the credit resources and to impart greater liquidity to the credit system of the country as well as to mobilize the national savings by the establishment of an active securities market. The Central Bank is also authorized to grant loans to the Government for self-liquidating, income-producing projects.

The banking system was further reorganized to take care of the increased tempo of business activity during the post-war period and to direct the flow of domestic capital held by banks in order to aid productive industries of the country. The investment outside the Philippines of deposits received by branches of banks with head offices abroad is prohibited. The receiving of deposits is allowed only to domestic banks and to branches of foreign banks already established prior to 24 July 1948.

The new banking law encourages the organization of new banks by abolishing the minimum capital requirement, but provides that the direction and control of new banks shall be in the hands of nationals. And in order to permit banks to handle more deposits than before, the 10-to-1 ratio of deposit to capital previously required was replaced by a more reasonable basis of capital requirement of at least 15 per cent of risk assets.

Subject to certain limitations, banks are expressly allowed to invest in

/high-grade bonds

high-grade bonds and other securities. Government securities, to a certain extent, are made eligible as part of the required reserve against deposits. In the past, commercial banks were allowed to give loans with a maximum maturity of five years. Under the new banking act, they can grant loans up to a maximum maturity period of 15 years. The evident purpose of this change is to allow the commercial banks to utilize a larger proportion of their assets in the granting of capital loans to various enterprises. On the whole, the Central Bank is given ample powers over the banking system to attain the objective of a healthy growth of the national economy.

Certain proposals for extending banking facilities to the rural communities all over the Islands

Partly to encourage the entry of domestic capital into the banking business, the General Banking Law has been amended with a view to nationalizing the business of deposit banking. With these amendments, together with the encouragement from the Central Bank, private capital may be expected to enter the field of banking, particularly in the rural communities. In fact, there are unmistakable signs that the growth of private banking in the provinces will be speeded up in order to encourage savings and channel such savings to productive investments and thus enlarge the credit structure of the economy.

At this juncture, mention may be made of certain proposals that have been advanced for the establishment of small banks in the rural communities.

In this proposed rural banking system, the following factors are considered:

1. The farmers being the main users of credit in the rural districts should be made to feel that they are, at least, part owners of the bank in their localities.
2. The farmers are yet unfamiliar with the intricacies of the banking business, and therefore need leadership and assistance, especially in the technical aspects of banking.
3. In order that rural banks may be able to serve properly the community wherein it draws its deposits, it should be in a position to respond to the credit needs of the locality by being able to make its decisions on the spot.

Bound together by community of interests, the rice growers from Central Luzon have formed themselves into an association known as the Rice Growers Association with local chapters scattered all over the region. This association is expected to broaden its sphere of activity to encompass not only the rice industry but also

/other principal

other principal agricultural products of the Philippines, such as sugar, hemp, coconut, tobacco etc. Based on the principle of self-help, the credit needs of the farmers can be well supplied by small unit banks owned partly by this association of farmers and partly by the individual farmers affiliated there with. While each unit bank will be a separate and distinct corporation, identified with the locality where it operates, proper co-ordination with the other unit banks in other districts, standardization, centralized training of personnel and other favourable elements inherent in a large organization can be accomplished through stock ownership by the association among the various units. Correspondent relationships to be established among these rural banks will make fluid the available supply of credit, which will be made to flow wherever it is most useful or needed, and thus the system will be made responsive to the seasonal credit needs of the different parts of the country. The supply of farm credit will further be enhanced by the discount facilities at the Central Bank which are available to the full extent required by the legitimate needs of the national economy.

With the above background on the Philippine banking structure and the proposals for its expansion to rural communities, we come to the problem and prospects of developing the domestic money market in the Philippines.

DEVELOPMENT OF A DOMESTIC MONEY MARKET

The Large-scale development of the domestic money market to channel private capital into productive enterprise has just started under the initiative of the Central Bank. The market for government securities is at present undeveloped. It is confined almost exclusively to banks and insurance companies, as well as to trust funds and sinking funds of various government issues. A large amount of government dollar bonds is held by American investors, but the peso bonds are held almost exclusively by local institutional investors. However, private local investors prefer to lend their money at a much higher rate of interest despite the admitted advantages of government securities.

One of the reasons why private investors have pruchased government bonds only in limited amounts is the lack of an active securities market which could absorb the bonds at current prices in case investors want to liquidate their holdings. The difficulty of disposing of government bonds except at a large discount has also limited the number of private investors to those who have large savings not immediately needed to meet consumption needs. As of 26 July 1949, there were only 147 private holders of peso government bonds outside of institutional investors.

/Upon the

Upon the establishment of the Central Bank, steps are being taken to develop a domestic market for government securities. As previously indicated, under Section 137 of the Central Bank Act, the bank is authorized to make direct advances to the Government until 30 June 1951, in an amount not exceeding P200,000,000 for income-producing projects. The Government gives against these advances an equivalent amount of negotiable government securities with maturity not exceeding 15 years. The first advance under this law was made on 11 March 1949, in the sum of P469,200, and the Government issued a ten-year interim bond for this amount. Several advances have been made, and the total amount as of 30 July 1949 is P10,354,420.

The Government has also started to develop the Treasury bill market to meet its temporary budgetary deficits pending the collection of current revenues. The first offering of Treasury bills was made on 11 July 1949, when P1,000,000 of one-year Treasury bills was sold by the Central Bank at a discount of $1\frac{1}{2}$ per cent. This first issue was oversubscribed with five banks participating in the bidding. More Treasury bills are expected to be sold under the same favourable conditions as the first offering.

The Government has already ordered the printing of its rehabilitation and development bonds, both bearer and registered bonds, as well as Treasury notes, with maturities of ten years and five years, respectively. As soon as the bonds are printed, an active campaign will be conducted to sell these securities not only to institutional investors but also to private individuals. The bonds are in small denominations, as low as P20, in order to encourage people of modest income to buy government securities. It is generally believed that the widespread hoarding of money income by people in the provinces and in the rural districts would be minimized by an active campaign to mobilize idle savings and to channel them into various projects which the Government has planned to undertake.

<u>Conditions limiting the development of a securities market</u>

The development of a securities market in the Philippines must of necessity be slow. The principal occupation in the Philippines is farming in an antiquated form, operated under the single proprietorship system, rather than in the corporate form. The people in general are individualistic in their pursuit of economic life and unaccustomed to the forms of co-operative effort. The savings are reinvested in farms as fast as they can be accumulated.

It is felt that the real appreciation of the advantages of investment in government and corporate securities will come gradually and will keep pace with the

/expected growth

expected growth of corporate enterprises and with the realization of the advantages of large-scale production. Thus it is often charged that there is dearth of venture capital in the country. But in a country like the Philippines whose economy has long been dependent upon the exportation of a few agricultural products, it is not surprising that private capital should be timid to take unwarranted risks on a big scale.

Confronted with the need of diversification of the national product, the Government had to take the initiative of going into pioneering ventures where private capital is afraid to assume risk, with the end in view of turning over to private interests its various business undertakings as fast as the latter are prepared to take them over. In the development of a securities market, therefore, the Government has to take the lead and market its own securities first.

The existence of an active stock exchange is indispensable in the development of a securities market. There is in operation in Manila a stock exchange under the supervision of the Securities and Exchange Commission. Trading in this exchange so far is predominantly in mining securities rather than in securities of non-speculative ventures. The Manila Stock Exchange, however, is well prepared to handle both Government and corporate securities as the investing public becomes more and more interested in such securities.

The authorities are aware that the healthy growth of a securities market in the Philippines can be encouraged only if there is a certain assurance of market support. In the case of Government securities, the Central Bank Law provides for the establishment of a Stabilization Fund precisely for the purpose of maintaining the market for Government securities.

The Philippines, through its instrumentality, the Central Bank, will soon be geared for launching internally an intensive campaign to encourage investments in local bonds. The Central Bank is expected to utilize towards this end the facilities of all banks and other moneyed institutions, schools, colleges and universities and other civic organizations. It is also expected that a wide publicity for the accounting and utilization of the proceeds of these bonds will greatly aid in obtaining full support from the public for this cause.

Financing Economic Development in Puerto Rico

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Puerto Rico

PATTERN FOR EXPANSION

Puerto Rico's bid to raise the level of living of its people rests on a comprehensive programme of economic development started in 1941. Its design for economic expansion is characterized by a balanced allotment of public funds for regular public services and outright capital investment for economic development. Health, education, housing and pure water are fostered to raise levels of living and to increase labour productivity. Modern roads, airports, fast communications and abundant electric power are to facilitate manufacture and commerce. Developmental agencies to aid private enterprises, and with authority when needed to invest funds directly in industrial and agricultural ventures, spearhead the expansion effort. A Government Development Bank, fiscal agent of the government and long-term credit source for industry, rounds out the organizational set-up. Institutional reform to encourage economic growth, with tax relief as one of its principal features, completes the pattern for development.

Puerto Rico's broad development programme has been financed mostly from insular treasury surpluses accumulated during the war years. During fiscal years 1941-42 to 1948-49 the total government receipts for governmental purposes amounted to $713 million (Table 1). Appropriations for current operating expenditures of the government, including unemployment emergency relief programmes were $446 million during the same period. This left $267 million over current needs, of which $107 million was appropriated for the construction of public works. Capital programmes for health, education and roads accounted for 65 per cent of that figure (Table 2). Operating expenses of the government rose from $24 to $73 million from 1941-42 to 1948-49. Current expenditures for health and for education more than tripled (Table 3).

Of the balance of $160 million, the 12 public corporations established between 1941 and 1949 received a total of $144 million (Table 4), which actually exceeded the appropriations for public works mentioned above. In addition public corporations have secured through bond issues $72 million, of which domestic banking concerns and the Government Development Bank purchased $14 million. The Government Development Bank for Puerto Rico is also committed to a loan of

/$6.5 million

$6.5 million to the Puerto Rico Development Company. Combining appropriations and credit, the public corporations have commanded since their establishment $225 million of resources. A small proportion of these resources refunded existing debts.

To the student of economic expansion three of Puerto Rico's public corporations hold special interest. These are the agencies directly concerned with promoting industrial and agricultural expansion, the Puerto Rico Industrial Development Company, the Agricultural Company and the Government Development Bank for Puerto Rico. The legislative grants received by these three corporations amounted to over $55 million up to 30 June 1949.

THE PUERTO RICO INDUSTRIAL DEVELOPMENT COMPANY

The Puerto Rico Industrial Development Company was created in 1942. It was charged with the development of the Island's resources. To this end it was empowered to examine, investigate, experiment and do research on insular resources and their effective utilization, and on the marketing, distribution, advertising and exporting of Puerto Rico's products. It was directed to establish and operate a laboratory of design to prepare plans, specifications and models of products that could be made in Puerto Rico or from insular products and to disseminate that information.

The Industrial Development Company is empowered to make loans to private producers to establish, enlarge or operate industrial, mining and commercial concerns.

It is authorized to establish and operate on its own account enterprises for processing or distributing manufactures from local or shipped-in raw materials.

The Company is directed to enlist the co-operation of private capital by permitting the private acquisition of stock in the companies it establishes as a minority interest. The Development Company also has all the other general powers of private corporations.

An extensive section of the organic act of the Industrial Development Company is devoted to the authorization and statement of the conditions under which it can issue bonds. These bonds will not be obligations of the Insular Government of Puerto Rico or of any of its sub-divisions. The bonds would be tax exempt, legal investment for fiduciaries and collateral security for public deposits. This authorization has not been used.

The Development Company is not subject to the rules and regulations on personal administration, budgetary control and pre-audit as are regular Insular Government agencies. It is exempted from purchasing through the centralized purchasing agency of the Insular Government and has its own independent treasury. It is, however, subject to examination every year by auditors of the Office of the Auditor of Puerto Rico. Its capital investment projects are subject to prior review and approval by the Puerto Rico Planning Board, which determines whether they are in accordance with master plans for the Island, do not conflict with those of other agencies and conform with zoning regulations. The corporation's requests for capital funds must be made through the Planning Board.

The corporation was formed and incorporated by the members of the Executive

/Council

Council of Puerto Rico which is composed of the heads of the executive departments of the government and presided over by the Governor. The Executive Council selects and appoints the five directors who determine the operating policies of the Company.

Direct Investment

The activities of the Industrial Development Company can be divided into three distinct phases. During the first period extending between 1942 and 1945 direct investments in industries for its own account predominated. The war was in full swing and there was little opportunity of incentive for new private investment in industry. The purchase of building materials, machinery and equipment was very restricted. Private industry in the United States was fully occupied with the production of goods for the war. In Puerto Rico this was not a propitious time to expect to change the long-standing traditions and habits of private investment, almost exclusively in agriculture, commercial and real estate ventures, which were well understood and yielded high returns.

The Industrial Development Company tried from the very start to promote private industrial manufacturing enterprises but it found that it had to turn to the establishment of industries on its own account if it was to accomplish something during this war period. The glass, paper, ceramics and shoe factories were started during those years. The cement factory which was a public corporation organized by the Puerto Reconstruction Administration, a Federal rehabilitation agency dating back to the year 1935, was acquired by the Development Company late in 1943.

At the present time the Industrial Development Company is operating, through subsidiary corporations, four factories. In August 1949 it discontinued operation of a paper factory. The industries established by the Development Company represent a direct investment of $11.1 million (Table 5). The four plants now operating employ 820 workers, who receive an annual payroll of $850,000 and turn out goods with a gross value of $7 million.

Aid to Industry

As the war came to an end, and there was more opportunity for private investment the emphasis of the Development Company's industrial effort shifted from the direct establishment of industries to what was termed the Aid to Development of Industry Programme, better known as the Aid Programme. The programme

/was officially

was officially launched in September 1945 and with it the second period began. The Company offered to build factories and lease them to selected industrialists under very favourable terms. The lessee had an option to buy the plant within a certain period and the rentals paid would be partly applied to amortization. In return the lessee obliged itself to maintain a certain annual payroll or pay some small penalty. The company entered into contracts under this project with well-known national firms and with local industries (Table 6). At the beginning the Industrial Development Company contracts were very liberal in their terms.

In July 1949, there were operating or were being established 17 enterprises, which had been aided financially by the Development Company. The total financial aid committed to these enterprises amounted on 30 June 1949, to $16.2 million (Table 6). Of this amount $10 million had already been disbursed and it is expected that the remainder will be disbursed by the end of the year. The 17 enterprises financially aided by the Development Company give or will give employment to 3,600 workers, will have total annual payrolls of $3,000,000 and a total gross value of production of over $23,000,000.

Financial aid granted to these 17 enterprises varies as to type, terms and conditions. Nine enterprises have obtained leases of properties that the Company built or is building at a cost of $7 million. Of this a hotel enterprise accounts for $6.5 million. For eight firms the Company has built the factories and transferred them on a mortgage loan basis. Mortgage loans of this type amount to $8.7 million. Interest rates range between $3\frac{1}{2}$ to $4\frac{1}{2}$ per cent. The length of the loans ranges from 7 to 30 years. Two companies have received working capital loans amounting to $565,000.

Very early after the inauguration of this programme it was apparent that it required heavy financial obligations. It was soon clear that the allotment of resources for the industrial aid programme from current revenues could not, in the post-war years, amount to enough to maintain the rate of investment required to make a noticeable contribution to raise the standard of living. In 1947 the Development Company sponsored the so-called tax holiday which was broadened in 1948 and which consists in the exemption of property, income and municipal taxes of new industries established after 1947. There was also a list of selected existing industries in the Island, considered capable of expansion, to which tax exemption would be extended if a new unit increasing the industry's output was established.

/The tax

The tax holiday is to last 12 years. After that there would be an adjustment period involving a gradual reduction in tax exemption of 25 per cent per year finally ending in 1962. In 1948 the exemption from the income tax was extended to the income received from dividends of the exempted industries and, in 1949, to the rents derived from real estate built for the use of exempted industries.

After the passage of the tax exemption law and specially during the years 1948 and 1949 the Industrial Development Company has mainly relied for the establishment of industries on the tax incentive created by the tax holiday, on its publicity campaign in the mainland as to the Island's advantages and on its promotional and facilitating services to industrialists. Lately financial aid has only been granted to very carefully selected industries.

The Development Company has already committed for industrial aid the entire amount of its legislative grants, the accumulated profits from the cement factory and the loan to the amount of $6,500,000 which it is negotiating with the Government Development Bank for Puerto Rico in accordance with a commitment secured in 1947 (Table 5).

The period of current surpluses of government revenues is over and there is little possibility of annual appropriations of the size needed for a financial aid to industries programme. The time has therefore come when the Development Company must rely almost exclusively on tax incentives, on its facilitating services and propaganda to obtain the establishment of industries. This is the third period in its activities. The operation of the Development Company under these new conditions is one of the problems under consideration by the recently created commission for the reorganization of the Executive Branch of the Insular Government, patterned after the Hoover Commission.

The Development Company maintains research laboratories, economic services, labour relations advisers, legal services, engineering offices and gives general commercial aid. All this helps prospective industrialists who may desire to operate in Puerto Rico.

From an office maintained in New York, continental industrialists are canvassed to explain to them the advantages offered by Puerto Rico if they are considering the expansion of their operations or the inauguration of new lines of work. Up to the present time contact has been established with about 400 interested firms. Ninety representatives of these firms became sufficiently interested to visit the Island at their own expense and about 41 have definitely made arrangements

/to start

to start operations in the Island or have already started.

This promotional work, and the facilities offered by the Company have resulted in the establishment of 31 new enterprises to which no financial aid has been advanced. These new industries employ or will employ about 3,500 workers, pay annual payrolls of about $2,300,000, and produce yearly $7,500,000 in gross value.

Criteria for financial help

From the start the Development Company was conscious of the limitations of its resources in the face of insular needs for industrial expansion. There was always a problem of choice and the Company developed a set of criteria to select the industries it was going to establish or finance. The Company has preferred industries which meet the following requirements; (1) use mostly local raw materials; (2) have bulky products and therefore enjoy the advantage of lower freight costs as against previous sources of supply; (3) produce goods essential or complementary to already existing industries; (4) have relatively high labour costs; and (5) have a large market in the Island. Because raw materials are scarce in the Island and they can be brought in freely from the United States, the Company has also been promoting industries processing chipped-in raw materials and requiring a high proportion of labour.

In the selection of the individual firms for financial help the most important considerations have been; general reputation, financial standing, industrial experience and know-how, facilities to distribute the produce locally and nationally and willingness to participate financially in the venture.

Though interested in industries with a high wage-cost factor the Company did not favour the sweat-shop type of industries or those that because of the lightness of their equipment could easily become fly-by-night operations.

Criticism and appraisal

The criticisms most generally made of the Development Company's efforts in Puerto Rico are:

(1) The direct establishment of industries by the Company.

(2) The choice of industries to be operated by the Company which required heavy investment per worker.

(3) The failure to operate the industries it established at a profit.

(4) Lack of consideration of the problems of existing industries and their possibilities of expansion because of too great an interest in the introductio[n] of new enterprises.

/(5) Excessive

(5) Excessive liberality in the terms of the leases or loans to the industries; too low interest rates and too long amortization terms, which made the loans or leases a rather difficult paper to use for refinancing purposes.

(6) Quick turn-abouts in policies that reveal the lack of long-term, well-studied objectives.

(7) A tendency to act on its own, losing the broad perspective of the Island' programme and its close tie-up with other public policies.

We can quickly dispose of the first criticism. It is generally agreed that in under-developed countries the government must directly establish industries when they require heavy investments or are too risky for private initiative. In the Company's case there was the additional justification of the war emergency effects previously explained.

In a heavily populated, capital-poor community, industries requiring a high investment per worker do not appear at first sight to be particularly well adapted. Yet there is little long-range hope under the conditions existing in Puerto Rico for handicrafts. Men working with their hands alone do not produce much. And usually there is a limited market for handicrafts and other specialities. The Company's entire programme is not over-weighted with industries with a high investment per worker.

A closer, slower appraisal of the outlook for some of the industries that the Development Company set up and which later pr ved unprofitable like the paper factory, might have prevented their establishment. But most of the industries sponsored or set up by the Company are economically justified. They have had to grow in an environment not particularly favourable to them as yet. There is still a lack of skills and techniques, and a shortage of experienced managers. The war period made these difficulties even more acute. In my judgment most of the operations may still be made profitable if courage is not lost. Most raw industrial ventures initially operate at a loss for some years even in well-developed industrial nations. This truth is not yet fully understood in the Island.

Perhaps the only way to attract responsible firms to a new area was to be very liberal in the terms of the first lease contracts or loans. At least this is the Company's answer to the charge of excessive liberality. Others contend that this has actually retarded progress because new industrialists insist on as good terms as the early ones. Though there is a measure of truth in both statements, in my judgment, in an early period of development, it would be impossible to attract the industries desired on the basis of usual bankable transactions.

The Company has helped existing industries. It appeared before the War Production Board on behalf of several industrialists to obtain permits and priorities. It has made at least two studies of the needlework industry. Help in the form of designs and technical advice has been given local firms engaged in furniture manufacturing. However, it has extended financial help only to a few already existing industries. The Company sponsored the creation of a tourist development board and secured appropriations for it. It fought for the advertising campaign of Puerto Rican rum in the mainland and put the project across in the face of considerable obstructions. Tax exemption, sponsored by the Company, covers a long list of already existing industries.

One of the Company's weaknesses as well as one of the merits is that it has been very active in many fields. I am one who believes that in many instances the Company has acted too hastily. Long-term views have not received enough consideration. On the other hand the Company has done things. It has been a pushing agency whose vigorous and bold actions has been a good stimulant in insular business and public life.

Many mistakes have been made, but also a lot of good has been done. Allowing for the novelty of its efforts, and for the difficult times caused by the war, during which it had to start operations, the job done has been satisfactory and is a contribution to insular progress. It is to be hoped that in correcting past errors it is not forgotten that there is little likelihood of real progress in the development field if the public agencies charged with industrial promotion become over-cautious as to possible losses.

The orientation and functions of the Development Company now that the resources for financial aid to industrialists are scarce have not been clearly defined yet. But the course appears clear. Its facilitating services and its promotional activities must be retained, perhaps separated from the operation of subsidiary enterprises. The management of the subsidiaries must be strengthened and their operation continued for the time necessary to determine the actual potentialities of the industries and to extract as much knowledge and experience as possible. The Company should receive some legislative grants to help industries to start operations in the Island and even to establish them on its own account when they are basic to the Island's economic expansion.

The co-ordination of the development agencies with the broader policies of the government and among themselves has not been satisfactorily achieved yet. This deficiency is now the object of considerable thought by insular leaders and their expert advisers. The solution of the problem of co-ordination, as well as the clear definition of long-term objectives for the development agencies, are essential to the effective utilization of their effort to expand the economy.

THE AGRICULTURAL COMPANY

When first established it was expected that the Puerto Rico Industrial Development Company would extend its activities to agricultural production, marketing and processing. The manufacturing industries programme left little time for work on the processing and marketing of agricultural commodities. Conscious of the need to extend the development effort to agriculture, Governor Rexford G. Tugwell recommended, and the Legislature passed, an act creating an Agricultural Company in 1945.

The Agricultural Company is a public corporation created by the Legislature and made up of the members of the Executive Council. The Company's affairs are run by five directors appointed by the Governor, with the advice and consent of the Senate for four-year periods.

The Agricultural Company was directed to promote the expansion of agricultural production. To do that it was to introduce and show the commercial possibilities of new crops and of better varieties of old ones. It was charged with the expansion of commercial processing and marketing of agricultural products. Experimentation and actual operation of improved fishing techniques was also within its field of action. Tree and fruit crops were to be fostered. The rationalization and modernization of the agricultural marketing system for the benefit both of the farmers and the consumers was another objective.

The Agricultural Company is empowered to conduct necessary research which does not duplicate that of established agricultural research agencies. It is to investigate problems of agricultural production, marketing, packaging, grading and advertising. It can grow on a pilot scale new crops or new varieties of crops and experiment on a laboratory or small commercial scale to determine the possibilities of further development of livestock, manufactured food products and by-products.

It can assist private persons to follow preferred practices in the growing or sale of crops or livestock and in land-use planning and soil conservation practices. It can provide incentives for compliance with those preferred practices by private persons.

It may establish and operate agricultural, livestock, fishing and forestry products enterprises, engage in dairy, farming, food, feed and feed by-product production and establish businesses to improve the marketing of the output of agriculture.

It may organize stock companies and permit private investors to subscribe on the basis of a minority interest or as a majority non-voting interest.

It can make loans in the furtherance of its objectives.

The Company has exclusive jurisdiction over the economic rehabilitation of the Island of Vieques. This is an island of about 30,000 acres, nine miles east of Puerto Rico inhabited by about 11,000 people and adversely affected by large acquisition of lands by the Navy, and the suspension of sugar milling.

The Company is granted all the general powers possessed by private corporations in order to be able to do their business.

It is empowered to issue bonds up to the amount of 5 million dollars which would not be obligations of the people of Puerto Rico or of the latter's political sub-divisions. These bonds would be tax-exempt, legal investments for fiduciaries, and can be accepted as security for public funds. No bonds have been issued under this authorization.

As in the case of the Industrial Development Company the Agricultural Company is not subject to budgetary, personnel and pre-audit controls, and other such rules and regulations. It does its own accounting and has its own treasury. But it is subject to an annual audit by the Office of the Auditor, its capital improvement projects have to be submitted for review and approval to the Planning Board and its requests for appropriations must be made through that agency.

Results of operation

The Agricultural Development Company was granted ten-odd million dollars for its general purposes and about $2 million for economic development of the Island of Vieques.

The Agricultural Development Company has relied exclusively on direct investment in the discharge of its responsibilities. The latest available facts on the activities of the Agricultural Development Company show the following resources and their application to 30 June 1949:

Resources	(Million dollars)	
General legislative grant	10.2	
Grant for Vieques Rehabilitation	2.0	
Total available resources	12.2	
Less		
Deposited in the Insular Treasury	2.1	
Amount disbursed to the Company		10.1

/Disposition

Resources	(Million dollars)	
Disposition:		
Investments	4.3	
Working capital	1.5	
Promotional current expenditures and losses	4.1	
Deferred costs	.2	
Total		10.1

The Agricultural Company's programme has been mainly devoted to the introduction and commercial planting of a variety of pineapples especially suited for canning, the establishment of a cigar factory, the trial on a commercial scale of raising chickens, egg production, hog fattening and beef-cattle raising. It also established, mostly as an emergency project, a number of cash-and-carry groceries throughout the Island. The processing of agricultural products has been tried through the establishment of a milk plant and an experimental plant for making candies and preserves. Fishing at a great distance from the Island, with a modern well-equipped refrigerated boat, is also being tried.

The chief purpose of the Agricultural Company was to show in practice the profitableness of new crops, livestock enterprises and improved practices that had already been proved desirable by agricultural experimentation. The translation of this objective into practice has been very difficult. At the time of this writing the Company is undergoing a drastic re-organization. Heavy losses have occurred in most of the projects.

The experience with the Agricultural Company in Puerto Rico shows, in my judgment, that strong and unorthodox measures for agricultural expansion are very risky. Large scale ventures in agricultural development, such as are needed to change practices and establish new crops quickly are liable to great losses. A more moderate course goes very little beyond what already established agencies for agricultural research and extension are doing or can do. And the results of the usual research and extension activities are much too slow to meet the need for the fast development in agricultural industries required in most economically under-developed areas. If quicker results are desired large risks must be taken. There is hope in some programme parallel to the aid-to-industries programme of the Industrial Development Company in the processing of agricultural products and perhaps in marketing farm products.

THE GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

The Government Development Bank was originally created in 1942. Its general objectives were to aid the Insular Government in its fiscal duties and to promote economic expansion, in co-operation with the Industrial Development Company, by making long-term loans for the creation of new industries and commercial enterprises. The Bank was originally granted very broad powers. It operated under its original law until the end of 1948 when it was legally and administratively reorganized. The powers under the new charter are much narrower but more precise. Under the original law the bank had general banking powers. The new law creates a fiscal auxiliary to the treasury with some central banking functions and a source of long-term credit for private enterprises especially for industrial purposes.

The legal and administrative reorganization was undertaken primarily to enable the bank to secure long-term credit for the government and its public corporations on the best possible terms in the mainland money markets. As mentioned before, between 1942 and 1948 the Island's Government and its public corporations financed the development effort mostly from the surpluses of current revenues accumulated during the war years. Between the year of its establishment, 1942, and the end of the war emergency, around 1946, there was little demand for industrial loans from private quarters in Puerto Rico. During those years, until its administrative reorganization in early 1949, the Development Bank did not function at full speed. Personnel was held at a minimum and full time top-level management was limited to one official. The chairmanship of the Board and the presidency were held without compensation on a part-time basis by the Treasurer of Puerto Rico.

Powers

The powers of the Government Development Bank are classified below under the headings of fiscal and developmental.

Fiscal powers

1. To act as fiscal and paying agent, financial, advisory and reporting agency of the Insular Government and of its municipalities, commissions, authorities and instrumentalities and of the Governor, the Executive Council and the Treasurer.

2. To act as depositary or trustee of public funds for the government or any of its agencies.

3. To lend money to the Insular Government or to any of its instrumentalities or political subdivisions.

Developmental powers

1. To lend money to any person or firm engaged in commercial or industrial enterprises for the furtherance of the development of the economy, especially in respect to industrialization.

2. To invest its funds in obligations of the United States or Puerto Rico.

3. To discount at uniform rates paper eligible for discount by the Federal Reserve System to banks or trust companies operating under insular banking law.

4. To lend money at uniform rates to banks and trust companies subject to the banking law of Puerto Rico.

5. To lend securities on a fully secured basis to banks operating under insular laws.

6. To borrow money for its corporate purposes.

7. The Bank has also all the necessary general powers of such institutions.

Resources

On 30 June 1949, total assets of the Government Development Bank for Puerto Rico amounted to $53.4 million (Table 7). Cash resources were $1.7 million. The Bank had outstanding loans of $11.5 million. Its total investment stood at $39.6 million.

Total government deposits amounted to $27.1 million. The banks capital account was $24.2 million which was classified as $20.5 million of paid-in capital contributed by the Insular Government, $3.2 million of earned surplus and half a million dollars in reserve.

Loans

On 30 June 1949 the Government Development Bank held $11.5 million of outstanding loans (Table 8). Four million four hundred thousand dollars was in secured loans, guaranteed in practically all cases by mortgages on land, buildings and equipment. The Bank classified this amount into $910,000 in real estate loans, and $3.5 million in industrial and commercial loans. I have further classified the industrial loan figure into $1,440,000 for loans to manufacturing industrial concerns for the building or acquisition of plant and equipment, and the remaining $2,083,000 in loans for other types of business such as private hospitals, private schools, theatres, stores and warehouses. Unsecured loans amounted to the insignificant figure of $7,000.

The Bank holds the notes of a large contractor, guaranteed by building equipment and materials. This large-scale builder is constructing in the Island, under government sponsorship and with financial help from the Bank, one of the largest single-house developments in the world. The Bank participation in this project consists of granting operating capital on the guarantee of building equipment and materials. On 30 June 1949 there were outstanding notes discounted worth $1,757,000.00. As the contractor finishes and sells the houses, the Bank acquires the mortgages, which are guaranteed by the Federal Housing Administration and, or, by the Veterans Administration and at the same time the Bank secures payment on the notes of the contractor. The Bank sells the Federal Housing Administration guaranteed mortgages to the Federal National Mortgage Association, a subsidiary of the Reconstruction Finance Corporation. While processing the mortgages for sale the Bank holds them; it had $4,545,535.67 in 30 June 1949.

As a public service and in response to public policy, the Bank inaugurated in 1946 a programme of veteran's loans under the provisions of the Veteran's Act. The Bank undertook either to make loans direct to veterans for housing or business or to discount veteran's loans made by local banks. On 30 June 1949 veteran's loans held by the Bank amounted to $1,183,000.

The Bank's credit has been a decisive factor in making possible the previously mentioned large housing project. To date 4,228 units have been completed, and when this project is finished there will be a total of 4,426 houses, worth on the average $4,000. The Government Development Bank funds made possible the flow into the Island of about $17 million for investment in the critically short field of housing for the lower middle-income group. The extension of housing projects of this type is under consideration.

The objective of the Bank through its loan policy was from the start to stimulate industrial development. The Bank did not begin to operate until 1944 although actually established in 1942. The nation was at war then and there was little demand for industrial loans. Therefore, the Board decided to make long-term real estate loans when the restrictions on private builders diminished. There was no other source of credit for the type of real estate financed by the Bank except private lenders, who charged high interest rates. The financing of large buildings for offices, hospitals and other such businesses was considered a contribution to the community's progress. These loans, incidentally, also yielded more than federal, insular or municipal government bonds. The policy of loaning

/for real estate

for real estate has since been changed. At present loans are made only for industrial purposes, with the exception of adjustments and enlargements, when desirable for some good reason, of already granted loans.

Loans for working capital are generally not made. However, in some instances, refunding loans have been made which were somewhat larger than the original long-term loans in order to provide some working capital. Loans are generally not made for refunding already existing mortgage debts. Some loans are made to refund debts for long-term purposes which were originally financed through short-term loans.

The Bank as a rule does not loan more than 60 per cent of the value of physical plant. Maturities for loans secured by land and buildings are 10 years though the Bank extends it to 15 years in exceptional cases. Maturities for loans secured by equipment are shorter, not extending beyond 8 years. Typical maturities in industrial loans are 3-5 and 7 years with only a few cases extending into 10 years. These are the general criteria and terms used in the granting of loans by the Government Bank although no written statement of loan policies has been made.

The interest rate on the real estate loans is usually $4\frac{1}{2}$ per cent. A few early loans were at 4 per cent and some recently adjusted loans are at 5 per cent. For industrial loans the rates are usually $4\frac{1}{2}$ with some at 4 per cent.

Loans made by years, were as follows:

Year	Loans made (Number)	Amount (Thousand dollars)
1945	8	1,233
1946	34	1,025
1947	45	5,907
1948	24	1,037
1949	7	264

The Government Development Bank can exert a great and beneficial influence on the industries borrowing from it. An alert industrial loan department can provide invaluable financial guidance to borrowing industrialists before and after obtaining the loan. It is one of the Bank's plans to expand the industrial loan department to provide this service to borrowers on a permanent and effective basis.

Investments

Bank investments reveal another important contribution of the Government

Development Bank to the financing of the Island's development programme. On 30 June 1949 the Bank held $4 million of Puerto Rico Water Resources Authority bonds (Table 9). This was its share of the $50 million issue of Puerto Rico Water Resources Authority bonds of 1947. At that time other local banks bought $7 million worth of these bonds which they still hold (Table 10).

As fiscal agent of the public corporations of the Government of Puerto Rico the Bank negotiated the sale of Puerto Rico Water Resources bonds. On 30 June 1949 the Puerto Rico Water Resources Authority had already invested the proceeds of the 1947 bond issue and the Bank had advanced the Authority $2 million on the security of its notes. The Authority needs $19 million of financing to 30 June 1951. On August of this year the Bank was negotiating for the temporary financing and the future funding of the obligations to meet this capital need.

On 30 June 1949 the Development Bank had advanced the Puerto Rico Aqueduct and Sewer Authority $7.5 million on the security of its notes. These notes were paid by the Aqueduct Authority when its bond issue was delivered to the buying syndicate on 1 September 1949. The negotiations for the sale of this bond issue were also made by the Bank.

The Bank holds $3.6 million worth of Puerto Rico Land Authority notes. This advance to the Authority was made to enable it to reimburse the Insular Government for a loan used to acquire sugar cane lands in the furtherance of its land reform programme. The Bank, as fiscal agent for the Land Authority, also obtains for it an annual production loan. For the 1949-50 crop year $11 million were secured at 2.25 per cent interest rate.

The Bank also held on 30 June 1949 notes of the Puerto Rico Industrial Development Company for $1.3 million. This amount is an advance on the $6.5 million loan that the Development Company is negotiating with the Bank following the commitment obtained in 1947.

The remaining investments of the Bank were $17.4 million in United States treasury bonds and bills, $600,000 in insular government bonds, and $3,100,000 in municipal government bonds and notes.

Appraisal

The main criticisms made of the Government Development Bank are as follows:

1. It is too conservative in granting industrial loans.

2. The long-term loan programme for industrialization has been reduced, especially during 1949, to a secondary activity as a result of the overwhelming importance of the Bank's fiscal tasks.

/3. The Bank's

3. The Bank's policies are not as well integrated as they should be with general public policy.

4. There is lack of formal co-ordination with the Development Company. The Development Company is equally blamed for this deficiency.

There is, in my judgment, little justification to criticize the Bank for being conservative in its industrial long-term credit policy. Out of 80 industrial and commercial loans, originally amounting to $6.9 million, only two loans have defaulted and another is in quite a difficult position. The three loans add up to only $200,000 and if there is any loss it will be less than half that figure. The Bank began operations in 1944 and for the first two years there was really a very small demand for bona-fide loans for industrial expansion. However, at the beginning the Bank received innumerable applications for very risky and unsound propositions. The strictness and good sense in the approval of loans dispelled the notion that may have been originally held by some people that the Bank was a government agency ready to finance long-risk operations indiscriminately. In this sense the Bank's conservative policy deserves praise and has established an excellent standard.

There are grounds to say that the development of the industrial loan department of the Bank has not received as much attention as it should have. In this respect it is necessary to repeat that the Bank was not fully organized administratively for its tasks until early in 1949. This reorganization should have been made perhaps in 1946 and there would have been time to organize more adequately the industrial loan programme. It is equally true that the fiscal aspect of its work has been recently characterized by urgent needs of financing public corporations. This has been a delicate and time-consuming work that has occupied most of the time of the management during 1949. But whatever justification there may be for past actions there is no doubt that industrial loan activities should receive more attention from now on. The Bank's management is aware of this and it is in the process of correction.

As in the case of the Industrial Development Company, the corporate set-up of the Bank, very effective in securing a flexibility of operation not possible in the regular executive departments, has created problems of co-ordination with the Governor and with other government departments and corporations, particularly with the Industrial Development Company, that have not yet been solved. These problems are now being very carefully considered and, in my judgment, are in the process of solution.

/Summary of

Summary of the pattern

The preceding section of this work has briefly described Puerto Rico's development programme. Between 1941-42 and 1948-49 economic development was furthered by investments in public works by the regular executive departments of the government to the extent of $107 million. Public corporations to provide public services received $144 million mostly for investment. Of this amount, three agencies specially created for the promotion of new industrial and agricultural enterprises received $55 million.

The Industrial Development Company, with total available resources of $33.5 million, has directly invested $11 million, has loaned $8.7 million and has built or is building, under the industrial aid programme to lease to industrialists $6.9 million worth of plants for industries and a hotel.

The Agricultural Development Company has relied exclusively on direct investments in the furtherance of its objective to expand agricultural output. To 30 June 1949, it had invested over $4 million of the $10 million it has used. Its operating expenditures and losses for agricultural development amounted during these years to $4 million.

The Government Development Bank for Puerto Rico with capital provided by the Legislature of $20,500,000 and an earned surplus of $3.7 million had on 30 June 1949 outstanding loans for industrial and commercial development of $3.5 million. It had on the same date $18.5 million invested in bonds and notes of the government corporations.

APPRAISAL OF THE EFFORT

The second part of this work will endeavour to appraise the methods used in economic development, point out the results, enumerate obstacles, call attention to problems, undecided policies and questions outstanding.

The most encouraging aspect in the financing of Puerto Rico's economic development is that to date it had been predominantly done with the savings from current government revenues. The government of the Island, with exceptional self-restraint resisted the temptation to allot the higher revenues of the war years exclusively to expand traditional public services. Thirty-five per cent of the total government income between 1941-42 to 1948-49 was devoted to the expansion of the Island's economic base. This accomplishment, remarkable in any jurisdiction, deserves special commendation in Puerto Rico, where regular public services have not yet attained the levels of the most advanced western countries

/and where local

and where local demand for public services is constant and clamorous.

The utilization of the surpluses permitted the financing of a very high proportion of the Island's development programme from domestic sources. Of the entire long-term financing of public works and public corporations amounting to $337 million, domestic sources have provided $278 million or 82.5 per cent (Table 10). The remaining 17.5 per cent was secured in the private money markets of the United States.

Puerto Rico was in a favourable position during the war in respect to government revenues. Income from the mainland flowed into the Island as a result of long established taxation arrangements. The Federal internal revenue tax on rum and cigars which is imposed on Puerto Rican distillers and cigar manufactures to equalize the competitive position with mainland producers resulted in the flow of about $196 million to the Island.

But the Island's investments in economic development and in public works by the executive departments and the public corporations exceeded the total amount reimbursed to the Island from the internal revenue taxes. Total appropriations for public works and for the corporations amounted to $250 million, that is, $54 million more than the proceeds of the federal internal revenue taxes. Puerto Rico taxed itself for the purpose of expanding public works and fostering economic development. Income tax payments were raised over ten times. This permitted the diversion of income to public works and economic development. Economic expansion was helped through a better distribution of the income of the Island, with the consequent stimulating effect on consumption and therefore on general economic activity.

Assuming that there are profitable opportunities for enterprises, it is estimated that between $300 and $500 million are needed for capital investment in industrial plants to employ the increase in the labour force that is expected in Puerto Rico between now and 1960.

Capital needed for public works is estimated at about $561 million. Most of this amount is needed despite the progress already achieved for housing and roads.

The annual capital requirements of the insular economy to assure the degree of progress desired is about $80 million.

The most recent estimates of the gross product of Puerto Rico for 1945-46 is $639 million. Net capitalization for the entire economy, that is, capital

/expenditures on

expenditures on construction and machinery less depreciation, amounted to $37 million.[1] Although an exceptionally prosperous year, capital investment had not yet attained a reasonable level in 1945-46 because of the restrive effect of wartime regulations and scarcities of materials.

The economists who have studied the insular economic situation believe that Puerto Rico cannot save enough to provide the capital requirements for economic expansion and for essential public works out of its yearly national income. Puerto Rico has therefore to tap the money markets of the mainland if it is to go on with its economic development programme and its public works. And we can happily report that the pipes between the mainland money markets and the Island are open and credit is flowing.

Puerto Rico, its instrumentalities, and political sub-divisions have an excellent credit standing in continental money markets. Neither the Insular Government nor any of its instrumentalities or political sub-divisions have ever defaulted or been delinquent in the payment of their obligations. But the Island has not yet achieved a position of equality with the cities or states in the mainland in respect to interest rates or ease in borrowing. This is partly due to distance, to lack of knowledge about the Island's credit record and the strictness of its debt management laws and practices. It is also partly due to an unconscious mistaken association with foreign countries located in similar geographic areas of poor credit histories. The goal of the Treasurer of Puerto Rico and the Government Development Bank is to make the Island, its credit record, its tradition of political stability and its scrupulous handling of financial affairs widely known in the money markets of the mainland.

Credit is flowing into Puerto Rico for its economic expansion programme. In 1947 the Water Resources Authority sold $50 million worth of its revenue bonds, without any pledge by the Government of Puerto Rico itself, at an average interest of 2.67 per cent.

In August 1949, the Aqueduct and Sewer Authority of Puerto Rico sold $4,500,000 of serial bonds running up to ten years at an average interest rate of 2.76 per cent and $18,500,000 of term bonds at an average effective interest rate of 3.66 per cent. These were also revenue bonds and there was no pledge on the part of the Government of Puerto Rico.

1/ Daniel Creamer, Gross Product of Puerto Rico, 1944-46, University of Puerto Rico Press, 1949.

/Arrangements are

Arrangements are being made for the temporary financing and future funding of a $19-million, two-year construction programme for the Puerto Rico Water Resources Authority, an insular agency operating an Island-wide integrated system of hydro and steam generated electric power.

The amount of financing required for the programme of public works and of direct investment in industry to develop Puerto Rico is, as stated in the previous paragraphs, beyond the resources of the Island. Yet, it is generally held that the amount of local private funds flowing into these fields is undesirably low. A higher proportion of the income should be diverted to these investment fields. In Puerto Rico, as in other under-developed areas, the institutions and traditions facilitating the flow of capital into industrial investment, are not well established yet. It is, therefore, a government responsibility to promote the creation of such attitudes and institutions. Savings must be mobilized for long-term investment in industry and public works.

Facts indicate that an effort to that end is worthwhile. Total deposits in Puerto Rico's private banks amounted on 30 June 1949 to $251 million (Table 11). Of these, total private deposits were $132 million and private savings deposits $50 million. Postal saving deposits amounted to $8 million that same date. In 1947 Puerto Rico ranked third in respect to private bank deposits when compared with other Latin American countries. Only Argentina and Cuba surpassed Puerto Rico in this respect (Table 13). But the banking system of Puerto Rico lacks the specialized institutions that channel these resources into long-term investment.

As a step in the mobilization of capital, the Industrial Development Company in co-operation with private organizations, is sponsoring the establishment of an insular stock exchange. The project has progressed very slowly thus far. The Island was able in recent years to finance from domestic resources a large part of its public work and economic development programme because the savings of the government were diverted to these fields of investment. Because public revenues have returned to more normal levels and because of the acute need for public services it has not been possible in the last two years to continue that practice. It is imperative, then, that every effort be made to enlist the existing savings of the economy in this task. The largest possible share of the economy's expansion should be financed from domestic resources.

/The promotion of

The promotion of savings in under-developed communities is difficult. In the Island, as in all under-developed countries, a large proportion of the population has a very low income. It is estimated that about 70 per cent of Puerto Rican families have a yearly income of less than $1,000. These families have innumerable unfilled needs. Under such conditions an increase in income causes higher expenditures for consumption. Therefore, Puerto Rico's propensity to consume is very high.

The 70 per cent of the families, who receive 30 per cent of the insular income, can save very little. The same is true of the income groups with slightly higher incomes. Therefore a disproportionate share of the savings must come from a relatively small number of high-income families. Under such conditions saving, and direct or indirect investment by the government in industry, can counteract the tendency toward an increasing concentration of wealth. This desirable governmental objective demands a high taxation of income. But this must be achieved without discouraging private investment. This is possible through a tax system specially adapted to the existing conditions. The basic work to orient such a tax policy is being done and some steps have already been taken principally through tax exemption of new industries.

The task of furnishing private agencies with long-term credit for industrial expansion and modernization is now a responsibility of the Government Development Bank. There are no private agencies filling this need. The Industrial Development Company has all its resources committed. Sugar mills are applying to the Development Bank for long-term and intermediate loans to finance the modernization of their milling facilities. Up to the present the Government Development Bank has had applications of about $10 million for this purpose. Because of the scarcity of resources, relative to the public and private demands for credit, the Bank has not approved loans for this purpose though it is clearly advantageous to the Island. The Bank has not definitely decided whether it will make these loans.

There is a similar situation in respect to working capital for new industries. Up to now the Bank has had an unwritten rule that it would not make loans for working capital. The theory is that short-term credit needs can be met by existing commercial banks. It has been found, however, that some of the promising new industries, struggling for expansion during their first years of operation have not been able to secure loans from private commercial banks. The lack of working capital results in a slower growth of well adapted and

/profitable

profitable industries.

There is at present a considerable demand for credit for industrial development. We have mentioned the $10 million request for modernization of sugar mills. The Development Bank has other requests that may be estimated at about another $10 million. The Development Company's list of financial help requested by industries that had not established factories on the Island because the Company could not held them amount to $8 million. These three items add up to the sizeable sum of $28 million which is indicative of the magnitude of credit demands for economic development which the Island is facing.

In discussing the Government Development Bank and the Industrial Development Company the problem of co-ordination of these agencies with broader public policy, with the Chief Executive and with each other was mentioned. It was stated that the problem exists, that officials are conscious of it, that it is being studied by experts, and means toward its solution are being explored.

The desirability of well defined objectives, and their partial absence in the past was mentioned in the sections on the Industrial Development Company and the Government Development Bank. There is reason to regret that more study and discussion was not given to development policies, especially policies as to how to attain broad objectives. It is also regrettable that very few times were these policies clearly and definitely formulated. The Island's development effort requires, to become more effective, that more time be devoted to the joint discussion of policies by all the officials concerned. There should not be, in my judgment, the expectation that the policies adopted should be useful for a very long period of time. Policies in this field require constant re-examination and change.

PUERTO RICO'S FAVOURED POSITION IN ECONOMIC DEVELOPMENT

There are wide differences in the degree of economic development as between different areas in the world. The Sub-Commission of Economic Development of the United Nations Economic and Employment Commission in the report of its first session states that "economic development has to be thought of largely in terms of industrialization". Following this reasoning the proportion of the labour force engaged in manufacturing can be used as a good indication of the degree of economic development. Well-developed countries like the Netherlands, Sweden, Canada, Denmark and the United States have over 30 per cent of their labour force engaged in manufacturing.

/Puerto Rico ranks with

Puerto Rico ranks with Argentina as to the percentage of the labour force employed in manufacturing and handicrafts. It has 23 per cent of its gainful workers so employed as against 20 in Chile and Venezuela, 19 in Peru, 11 in Ecuador, 10 in Brazil and 13 in Colombia (Table 12). These figures are enough to show that Puerto Rico is in a relatively advanced position as to economic development within the group of under-developed communities. Some observers state that Puerto Rico is in a transitional stage between under-developed and developed communites. Comparative data on national income and other indicators of the level of living confirm the relatively advanced standing revealed by the employment-in-industry index (Table 13).

Puerto Rico is a part of the American economic system. It has not been and is not affected by the prevalent dollar scarcities that have slowed down developmental efforts in other countries. As a part of the American political and economic system it has an assured flow of income from the United States for military and naval installations, aid to veterans, grants-in-aids and tax refunds which constitute a very important factor in its economic situation. It has a good base for development in the relatively high monetary resources of its citizens and in the excellent financial position and credit standing of its government.

The movement of peoples between the Island and the mainland is another economic safety valve as well as a source of stimulation to commercial and industrial expansion.

The Island enjoys a very stable political situation, outstanding political leadership and a well-trained officialdom. It was one of the first areas to start a rounded-out programme of economic development.

Small area, dense population, good communication facilities, a culturally very homogenous population, with one western language, Spanish, used by all, and a growing use of English, easy transportation, and a comprehensive statistical system, Puerto Rico offers great advantages for the objective observation of economic development processes.

On the other hand the gravity of its problems, high population density, the fastest rate of natural population growth in the world, small area, niggardliness of resources, ingrained habits, traditions and institutions of an agricultural economy, which are so difficult to change, are adverse factors which require the highest order of intellectual and technical effort as well as a most enlightened and bold political statesmanship to overcome.

In Puerto Rico the struggle against poverty is hard but not hopeless. It has been going on for seven years and the intensity of purpose is as strong as ever.

All this makes Puerto Rico believe that it is the natural place for a laboratory on economic development. It is the Island's hope that this becomes accepted and that its experience, its knowledge and its will are allowed to serve in this most noble purpose of securing a better life for the billions of human beings who now half-exist in hopeless poverty over more than three-fourths of the face of the earth.

/Table 1

Table 1. Resources of the Insular Government of Puerto Rico and their utilization, fiscal years 1941-42 to 1948-49

Item	Amount (Million dollars)
Total resources[a]	
Government receipts	705
Authorized bond issue	8
Total	713
Utilization[b]	
Current expenditures	
Operating expenditures	424
Unemployment emergency programme	22
Sub-total	446
Construction of public works	107
Grants to public corporations	144
Debt service and redemption	16
Total	713

Source: Special tabulation made under the direction of the author.

a/ Includes revenue receipts and other government receipts available to be used by the Government in the General Fund and other funds.

b/ As indicated by appropriation bills.

/Table 2

Table 2. Appropriations for public works for the regular executive departments of the Insular Government of Puerto Rico, by main object, fiscal years 1941-42 to 1948-49

Object	Amount (Million dollars)
Education, total	19.5
Elementary and high schools	11.0
Vocationals schools	4.6
University, not including vocational	3.3
Other	0.6
Health and public welfare, total	16.4
Hospital and dispensaries	13.7
Public welfare institutions	1.2
Other	1.5
Public safety	
Police headquarters, fire stations, jails	1.8
Agriculture, commerce and labour	
Forestry, seed farms, rice mills, soil conservation	3.4
Roads	33.7
Public buildings	1.0
Other public works and piers and wharves	8.9
Parks and recreation	3.6
Emergency unemployment programme	19.0
Total	107.3

Source: Special tabulation made under the direction of the author.

/Table 3

Table 3. Operating expenditures, Insular Government of Puerto Rico, by main functions, 1941-42 compared to 1947-48

Function	Expenditures (Million dollars) 1941-42	Expenditures (Million dollars) 1947-48	Per cent increase
Education, total	7.9	26.8	239
Elementary and high schools	5.5	20.8	278
Vocational schools	0.8	1.1	38
University	1.5	3.9	160
Health and public welfare, total	4.8	17.0	254
Hospitals	1.3	4.9	277
Public health	1.8	4.8	167
Public welfare	1.4	5.7	307
Public safety and protection, total	2.1	5.4	157
Department of Justice	0.6	1.4	133
Police Department	1.4	3.2	129
Fire Department	-	0.4	-
Roads and conservation of public works	4.0	7.3	83
Agriculture and Commerce	2.1	3.8	81
Recreation	0.2	0.8	300
General government	3.3	12.0	264
Total	24.3	73.1	201

Source: Special tabulation made under the direction of the author.

/Table 4

Table 4. Appropriations to the public corporations by the Insular Government of Puerto Rico, fiscal years 1941-42 to 1948-49

	Name	Purpose	Amount (Million dollars)
1.	Land Authority	Land reform	29.5
2.	Aqueduct and Sewer	Provide island-wide pure water and sewerage service.	12.8
3.	Transportation Authority	Provide bus service in metropolitan area, run public piers, build and operate airports.	8.4
4.	Water Resources Authority[a/]	Operate island-wide interconnected steam and hydroelectric plant system and south coast irrigation service	2.7
5.	General Supplies Administration	Price control and scarce commodities supply agency	8.5
6.	Coffee Insurance Corporation	Insure coffee crops and plantations against hurricane risk	5.0
7.	Communications Authority	Provide island-wide telegraph service, regional telephone service, and improve communications service	22.1
8.	P.R. Housing Authority	Build and run low-rent public housing projects	18.0
9.	Isabela Irrigation Service	Run northwest area irrigation services	1.5
	Sub-total		88.5
	Direct Developmental Agencies		
10.	Industrial Development Company	Promote industrial expansion.	22.4
11.	Agricultural Company	Promote agricultural industries expansion	12.2
12.	Development Bank for Puerto Rico	Aid the Insular Government in its fiscal duties and make long-term loans to develop the economy especially for industrialization.	20.5
	Sub-total		55.1
	GRAND TOTAL		143.6

Source: Special tabulation made under the direction of the author.

a/ Part of this is an annual remission for thirty years of the obligation to pay $500,000 to the Government in lieu of taxes. The amount remitted to be used for the purpose of paying interest and amortization for bonds to finance irrigation projects.

/Table 5

Table 5. Sources and disposition of funds, Puerto Rico Industrial Development Company, at 30 June 1949

Item	Amount (Million dollars)
Resources	
Legislative grants for general company objectives	22.4
Reimbursement by the Insular Government of certain operating expenses	0.3
Dividents earned by the Cement Corporation	3.8
Loans	
Advance by the Government Development Bank	1.2
From a private bank	0.4
Loan commitment of Government Development Bank	5.3
Other receipts	0.1
Total	33.5
Disposition	
Direct investment in subsidiary plants	11.1
Aid to industry (leases, loans and buildings sold on credit and working capital loans made or commitments) a/	16.2
Investment in fibre textile and ceramics and yeast plants and geophysical survey	0.8
Receivables	1.1
Other assets and working capital	1.7
Operating expenses	2.6
Total	33.5

Source: Puerto Rico Industrial Development Company

a/ See Table 6 for details.

/Table 6

Table 6. Industrial Development Company of Puerto Rico financial aid to private industrialists, amount expended, budgeted and contribution of firm to 30 June 1949

Firm	Commodities to be produced	Total Amount expended (Thousand dollars)	Amount budgeted but not expended (Thousand dollars)	Contribution of firm (Thousand dollars)
Mortgage loans				
Crane China Corporation	Chinaware	924.0	-	200.0
Ponce Candy Industries	Candy	140.0	-	356.4
Bartfield Manufacturing Co.	Refrigerators	56.0	-	21.0
Textron Puerto Rico	Print cloth	2,795.7	1,204.2	500.0
Textron Puerto Rico	Tricot knitting, weaving and finishing and sewing plant	1,500.0	750.0	750.0
Beacon Textiles	Blankets	214.5	685.0	800.0
Puerto Rico Rayon Mill	Rayon	35.5	164.5	15.0
Jantzen Knitting Mills, Inc.	Knitted goods	-	150.0	Machinery
American Syntex, Inc.	Pharmaceutical products	-	70.0	-
Total		5,665.7	3,023.7	2,642.4

Source: Puerto Rico Industrial Development Company

/Table 6 (continued)

Table 6. Industrial Development Company of Puerto Rico financial aid to private industrialists, amount expended, budgeted and contribution of firm to 30 June 1947 (continued)

Firm	Commodities to be produced	Total Amount expended (Thousand dollars)	Amount budgeted but not expended (Thousand dollars)	Contribution of firm (Thousand dollars)
Leases				
Red Cape Leather Corporation	Wallets	80.0	-	1.3
Hilton Hotel Corporation	Hotel	3,900.0	2,567.7	150.0
San Juan Glove Company	Gloves	117.9	22.0	50.0
Rio Grande Artificial Flower	Flowers	45.8	-	5.0
Metal Products Co.	Metal products	38.3	-	70.0
De Luxe Dye Works	Dyes	45.1	-	20.0
La Mirada Pottery	Ceramic products	64.9	-	1.0
R. Lopex Irizarry	Candy	40.8	-	15.0
Senorita Hosiery Co.	Hosiery	21.2	-	-
Total		4,354.0	2,589.7	312.3
Working Capital Loans				
Textron Puerto Rico	Print Cloth	500.0	-	500.0
La Mirada Pottery	Ceramic products	64.9	-	26.0
Total		564.9	-	526.0
GRAND TOTAL		10,584.6	5,613.4	3,480.7

Source: Puerto Rico Industrial Development Company

/Table 7.

Table 7. Government Development Bank for Puerto Rico, statement of condition, June 30, 1949

Item	Amount
Resources	
Cash on hand and due from banks	$ 1,683,947.52
Investments1/	39,593,925.44
Loans and discounts2/	11,537,532.38
Real estate owned	110,000.00
Furniture and fixtures	40,049.47
Other resources	401,890.25
Total	53,367,345.06
Liabilities	
Time deposits	
Insular Government	21,833,808.62
Insular Government corporations	3,851,286.72
Sub-total	25,685,095.34
Demand deposits	
Insular Government corporations	1,462,821.68
Other deposits	1,856,597.60
Sub-total	3,319,419.28
Deferred credits and other liabilities	141,959.14
Capital accounts	
Paid in capital	20,500,000.00
Surplus	3,178,382.64
Reserve	542,488.66
Sub-total	24,220,871.30
Total	53,367,345.06

1/ See table 9.
2/ See table 8.
Source: Government Development Bank for Puerto Rico

/Table 8.

Table 8. Government Development Bank for Puerto Rico loans outstanding by type, June 30, 1949

Type	Amount (Thousand dollars)
Secured loans	
Industrial 1/	3,523
Real estate	910
Unsecured loans	
Industrial	7
Discount on notes secured by building materials and equipment (F.H.A. loan advances)	757
F.H.A. Loans	4,546
F.H.A. loan commitments	1,359
Veteran's business loans	66
Other loans	369
Total	11,537

1/ Subclassified by the author into $1,440,000 of loans for manufacturing industries and $2,083,000 of commercial loans for such purpose as hospitals, theaters and commercial enterprises.
Source: Government Development Bank for Puerto Rico

/Table 9.

Table 9. Investments of the Government Development Bank for Puerto Rico
30 June 1949

Security	Book Value (Million dollars)
Federal and Insular Government bonds	
U.S. treasury bonds and bills	17.4
Insular Government of Puerto Rico bonds	.6
Sub-total	18.0
Authority bonds and notes	
Puerto Rico Water Resources Authority bonds	4.1
Puerto Rico Water Resources Authority notes	2.0
Puerto Rico Aqueduct and Sewer Authority notes	7.5
Puerto Rico Industrial Development Company notes	1.3
Puerto Rico Land Authority notes	3.6
Sub-total	18.5
Municipal bonds and notes	
Municipal Government bonds	1.3
Municipal Government notes	1.8
Sub-total	3.1
TOTAL	39.6

Source: Government Development Bank for Puerto Rico

Table 10. Summary of sources of long-term financing of Government of Puerto Rico for public works and public corporations from domestic sources and United States money markets, 15 September 1949

Item	Amount (Million dollars)
Government appropriations	
Appropriations of the Insular Government for executive departments for public works	107.3
Appropriations of the Insular Government for public corporations, primarily for investment	143.6
Total government appropriations	250.9
Domestic purchases of bond issues	
Puerto Rico Water Resources Authority bonds, 1947 issue	
Development Bank for Puerto Rico	4.0
Other local banks and institutions	7.0
Sub-total	11.0
Puerto Rico Aqueduct & Sewer Authority, 1949 issue	
Puerto Rico Development Bank	0.5
Other local banks	2.5
Sub-total	3.0
Temporary financing	
Government Development Bank	
Puerto Rico Water Resources Authority notes	4.3
Puerto Rico Industrial Development Company	3.0
Puerto Rico Land Authority notes	3.6
Sub-total	10.9
Other local banks	
Puerto Rico Industrial Development Company	1.7
Total temporary financing	12.6
Total long-term domestic financing and appropriations	277.5
Resources from United States money markets	
Sale of bond issues	
Puerto Rico Water Resources Authority bonds, 1947 issue	37.0
Puerto Rico Aqueduct & Sewer Authority, 1949 issue	22.7
Total from United States money markets	59.7
GRAND TOTAL	337.2

Source: Compiled from official records under direction of author.

Table 11. Assets, liabilities and capital of banks in Puerto Rico, 30 June 1949

Item	Amount (Million dollars)
Assets	
Cash	20.4
Due from branches	19.5
Investments	137.5
United States Bonds	(100.0)
Loans	119.4
Other assets	25.3
Total	322.1
Liabilities	
Deposits	
Private demand deposits	83.6
Private time deposits	48.7
Total private deposits	132.3
Federal Government deposits	10.3
Insular Government deposits	72.9
Other Government deposits	4.8
Total Government deposits	88.0
Other deposits	30.7
Total deposits	251.0
Other liabilities	31.6
Total liabilities	282.6
Capital[a]	
Paid-in capital	26.7
Surplus	9.7
Undivided profits	1.6
Reserves	1.5
Total capital	39.5

Source: Department of Finance of Puerto Rico, Division of Bank Examiners, San Juan, Puerto Rico.

a/ The capital accounts of domestic banks only. Does not include National and Canadian bank branches in Puerto Rico.

/Table 12.

Table 12. Percentage distribution of the gainfully occupied population, Puerto Rico and selected countries[a]

Country	Year	Agriculture, fishing, forestry	Manufacturing, handicraft and construction	Trade services and other
PUERTO RICO	1940	45	23	32
	1948	39	24	37
England	1948	8	55	37
United States	1940	19	30	51
Netherlands	1930	21	38	41
Germany	1939	27	42	31
Sweden	1940	29	36	35
Canada	1941	29	31	40
Denmark	1940	32	35	33
Argentina	1942	40	23	37
Chile	1940	36	20	44[b]
Venezuela	1941	46	20	34
Peru	1940	62	19	19
Ecuador	1948	63	11	26
Brazil	1940	68	10	22
Colombia	1938	74	13	13

Source: From Harvey Perloff's "Puerto Rico's Economic Future," 1948, unpublished. Compiled from United States census reports and reports of the Puerto Rico Bureau of Labor Statistics; International Labor Office, Yearbook of Labor Statistics, 1943-44. (Montreal, 1945) pp. 6-18; Henry W. Spiegel, The Brazilian Economy, (Philadelphia, The Blakiston Company, 1949), p. 92; Unpublished reports of the International Monetary Fund. Data for England obtained from the International Labor Office, Yearbook of Labor Statistics, 1947-48 has been added.

a/ These data are not strictly comparable, because of the variety of definitions and methods of estimating employed, but they serve to indicate the general order of magnitudes involved.

b/ Of this amount, 5.5 per cent is mining employment.

/Table 13.

Table 13. National income per capita and other indices of living standards, Puerto Rico compared to other Latin American countries

Country	Income per capita in dollars of comparable purchasing power 1940	Radios per 1,000 inhabitants 1943	Motor vehicles per 100 inhabitants 1943	Kilowatt hours per year per person 1947	Private bank deposits per person[a/] 1947	Total foreign trade per person in dollars 1946	Highway mileage per 100 square miles 1943	Telephone per 1,000 inhabitants 1943	Per cent literacy, persons 10 years old or more, 1943[b/]
PUERTO RICO	122	34.8	13.7	200.4	80.4	216	50.8	10.4	68
Argentina	334	87.2	29.0	190.7	96.4	110	23.5	30.1	85
Bolivia	47	11.1	2.0	35.8	4.0	33	10.9	1.3	20
Brazil	80	20.5	5.0	46.3	30.2	35	4.0	6.6	50
Chile	164	48.0	10.7	195.6	28.0	78	8.5	17.5	76
Colombia	92	18.1	3.3	49.2	18.0	41	3.2	4.4	43
Honduras	35	10.1	1.1	"	"	28	1.7	1.7	52
Mexico	56	35.4	8.4	121.9	15.4	42	5.7	8.3	55
Panama	139	43.3	31.2	"	50.9	100	2.9	11.0	65
Paraguay	55	13.1	1.7	"	"	40	2.7	3.4	25
Peru	95	11.8	4.6	"	70.7	40	4.3	5.3	42

Source: Data on literacy, motor vehicles, telephones, radios and highway mileage was obtained from Basic Data on Other American Republics published by the Co-ordinator of Inter-American Affairs, Washington D. C., 1945. Data on national income per capita was obtained from the "National Income Estimates of the Latin American Countries" published by the Inter-American Statistical Institute. The rest of the data was obtained from the Monthly Bulletin of Statistics published by the Statistical Office of the United Nations, May 1948.

" Not available

a/ Data for Argentina and Bolivia is for 1946.

b/ The figure is from "United States Census, 1940".

/Memorandum

Memorandum on Methods of Financing Development in United Kingdom Dependent Territories

Prepared by
Sir Sydney Caine
United Kingdom

A. INTRODUCTION

1. The Colonies, Protectorates etc. which are commonly referred to as the dependent territories of the United Kingdom are in very varied stages of development. They include predominantly urban and fairly highly industrialized dependencies like Hong Kong, areas such as Cyprus and Malta which have been subject to the influence of western civilization for thousands of years, and other territories like the West Indian islands which have been under European settlement for two or three hundred years, as well as large territories which until a generation or so ago were inhabited only by peoples at a very early stage of civilized development or indeed almost completely uninhabited.

Generalization therefore about the capital needs of these dependencies and about the means by which those needs are or should be met is therefore subject to many exceptions. In order to avoid complications these exceptions will not be particularized in this memorandum which will deal with average conditions and ignore the wide variations from the average. In practice the territories most predominantly in mind will be the larger areas in Africa, south-east Asia and the continent of America, rather than the smaller but generally more highly developed territories elsewhere.

2. It is true to say of all the dependencies, but especially of the large continental areas just referred to, that they are undeveloped in the sense that the total of capital investment in them, whether expressed in relation to the population or to the area of potential natural resources, is very substantially below the standard of capital investment prevailing in advanced western countries. This is true at all stages of capital development. We can usefully divide the kinds of capital equipment which a modern community requires into three categories, the distinctions between which may not be entirely logical, but which are convenient. First there is the basic equipment of roads, drainage, hospitals and other health facilities, schools and universities, housing and other buildings required both for administration and general public purpose. These are all capital facilities, the existence of which can normally be taken for granted in considering any specific capital investment in an advanced country, but in the more primitive colonial dependencies are often still very largely lacking. Their provision is, therefore, the first essential to any more specific

capital development.

3. Next comes the provision of what may be called public utility services, that is, enterprises having something of a commercial character but providing services for industry rather than themselves concerned with production of individual commodities. These include railways, ports, road transport services, airports and other facilities essential for air services, water supplies, electricity and power supplies, postal, telegraph and telephone communications.

4. Thirdly there are the innumerable enterprises concerned with the production of particular commodities, whether for local use or for export and whether agricultural, mineral or industrial in character.

5. The first category which may be described as social capital is generalized in character and can hardly be provided on any basis which holds out any prospect of direct earning to cover the capital cost. It is inevitable, therefore, that in the main this part of the necessary capital equipment should be provided through government channels although at least in the spheres of health and education it may be to some extent supplemented by private and charitable activity.

6. The second category, or public-service type of capital investment, can more easily be organized on a basis of earning a surplus over current expenditure so that the particular enterprise can be made to provide for or contribute towards the capital cost. It has, therefore, frequently been found possible in the past for such utility services to be provided by private enterprise seeking a profitable investment. In modern times, however, the tendency has increasingly been for public utility services to be provided by government, partly because it has often been found socially advantageous to operate such services on a basis which does not ensure direct earnings sufficient to cover capital charges, and partly because of objections which are felt to placing in private hands so great a share of control of the economic life of the community as is implicit in the control of a major public utility. While, therefore, there are exceptions, it has always been the case that a large part of such utility services in the British dependencies have been operated by local governments and the proportion of governmental operation has tended to increase.

7. The third category, the investment of capital in the specific production of particular commodities, has been and still is overwhelmingly a field for private activity, whether of local entrepreneurs or of business interests outside the dependencies. Very recently, however, the State has entered this field also with

a view to initiating enterprises which, from their magnitude or for other special reasons, were not likely to be undertaken by private enterprise; and substantial sums of money have been set aside by the United Kingdom Government for overseas investment in direct productive enterprises through the newly formed Colonial Development Corporation and the Overseas Food Corporation. At the same time, the continuance of government control over the allocation of certain materials as well as in certain other spheres, even though not designed with that specific purpose, has tended to increase the power of the State to influence the direction of private business investment.

8. An indication of the order of magnitude of the annual capital investment which takes place in the United Kingdom dependencies is given by estimates published in the last annual report on the Colonial Territories (for 1948-49) presented to Parliament last June. These estimates, admittedly only very approximate, showed a total expected investment in 1948 of £188,000,000, of which between one-third and one-half was for maintenance and the remainder for new work. Of this £112,000,000 represented anticipated costs of imported materials and equipment and £76,000,000 local expenditure, mainly on labour. In very broad figures investment in category one above - basic social capital (including roads) - amounted to 20 per cent of the total; in category two - utilities - to 25 per cent; and in category three - specific productive enterprise - to 55 per cent. Virtually the whole of the first two categories and a small part of the third was on government account, so that the total appeared to be divided almost equally between the government and the private sector.

B. METHODS AND SOURCE OF FINANCE

9. In considering the sources of finance available for capital development in British dependencies, it would not be profitable, and would indeed be very difficult, to confine attention to internal sources in the sense of looking only at the resources available within the particular dependency under consideration. Regard must necessarily be had to the total of resources available within the area constituted by the United Kingdom plus its dependencies. Traditionally the United Kingdom has been the source of much the greater part of the capital invested in the dependencies and the financial relations between the dependent territories and the metropolitan country, both in the governmental and the private spheres, are so close that the precise allocation of sources between the one and the other would frequently be impossible.

/10. On the other

10. On the other hand, no account is taken here of possible sources of finance, private or institutional, from outside the "United Kingdom plus Colonies" ring. In fact investment has taken place in the United Kingdom dependencies in the past from the United States, from various European countries and from every one of the other principal Commonwealth countries including Canada, Australia, South Africa and India. It is understood that such sources of finance are intended to be excluded from this discussion which is of "local" sources only.

Taking "local" sources in the wider sense already explained, the channels of investment are virtually as multifarious as those commonly found in any advanced Western community. They can, however, be classified as follows:

(1) Governmental

(a) Local government

(i) Taxation. It has been the traditional practice of British Colonial Governments to devote whatever resources they can provide out of taxation, after covering current municipal expenses, to public works and other capital expenditure. In some territories, notably the former Straits Settlements, practically the whole of the "social capital" of roads, buildings and other forms of basic public services, involving quite large expenditures, have been made entirely from revenue without incurring any loan or capital charges. Obviously the amount which can be so found from taxation must vary according to the prosperity of the territory, but it can be assumed that it will remain a principle of policy to derive as much as possible from this source.

(ii) Accumulated balances. At the present moment, partly as a result of conditions during the war years and partly as a result of exceptional prosperity of particular industries, many dependent territories have accumulated balances held in cash or short term sterling investments in excess of what is needed as a prudent reserve against ordinary fluctuations in revenue, and they plan to spend such excess reserves on capital works in the next few years. This is, of course, only a special aspect of the general policy of providing as much as possible out of revenue sources.

/(b) United

(b) United Kingdom Government

The United Kingdom Government has made provision for substantial capital assistance to the Colonies in the following forms.

(i) Colonial Development and Welfare Acts. Expenditure has been authorized of £120 million over a ten-year period subject to a maximum expenditure in any one year of £20 million. This money is issued in the form of grants, or in a few cases, loans, to finance individual schemes of any particular Colony or of general interest to all Colonies or particular groups.

(ii) Special grants. These are being made to certain dependencies to meet the cost of reparation of war damage (which is in practice very hard to distinguish from new capital development) e.g., in Malta and Malaya.

(iii) Government corporations. Two Government corporations have been established, the Colonial Development Corporation and the Overseas Food Corporation, with capital respectively of £100 million and £50 million, to undertake projects of a specifically productive or commercial character. The reason for establishing two separate corporations is that the first is confined in its operations to the Colonial territories, although the scope of its activities covers any kind of productive enterprise, while the second is specifically concerned with food production and is at liberty to operate anywhere in the world outside the United Kingdom, not only in the Colonial territories. In fact the Overseas Food Corporation appears likely to confine its activities for some time almost entirely to one large project, the groundnut scheme in East Africa.

(c) Public loans

In addition to provision of funds from current revenues for capital purposes, it has always been common practice for Colonial Governments to raise public loans to meet such needs. In the past these have been raised predominantly in the United Kingdom but there have been some local issues, particularly in the more advanced territories such as Straits Settlements and Hongkong, and today there is an increasing tendency to

/look to local

look to local borrowing. For some time after the war no new Colonial loans at all were issued in London, partly because of the restrictions on any form of public issue in the London money market necessitated by current conditions in the United Kingdom and partly because most Colonial Governments had sufficient liquid resources to meet the cost of the capital works it was physically possible for them to undertake. A programme of Colonial loans to be issued over the next few years has, however, been agreed and a start was made in November 1948, with the successful raising of a £3,000,000 loan by the Government of Trinidad at 3 per cent. It may be assumed, therefore, that for some time to come the United Kingdom will again be the principal source of funds for public borrowing by the Colonies.

(2) Private

(a) Savings of local business enterprise

There is a steady and not insignificant flow of capital investment through the ploughing back of local business profits or the initiation of new enterprises out of local savings. Individually such activities are normally on a very small scale and, since this type of investment mainly consists of expansions in particular businesses or the undertaking of new enterprises directly associated with established concerns, it is very little susceptible to close measurement or organization. To a small extent local savings find their way into subscriptions to flotations of capital by local registered companies or issues of local government loans (see above) but the aggregate value of such investment of capital is small.

(b) Resources of United Kingdom-based firms

A larger and more easily identified source of capital consists of investments by firms with headquarters in the United Kingdom, either out of their own profits or by the issue of a series of bonds in the United Kingdom. The activities of some such firms, e.g. the United Africa Company, operating mainly in West Africa as well as elsewhere in that continent, or Messrs. Harrison and Crossfields, operating throughout the East, are often on a very large scale and their capital investment is correspondingly large. Historically there is no doubt that investment through channels of this kind has been one of the major methods of British capital investment overseas. Many of the largest concerns now operating in the British dependent territories have been built up from very small beginnings, starting with profitable trading operations, gradually enlarging by a local reinvestment of a substantial proportion of the profits and going on to the acquisition of plantations, mining interests, shipping and auxiliary industrial enterprises catering either for the processing of local produce, e.g. saw mills, or for local consumption, e.g. breweries or soap factories. From time to time growing enterprises of this kind have sought additional capital from the London money market and with certain exceptions it has been mainly on the basis of long established trading enterprises that independent British capital has found its way into the Colonial sphere; e.g., the United Africa Company (now a part of the great Unilever group) was formed by the amalgamation of a number of trading concerns whose origins stretch back many generations, while when the British sugar firm of Tate and Lyle decided to invest substantially in Colonial sugar production it did so by acqusition of controlling interests in two established Colonial concerns. Similarly the great Hongkong and Shanghai Banking Corporation was started on the subscriptions of a group of successful British traders in the Far East.

(c) Banking operations

A number of banks with headquarters in London or with close association with London are established in the Colonies and are the normal source of short-term finance. They both mobilize a proportion of local savings in the form of current deposits and procure additional short-term funds as necessary from outside. These banks do not themselves normally provide a source of long-term capital (except for the quite important floating capital required for financing current business operations as they grow over the years) but they form a bridge during the early stages of an enterprise and help to introduce local promoters to sources of long-term finance in London. In the last year or two, however, an initiative has been taken by two of the commercial banks with the object of providing certain funds for longer-term investment. Barclay's Bank (Dominion, Colonial and Overseas) has formed a subsidiary known as Barclay's Overseas Development Corporation all the shares of which are at

/present held

present held by the parent Company with the object of making loans to local enterprises for substantially longer periods than would be contemplated by the normal commercial bank. A similar development corporation has been formed by the Standard Bank of South Africa for operation in the East Africa Colonies. These corporations as they develop will form an additional channel for investment of funds in new enterprises but there are naturally limitations to the resources which they can command.

(d) Mining finance

As already indicated new finance, including new flotations of capital, has normally been channelled into the British Colonies through trading or business concerns already established in the territory concerned. In the mineral field the characteristic procedure, though analogous, is different in detail. There are in the United Kingdom a number of powerful mining groups commanding large financial and technical resources and willing to take up mining developments in any promising area. Accordingly when a mineral discovery is made in a quite new area it is commonly one of those groups which undertakes the development and provides or procures the capital, if necessary by a public issue. Most of these groups are, of course, interested in mining outside the Colonial sphere as well, and some at least of them have close American and/or South African connexions.

(e) Other sources of private finance

From time to time entirely fresh ventures are, of course, made by independent owners of capital who become interested in particular commercial possibilities; and where appropriate recourse may be had to the ordinary machinery of the finance and issuing houses of the London money market to obtain additional finance for such a venture by a public issue. But independent private ventures of that kind are now rare.

(f) Government stimulation of private investment

The Governments of the British Colonial dependencies have not adopted any general measures of stimulation of private investment, e.g., by guarantees of interest or principal or by tax-exemptions or other special privileges. Such measures have been adopted in rare special cases but the predominant policy has been to provide the basic requirements of law

/and order

and order and the necessary minimum skeleton of transport and other public services; to establish terms for the exploitation of natural resources (e.g., minerals or timber) which are believed to be fair and are applicable without discrimination to all comers; and to leave it to private enterprise to judge whether on that basis any particular investment in productive enterprise is worth while. Nor has the United Kingdom Government set up any special incentives to encourage investment in the Colonies. (The system of double income tax relief which operates within the Commonwealth is perhaps a minor exception in that it makes investment inside the Commonwealth somewhat more attractive than investment in foreign countries).

C. PROCEDURES

11. Governmental capital investment in British dependent territories is today treated as a single whole whatever the source of the funds involved. As part of the procedure envisaged under the Colonial Development and Welfare Acts all Colonial governments have been asked to prepare ten-year programmes of the capital development investment in their territories which, after being thoroughly discussed locally between the Administration and Legislature and discussed and agreed with the United Kingdom Government, are accepted as laying down the general pattern of development to be followed. Within that pattern individual schemes are undertaken by the governments either from their own funds or from new public loans or from grants from the United Kingdom under the Colonial Development and Welfare Acts. The proportionate amount of funds expected to be provided from these several sources naturally varies widely from one territory to another, but in total the programmes announced up to June 1949 envisaged the expenditure of £71,000,000 from accumulated local funds and anticipated future revenue sources, £64,000,000 from loans to be raised and £64,000,000 from Colonial Development and Welfare Grants.

12. In the field of private investment, precisely because it is the product of private enterprise, no such detailed programming is possible but governments have endeavoured to ascertain as exactly as possible what major private investments are planned and to make reasonable assessments of the probable total scale of private investment in the future. Combining these estimates with their own programmes and the proposed activities in their area of the Colonial Development Corporation and the Overseas Food Corporation, the governments are able to build up a picture of the total capital development in prospect and to lay down some tentative scheme of

/priorities

priorities where any competition for particular resources, e.g. of local labour, is likely to arise. No powers of control over private investment as such exist, but governments are usually in a position at least to influence the tempo and direction of such investment through the control of the issue of concessions, through building controls, through licensing of necessary imports of capital goods and otherwise.

D. RESULTS AND PROBLEMS

13. The mechanisms described have undoubtedly been effective in promoting a very substantial flow of capital investment in the past as is evidenced by the development which has already taken place in many of the overseas territories. To a large extent the normal growth of capital development was interrupted by the war but has been substantially resumed since. The plans for development drawn up in connexion with the Colonial Development and Welfare Acts were somewhat slow in getting implemented in the immediately post-war period but there has been an increase in the speed of development more recently. The actual issues of funds under the Colonial Development and Welfare Acts, which are, of course, only a fraction of the total government expenditure on capital development in the territories concerned, rose from £3,039,162 in the year ended 31 March 1945, to £6,354,084 in 1948/49.

14. In the private sphere also there has been very considerable activity. Among individual territories investment since the war has undoubtedly been heaviest in Malaya where very substantial sums have been spent on the restoration and improvement of the rubber plantations and tin mines. Considerable sums have also been spent elsewhere in the improvement and expansion of existing enterprises such as the sugar plantations in the West Indies and sisal in East Africa. Both in the government and private spheres, however, a major problem has been the procurement of physical supplies of the imported capital goods required for development. During the immediate post-war years, at any rate, neither government nor private business has been greatly handicapped by shortage of sterling finances. Their difficulties have been to secure deliveries of goods they wanted to purchase with their available funds. The most obvious and central problem has been that of securing sufficient supplies of miscellaneous iron and steel which enters in innumerable ways into every significant development project. To meet this situation special measures were taken in the United Kingdom to secure the allocation to Colonial requirements

/of increased

of increased quantities of the iron and steel available from British production and similar action has been taken in certain other fields where physical supplies were particularly short. In order to effect this it has been necessary to bring the whole problem of colonial development within the sphere of the general planning activities of the Central Planning Staff in London and for that purpose special machinery has been created to ensure that the capital goods of the Colonies are given an adequate priority in the total capital programme of the United Kingdom.

E. EFFECTS ON LOCAL SAVING

15. Little precise information is available to show what effect past policies have had in this field. It has always been the policy of local governments to promote individual saving. Nearly all the territories have local savings banks normally operated by the local government but in one or two cases operated as a special activity by a commercial bank. These institutions, however, normally re-invest deposits placed with them in general sterling investments instead of investing them locally, thus securing their own stability and solvency, but from the economic point of view adding rather to the general pool of sterling finance than to the finances immediately available for local capital purposes. This is, of course, only another example of the extremely intimate relation between the Colonial and United Kingdom financial systems.

16. Attention has already been drawn to the large part which has been played in the capital development of Colonial territories by the ploughing back of profits made locally by existing businesses with a purely local or United Kingdom control. Mention has also been made of the local policy of Colonial Governments in effecting what can properly be described as community saving by spending a part, and sometimes a very large part, of the proceeds of taxation upon local capital developments.

17. An important feature of this last policy is, of course, the attempt of Colonial Governments to secure for local governments purposes an increasing share of the proceeds of local production. This has always been the endeavour of local governments which have tried to secure a fair share of such proceeds by, e.g., the charging of royalties on mineral extraction or the imposition of export taxes on exports of primary produce. Today the rather rough and ready device of export taxes is largely replaced by more scientific general-income taxes. Mining royalties are similarly developing from flat percentage charges to more complex sliding scales under which the net royalty varies with the profitability of the enterprise. There

/is no doubt

is no doubt that by this means Colonial Governments are placing themselves in a position to ensure that as large a proportion as possible of the proceeds of local productivity is retained for expenditure on new internal capital development. At the same time the amount of profit available for reinvestment by individual commercial enterprises is correspondingly reduced and it is partly for this reason that governments are being advised to consider entering themselves into fields formerly regarded as reserved for private enterprise.

F. SUMMARY

18. The local resources of individual Colonial Dependencies are mobilized partly through private investment of savings out of current income, in extension of business enterprises or initiation of new enterprises; partly through small local savings institutions and subscriptions to occasional public loans issued by the local government; and to a substantially larger extent by the application to capital purposes of a considerable proportion of the revenue raised by local governments from taxation, which thus constitutes a kind of forced saving. In addition to these local resources in the narrow sense, the Colonial Dependencies draw systematically on the financial resources of the United Kingdom itself with which the local finances are extremely closely interrealted. Such capital funds raised in the United Kingdom find their way to the Colonies partly through systematic government grants and loans, partly through the raising in the United Kingdom of public loans by Colonial Governments and partly through the innumerable channels of normal private-income investment.

According to such approximate estimates as it has been possible to make, new capital investment in British Colonies as a whole is going forward at the rate of about £100 million per annum with further investments of not far short of the same figure in the form of maintenance of existing capital assets. Of this total of approaching £200 million per annum, just about half is spent by governments and government-controlled institutions and half by private businesses and individuals.

G. SUPPLEMENTARY NOTE ON EXPERIENCE OF UNITED KINGDOM DEPENDENT TERRITORIES

Certain of the issues which were raised in the course of the discussions of the group were either not dealt with at all in the original memorandum on United Kingdom Dependent Territories or referred to only very briefly and this note is intended to supplement information previously submitted on certain points.

/1. Development

1. Development of local credit institutions

The provision of ordinary commercial banking facilities has been left almost entirely to private enterprise and British Colonial Governments have not in general taken any definite steps to promote the extension of such facilities. Indeed in most of the territories no special legislation for regulation of banking exists. Only in one or two e.g. Cyprus, has the exceptional growth of local banks necessitated the enactment of special regulations. The absence of special banking laws has no doubt to some extent facilitated the development of ordinary commercial banks as they have had no special obligations to incur.

Although there has been no general attempt to promote development of banking facilities, in individual cases, local Colonial Governments have given assistance in the opening of branches by arranging to hold Government funds locally in such branches, by facilitating the acquisition of premises and by other means.

Colonial Governments have, however, been more concerned in promoting more specialized credit institutions, e.g. land or agriculture banks, in a number of Colonies. These are normally particularly concerned with medium or long-term advances for agricultural pruposes. Colonial Governments have also very extensively engaged in the encouragement of co-operative credit institutions especially in Malaya, Ceylon (during its Colonial period), Cyprus and the West India colonies. Great attention has been paid in recent years to this co-operative development. Officers have been sent for special training in co-operative work in India, in the United Kingdom and in various European countries and members of the Colonial administrative service are increasingly encouraged to specialize in this branch of work. In some areas, of which Cyprus is a prominent example, co-operative credit institutions have been very successful in reducing the volume of agricultural indebtedness.

Comment was made on the possibility of banking facilities being devoted too much to the financing of trade and real estate transactions instead of other forms of development. This has not been a subject of any particular complaint in British Colonial territories, not perhaps because banks there have been any less inclined to concentrate in these fields, but because prevailing opinion has been that it is natural that they should do so and that sources of finance other than the ordinary commercial banks should be sought for industrial and other development. There has undoubtedly been some tendency for a large proportion of capital to be sunk in real estate developments in the urban areas, but this appears to be an almost

/universal phase

universal phase in development of "new" countries and it is probably inevitable since the provision of certain commercial financing and general trading facilities which must be concentrated in towns is an essential basis for the development of trade in such countries.

As stated in the course of the meetings, no attempt has been made in British dependent territories to require banks and other financial institutions to invest funds available from local deposits in internal development rather than holding them overseas. In practice, however, a portion, at times substantial, of deposits is held in sterling deposits or investments in London in the case both of commercial banks and savings institutions. This is a practice intimately bound up with the general character of the financial and monetary relationship between the dependent territories and the United Kingdom. In the case of the commercial banks, it is to a large extent a substitute for the holding of actual cash since under the normal monetary arrangements in the Colonies sterling in London is exchangeable at once and without question for local currency issued in the Colony by the local currency authority.

2. <u>Central Bank operations and credit policy</u>

Although nearly all the United Kingdom dependent territories have issues of currency separate from that of the United Kingdom itself, these currencies are all directly and automatically linked with sterling. Accordingly there is not at present any development of central banking institutions in these dependencies and no question of credit policy in the ordinary sense of the phrase arises. The extent to which, and the terms upon which, credit is available through the banking system depends primarily on the policy being pursued at the centre of the system, i.e. in the United Kingdom and the independent creation of credit is not a resource normally open to a Colonial Government.

3. <u>Limits of the contribution of domestic financing of specific projects in relation to total finance</u>

As explained in the original memorandum the total amount of funds available for development in a particular territory, whether derived from local savings or from United Kingdom assistance or investment are viewed as a whole, the proportion of contributions being determined by the estimated ability of the particular territory to contribute from its own resources. In the actual determination of the proportions, no account whatever has hitherto been taken of the division of the actual expenditure between local currency outgoings and external outgoings.

/Accordingly the

Accordingly the particular problems arising from the attempt to establish relationship between domestic financing and domestic expenditure which were discussed during the meetings have not arisen in the United Kingdom dependencies.

4. Rates of Interest

Rates of interest on commercial borrowing and investment in the United Kingdom dependent territories are normally higher than those prevailing in the United Kingdom itself owing to the greater riskiness of many of the transactions involved and owing also to the comparative scarcity of local capital and the still inadequate mechanism for securing a flow of capital from the United Kingdom itself to the dependencies. The prevailing rates of interest, however, are not as high as those reported from certain of the independent countries.

In the case of Government borrowing British Colonial Governments have normally borrowed mainly in the London market and only to a small extent locally. In the London market the rate of interest they have paid has been determined by the prevailing rate on Government securities there. Colonial Governments normally pay perhaps 1/2% more than the United Kingdom Government itself would pay for an issue on comparable terms. Colonial Governments have commonly been prepared to pay a little more than the London rate for local borrowings in order to encourage local saving and the habit of investment in Government securities but naturally they have not been willing to pay very much more. In practical terms therefore, at the time when the effective gilt-edged rate in London was about 2-3/4% Colonial Governments could borrow there at a little over 3% and would probably be willing to pay 3-1/2% for local loans. In current conditions, of course, all these rates would be higher in view of the rise in the effective long-term rate of interest in London, but still substantially lower than the rates of borrowing reported from some of the other countries discussed.

PART III: ANNOTATED GUIDE

CONTENTS

/III. GOVERNMENT

I. INSUFFICIENCY OF BANKING SERVICES AND CREDIT FACILITIES

Insufficiency of banking and other internal financing services in underdeveloped countries is either explicitly discussed or implied in all the documents submitted.

In the Philippines, the undeveloped banking system and money market have to a large extent limited the amount of available domestic capital and have consequently retarded economic rehabilitation. The total banking and credit machinery is stated to consist of less than 100 head offices, branches and agencies throughout the country which is a clear indication of the scarcity of such services. The failure of domestic capital to enter into the field of banking is attributed to the lack of familiarity of domestic business with the conduct of banking, to the high returns earned in money lending and to the scarcity of trained men who have previous experience in the business of banking. The absence of banking facilities in many parts of the country has led to widespread hoarding on the one hand, and to the growth of money lending and of government-sponsored credit organizations on the other hand. (Pages 245-246).

In Puerto Rico, the banking system lacks the specialized institutions that channel resources into long-term investment. (Page 273).

In Mexico, as late as 1934 there were only 102 head offices and branch offices of commercial banks operating. The present number of over 340 gives some indication of the insufficiency prevailing until very recently. (Page 210). Even now it is stated that there are still parts of Mexico where credit and its advantages are unknown. (Page 235). Reference is made also to the lack of banking habits. (Fund-Mexico, Page 53).

In Egypt, the insufficiency of savings was aggravated by the inadequacy of the financial mechanism. (Fund-Egypt, Page 9).

The tendency towards chronic inflationary pressures in Chile is linked with the insufficiency of machinery for collecting and channelling savings into productive investment. (Fund-Chile, Page 3).

The inadequacy of banking facilities in India is fundamentally traceable to the low level of savings and the propensity for hoarding. High rates of interest are partly due to this lack of facilities and the resulting immobility of funds and partly to the risks attached to some forms of financing. Although the spread of banking facilities has been fairly rapid during the last few years, investing habits are being inculcated among the masses of the population at a much slower pace. It is believed that this problem will be solved only by education and propaganda over a long period of time. (Pages 176-177).

In Haiti, the total banking system consists of only two head offices and thirteen branches and agencies. (Haitian Report).

/A. Substitution by

A. Substitution by Public Financing

The necessity to make up for this lack of private and spontaneous credit machinery by substituting government machinery or government intervention is universally agreed.

For Chile, it is stated that in view of certain defects of the financial system the State, under pressure from the circles most closely interested, has set up a series of development agencies. (Page 114). A specific contrast is drawn to the highly developed capital market of a country like the United States, and it is stated that in Chile where this degree of development has not been reached and where national savings are small, it was inconceivable that investments on such a scale could be carried out by private enterprise. This gap has been filled by the Development Corporation. (Page 123).

In Puerto Rico, institutions facilitating the flow of capital into industrial investment are not yet well established and it has therefore become a responsibility of government to promote the creation of such institutions. The widespread activities of the Government Development Bank are explained by the fact that there are no private agencies filling this need. (Page 274).

In Mexico, the national credit institutions as well as the Central Bank have filled the gap left by the absence of private institutions and account for over 60 per cent of the total bank assets (Fund-Mexico, table, page 12). The need for agricultural credit banks in that country is explained by the absence of private organizations ready to assume the risks of agricultural loans. (Page 215).

B. Private Money Lenders

The absence of a developed spontaneous credit system has favoured the growth and survival of private money lending, especially in the countryside. The reports are agreed that such private money lending plays an excessive part in the financing machinery of under-developed countries and that it has led to considerable abuse.

For Puerto Rico, it is said that there was no other source of credit for the type of real estate financed by the Government Development Bank except private lenders, who charged high rates of interest. (Page 266).

In the Philippines, mortgage loans among the great number of small businessmen are extended by private money lenders who charge for the use of their funds a price much higher than the borrowers can afford to pay. (Page 245).

For India, it is stated that the private money lender has for a long time formed an integral part of the rural economy of the country. (Page 168).

/In addition

In addition, the problems of the financing of the development of small-scale industries are in many ways similar to those of the financing of agriculture, alike in respect of the present dependence on the private money-lender, who also acts as the trader supplying the worker with his raw material and taking over the finished product for sale. (Page 171).

In Egypt, advances made by money lenders are often for consumption purposes, and indebtedness of the rural population to money lenders is taken as evidence of negative aggregate savings. (Fund-Egypt, pages 6-7). It is stated that the institution of village money-lender, though important, cannot be treated as a proper method of obtaining financial assistance for economic development. (Page 147).

A slightly different element is introduced in the case of Mexico where, it is stated, private lenders such as the storekeeper in the village may be a useful intermediary between the banks and the ultimate operator because the bank will not lend directly to the farmers, mainly for the reason that it is not equipped to collect large numbers of small loans. (Fund-Mexico, page 7).

In Haiti, it is reported that private money lenders do a considerable amount of lending both to farmers and to salaried persons in the towns at exorbitant rates of interest, and often for consumption purposes or emergency expenditures. (Haitian Report).

C. Specific Weaknesses of Credit Machinery and Financial Institutions

General insufficiency of spontaneous credit facilities is not the only weakness in under-developed countries. The reports stress that the financial mechanism of under-developed countries is not only generally insufficient but also unbalanced showing particular weaknesses in particular specialized fields or directions. Such particular weaknesses as they are indicated in the documents may be described as follows:

1. Undue centralization

In Mexico, stress is laid on the abnormally large share of financial institutions in Mexico City, and the fact that all the States with a greater concentration of banking are on the United States border or on the northern part of either coast. (Fund-Mexico, page 7).

In Egypt, the banking habit is very little developed outside the two large cities. (Fund-Egypt, page 18). It is indicated that to some extent the lack of financing facilities outside the large cities may lead to the supply of local financing by leading department stores and wholesalers. (Page 19).

For the Philippines, it is stated that outside Manila, Cebu and Iloilo, the principal ports of the Philippines, banking is almost wholly served by

/branches

branches and agencies of the Philippine National Bank. The latter has as its Board of Directors in Manila individuals who are virtually appointees by the party in power of the Government and decisions have to emanate from the head office located far away from the rural communities. Thus, even in the case of the Philippine National Bank, conditions are not conducive to decentralized banking. (Page 245). Efforts are being made to spread facilities more evenly over the country, and it is stated that there are unmistakable signs that the growth of private banking in the provinces will be speeded up in order to enlarge the credit structure. It is also stressed that in order to derive full benefit from the regional decentralization and the development particularly of rural banking, it is important that such banks must be able to make their decisions on the spot. (Page 247).

2. Undue share of financing going to foreign trade

In the Philippines, it is stated that most of the banks are more interested in the financing of foreign trade than in loans for production or development. (Page 244). It is pointed out that the resources of commercial banks in particular are devoted largely to the granting of short-term credit, chiefly to finance the export and import trade. The employment of bank resources in the financing of foreign trade is said to have been further facilitated by the absence of exchange controls. (Page 246).

For Egypt, we find that the principal activities of commercial banks consisted in the finance of foreign trade and particularly exports of cotton. (Page 147). Elsewhere it is stated that the banking system failed to mobilize internal resources for economic development partly because of this great preoccupation with finance for foreign trade. (Fund-Egypt, page 10). The foreign banks in particular are stated to have catered solely for the foreign and indigenous trading communities, especially cotton dealers. (Page 18). Merchant exporters are also an important source of finance to cultivators. This undue provision made for foreign trade - relatively to other sectors - is attributed, among other things, to the high development of hedging on the Alexandria Cotton Exchange, but also to the absence of laws authorizing industrial loans on the security of plant and machinery until very recently. (Page 20).

In Haiti, it is reported that the major portion of bank loans is used to finance import and export trade. (Haitian Report).

3. Undue share of credit facilities for domestic trading activities

It is not only in respect of foreign trade that lack of balance obtains in financial institutions in under-developed countries, but it is frequently stated that domestic trade as well is relatively over-supplied with financial facilities, to the detriment of other sectors of the economy. Illustrations of this may be drawn from the documents.

/For Chile,

For Chile, it is stated that preference is given to commerce which offers banks better security and higher profits. (Page 132). Most bank credit is in fact advanced to wholesale and retail trade and to agriculture, and only to a minor extent to manufacture. (Fund-Chile, page 46).

For the United Kingdom Colonies, it is stressed that many of the concerns now operating have started with profitable trading operations and that the origin of such an important banking institution as the Hongkong and Shanghai Banking Corporation was based on the subscription of British traders in the Far East. (Page 298).

As a result of emphasis on trade, credit institutions in Egypt are now described as having competent staffs for dealing with the cotton trade both internally and externally, but they lack the experience for studying the needs of industrial concerns. Their usefulness has been limited by this preoccupation with the finance of internal trade and the limited assistance they have given to industry. (Fund-Egypt, page 21).

4. Undue emphasis on short-term credit facilities

In Egypt, the disproportionate growth of short-term lending as compared to long-term lending resulted in the neglect of agriculture by Egyptian financial institutions. (Page 148). Even medium term loans are described as being very small, and cannot be considered adequate for the purpose. (Page 159). Mention is also made of the unwillingness of most banks to grant medium or long-term credits to industry. (Fund-Egypt, page 8).

For Mexico, we find that more than 90 per cent of the loans of all commercial banks were for terms of less than one year. This is explained by the greater profitability of short-term operations, the lower degree of risks attached to them as well as to legislation encouraging banks to maintain a high degree of liquidity. (Pages 216-217). Because some private banks have preferred fewer but much more profitable loans by advancing short-term commercial credit, the attempt on the part of the Central Bank of Mexico to shift emphasis to longer-term credits by offering rediscounting facilities is described as not having its full desired effect. (Fund-Mexico, page 16).

Similarly, in the Philippines, the resources of the banks are devoted largely to the granting of short-term credit. (Page 246).

/It is

It is another way of describing the undue emphasis on short-term credit facilities to say that in under-developed countries generally the money market tends to be better developed than the capital market.

In the last resort, the willingness of banks to enlarge on long-term credit operations may also partly depend on the effectiveness of a central bank to maintain liquidity throughout the economic system and to act as "lender of last resort". A preference for short-term loans on the part of commercial banks is not unknown in industrialized countries, and it raises general issues which are also discussed in connexion with central bank activities and general problems of commercial banking later on in this paper. The problem is, however, much more serious than it is in more developed countries, partly because of the greater importance of the risk factor, partly because of less confidence in central bank activities, and also partly because of the absence of specialized institutions for long-term credit.

5. Undue emphasis on credit facilities for consumption purposes

For Mexico, it is stated that the operations of the Savings Policy Banks (Capitalization Companies), like pledge loans, are principally a stimulus to consumption. (Page 220).

The Fund study on Mexico raises the point that although the governments of under-developed countries may try to shift credits from consumption into production by means of qualitative, selective credit control, this policy may be very difficult to implement. For instance, private individuals, businessmen or farmers may obtain credit on the basis of productive purposes, but having obtained the credits may then proceed to utilize the profits made in their business or farm for maintaining a high level of consumption, traveling abroad, etc.

In Egypt, too, it was found that mortgage banks were primarily engaged in providing big landowners, on the security of their lands, with loans which were mostly employed for purposes other than land improvement. For this reason, their activities are described as more harmful than useful. (Page 148).

For India, it is stated that cheap and easy credit has often been the ruin of the thriftless individual farmer who has used this double-edged sword to his own undoing. What he requires is cheap but controlled credit. (Page 169).

6. Undue emphasis on credit facilities for speculative purposes

The following is a clear indication of this type of imbalance in the credit system of under-developed countries:

In Mexico, it is stated that short-term credit from commercial banks has been very much in demand during the war years because, with rising prices, commodity speculation in building up and withholding commodity inventories has proved very profitable. Criticism of these types of loans by the Bank of Mexico and the Nacional Financiera are described as having been to little avail. (Fund-Mexico, page 25).

Speculative credit by banks in under-developed countries may be said to be particularly harmful to economic development for three reasons:

(1) Economic development in under-developed countries is inevitably linked with a certain degree of inflationary pressure (which should be distinguished from inflation itself).1/ In inflationary conditions, profits can be made on the withholding and hoarding of commodities, thus the danger of diversion of bank credit into finance of speculative activities is more prevalent than in industrialized countries where no such chronic inflationary pressure exists.

(2) The provision of financial facilities for holding stocks of commodities will itself serve to reduce supplies, drive up prices and further intensify inflationary pressures, and also hold up economic development.

1/ See Secretary-General's report on Methods of Financing Economic Development, document E/1333 (now in press), page 19.

/(3) In under-developed

(3) In under-developed countries there is, in any case, a tendency towards hoarding instead of monetary savings, and this tendency is generally recognized as an obstacle to economic development. For this reason, the unbalance in the development of financial institutions in the direction of speculative activities is particularly dangerous.

7. Undue emphasis on financing of real estate operations

The high proportion of resources and net investment being drawn into real estate development, speculative building, and landholding has been repeatedly pointed out as one of the major obstacles to economic development.[1] This is reflected in the financial institutions of under-developed countries, and attention is generally drawn in the documents to the high share of this type of transaction in the assets and operations of banks in the under-developed countries concerned. To some extent, the reports go even further in attributing some causal influence to banks and credit institutions in this over-development of real estate activities and the undue absorption of savings by them.

> Thus for Chile, this tendency is described as being typical of economically under-developed countries. It attributes to Chilean institutions a belief that such investment best attains the object of ensuring the stability of returns and of the investment itself, which other types of investment will not do. As a result, the employment of financial resources in real estate has been preferred by the institutions forming the Chilean capital market. (Page 134).

> For Mexico, too, it is stressed that real estate development around the principal Mexican cities, both residential and commercial, has become the typical private investment. This attitude is reflected in bank practices which have provided the greatest incentive to real estate building. While commercial banks will seldom lend on machinery and equipment, it is stated that they are always ready to advance credit on real estate security. Similarly, insurance companies are also described as having invested half their reserves in buildings and as holding substantial sums in mortgage paper of different types. (Fund-Mexico, page 54).

1/ Ibid.

/The willingness

The willingness of banks and other financial institutions to lend on the security of real estate has also affected business practices in that profits instead of being retained in firms have been invested in buildings.

> It is reported that the incentive for this diversion is that profits obtained from rents have been much greater than the interest paid on real-estate secured loans. This movement of profits into construction, and the use of bank loans for working capital purposes, is stated to be probably the greatest inflationary force in Mexico during the last ten years. Mortgage certificates are described as being the only security investments in Mexico which are regarded as sound and conservative and as enjoying the best market of all medium and long-term securities. (Fund-Mexico, page 55).

At the same time, low cost housing has not found adequate financial support, and several of the documents describe deliberate attempts on the part of governments of the under-developed countries to strengthen such credit facilities; Chile is perhaps the most noteworthy example.

The view generally expressed in the papers is that private financial institutions have had very little choice except to follow the popular preference for real estate investment, and perhaps even by developing the credit machinery in that direction and in creating a highly developed market in mortgages and mortgage certificates, further to strengthen this popular preference. There is no indication in the papers of a deliberate attempt by private institutions to counteract this relative over-development of real estate activities.

8. Undue emphasis on large-scale enterprise to the neglect of small farmers and businessmen

There are frequent statements in the papers submitted that the credit organization in under-developed countries is better suited for satisfying the needs of large-scale firms rather than of small firms. This statement, while also made for industry and commerce generally, is made with particular emphasis

/for the case

for the case of agriculture where neglect of small farmers, is for the most part mentioned as a feature of a normal credit structure, and as either an argument or explanation for specific government intervention.

> In Egypt, the function of the Credit Agricole d'Egypte is defined as being for the purpose of meeting agricultural needs which are not at present catered for by the credit institutions in existence; that is, it was expected to organize medium and short-term loans for small agriculturists, and thus assist the development of diversified agricultural production. (Page 150). Legislation in Egypt, meant to protect small farmers by forbidding foreclosures in their case, is stated to have backfired and have had the result of rendering impossible, up to the present, the formation in the ordinary way of any banking concern that would finance the little man who had nothing but his small holding to offer as security for loans. Thus, the Five-Feddan-Law put an end to the Agricultural Bank of Egypt and with it any similar attempt. (Page 148).
>
> Similarly, in the case of the Philippines, we find that while the large business enterprises have easy access to the banks for investment loans, most of the small businessmen have to depend upon their own savings, which are necessarily limited to finance their enterprises. (Page 245).
>
> In India, too, it appears that larger enterprises meet with less difficulty in raising investment capital than smaller ones, and an objective of Government policy has been to aid the small enterprises, where they deserve help, through the provincial Industries Departments and Industrial Loans Acts. (Page 174).
>
> In the case of Mexico, it is stated that the privileged position originally enjoyed by the large landowners has now been inherited by the larger commercial and manufacturing companies for whom credit is no problem. The ease with which they are able to borrow from banks has enabled many large commercial companies to become, in turn, lenders to small manufacturing firms and merchants. (Fund-Mexico, page 25).

It will be remembered that a similar statement was made in respect of Egypt.[1] There evidently are dangers in this dependence of small firms on larger firms as the intermediaries of bank credit.

1/ See page 311

/9. Undue

9. <u>Undue emphasis on expanding credit facilities to established old firms and undue neglect of new firms</u>

This also appears as one of the problems connected with the financial institutions of under-developed countries.

> The case of <u>Mexico</u> will serve as an illustration where it is stated that private banking institutions have been reluctant to lend to new industrial firms. As long as they could extend credit to the legal limit to old established firms with whose business activities they were quite familiar, it is pointed out that private bankers have not been willing to acquaint themselves with the characteristics of new industries. (Fund-Mexico, page 42).

> Similarly, for <u>Puerto Rico</u>, it has been found that some of the promising new industries, struggling for expansion during their first years of operation have not been able to secure loans from private commercial banks. (Page 274).

The complaint that banks show preference in dealing with old established firms but help little in the establishment of new ones, is one that is not peculiar to under-developed countries, but is also often heard in highly industrialized countries. Thus, it has been a constant source of discussion and investigation in the United Kingdom. It is obvious, however, that the tendency of the banking system to prefer dealing with old firms is even more marked in under-developed countries because of the heavier risks involved, and also that it is more dangerous since under-developed countries have to rely more than old industrialized countries on the growth of new firms. This lack of balance in credit facilities as between old and new firms in under-developed countries is particularly dangerous where the old firms are <u>foreign-owned</u> and the new firms, which could be established, are owned by nationals of the under-developed countries. In such cases, the weaknesses of the credit structure for new firms may be highly disadvantageous to the growth of domestic enterprise.

/10. <u>Undue influence</u>

10. <u>Undue influence of foreign banks and foreign financing institutions</u>

In the <u>Philippines</u>, we find that in the principal commercial centres, excluding the Government-owned Philippine National Bank, banking is handled mostly by branches of foreign banks or by domestically-incorporated banks owned by aliens. (Page 244). In the recent revision of the domestic banking system, investment outside the Philippines of deposits received by branches of banks with head offices abroad has been prohibited. The receiving of deposits is allowed only to domestic banks and to branches of foreign banks already established prior to 24 July 1948. (Page 246).

For <u>Egypt</u>, we find that the banking system, predominantly of foreign character, failed to mobilize internal resources for economic development. The majority of the banks are either branches of foreign financing institutions or locally-incorporated companies with predominantly foreign capital management. As a result, it is stated that no concerted policy by banks was possible since major decisions were taken by the main office abroad. The only all-Egyptian bank is the Bank Misr, but the Egyptian interest in some foreign banks is increasing. The development of the stock exchange is also described as having been held up by the prevailing feeling that the fortunes of investment are exclusively in the hands of foreigners. (Fund-Egypt, pages 9-11).

In <u>India</u>, however, it appears that the capital and deposits of Indian joint-stock banks now greatly exceed those of foreign exchange banks which are branches of banks incorporated abroad and operating in India. (Page 173).

The situation in the <u>United Kingdom Colonies</u> has some special features in that the banking system consists almost entirely of branches of British banks with head offices in London. (Page 298).

Strong foreign influence in the system of banking and financial institutions in under-developed countries is clearly related to the emphasis on financing of foreign trade, and also to the tendency to hold balances abroad.[1/] Furthermore, the absence of national banking may be an obstacle in the way of the popularization of banking and the development of banking habits, and may create inside under-developed countries financial repercussions of banking difficulties abroad.

Thus, for <u>Egypt</u>, it is stated that it is impossible to insulate the internal market from the incidence of booms and depressions originating abroad and every banking or political crisis in a country with important banking affiliations in Egypt produces serious repercussions within Egypt. (Fund-Egypt, page 16).

1/ See pages 341-342.

11. Obstacles in the way of improvement of banking and financial institutions

The documents available throw some light on the major obstacles which will have to be overcome by any reform and improvement in banking and financial institutions in under-developed countries. Insufficiency of banking and credit facilities in itself is largely a symptom of other deficiencies and habits, and improvement may involve dealing with those underlying causes.

> For the United Kingdom Colonies, it is indicated that the procurement of physical supplies of imported capital goods required for development rather than particular shortages or handicaps in financing or credit facilities has been the major problem. (Page 301)

> In Egypt, too, the difficulties of procuring machinery rather than financial intricacies have been a chief factor in calling a halt to new capital issues and capital increases. (Fund-Egypt, page 9)

> For India, it is stated that the problems of finance in relation to agricultural development are subisidiary to the problems of over-all organization of the economic efforts of the cultivator with a view to promoting greater efficiency and productivity in farming. (Page 169)

> In the Philippines, mention is made of the preferences of private local investors to lend their money rather than hold government securities, despite the admitted advantages of the latter. (Page 248)

Where such conditions exist, the banking system may be limited in its ability to persuade investors to absorb government securities.

> For the Philippines, it is also stated that the farmers are still unfamiliar with the intricacies of the banking business, and therefore need leadership and assistance, especially in the technical aspects of banking. (Page 247)

It is clear from this statement that banks in under-developed countries have greater obstacles to overcome than their counterparts in more industrialized countries.

> Furthermore, it is stated that the people in general are individualistic in their pursuit of economic life and unaccustomed to the forms of co-operative effort. (Page 249)

/Such an

Such an individualistic outlook may be a greater obstacle to the growth of co-operative forms of activity than the absence of credit facilities:

> In Egypt, we find even more clearly stated that the Banks' clients are usually reluctant to take advantage of the facilities offered to them. (Page 159).

This will serve as a reminder that the provision of banking services is a two-way business, and that improvement on the supply side may have to be matched with the improvement on the demand side.

> A further factor for which Egypt may serve as an illustration is the failure of many applicants for bank credit to keep adequate accounts which will understandably make banks reluctant to grant credit even though the financial standing of the applicants may be high. (Fund-Egypt, page 15).

Scarcity of acceptable industrial borrowers as well as laws making it difficult or impossible to give industrial loans on security of machinery or laws offering protection even to intentionally bad debtors may be other obstacles equally harmful as inadequacies in the banking system itself.

> In Puerto Rico, we find that the Government Development Bank at the beginning received innumerable applications for very risky and unsound propositions. (Page 269).

This illustrates another aspect of the lack of familiarity with the proper functions of the banking and financial institutions which often will prevail in under-developed countries.

> In Chile, reference is made to the present difficulty of carrying out reliable technical and economic studies regarding the prospects of businesses, for want of information concerning natural resources, shortage of trained staff, etc. (Page 136).

From that point of view, too, the work of banks and financial institutions in under-developed countries is more difficult than in industrialized countries.

/For Mexico,

for Mexico, mention is made of the low educational standard of the economy as a whole, as a main factor in the absence of banking habits. (Fund-Mexico, page 21). Other obstacles to the extension of private credit mentioned for Mexico include the extreme division of agricultural property which increases collection difficulties, erroneous opinion held by the uneducated farmer that national banks are charitable institutions, and the ignorance of the farmer who accepts oppressive terms from merchants who purchase his crop rather than make use of existing banking facilities. (Page 25).

Thus, the papers reveal the variety of obstacles outside the banking system itself which have to be overcome before an improvement in banking and financial institutions can bear fruit.

II. IMPORTANCE OF PUBLIC FUNDS

As has already been mentioned, the weaknesses and unbalance of domestic banking and financial institutions have led to considerable emphasis on the provision of public banking facilities in a variety of forms. Such forms include the use of direct government funds for discharging services normally undertaken by specialized banking and financial institutions, the setting up of publicly owned specialized institutions, the undertaking of financial and credit services by institutions charged with the promotion of economic development with the help of public funds, and activities by the central bank in fields normally undertaken by private institutions.

For all these types of public intervention in the credit and financial system the papers provide plenty of evidence. In some of the countries concerned, almost all of the various forms of public intervention listed above have been used, although with varying emphasis. Thus it may be said that Chile has particularly relied on providing financial and credit facilities through government-sponsored development corporations, that Mexico has particularly relied on central bank activities and the development of a national banking system, that Puerto Rico has specially relied on the direct use of government funds as well as a government promoted industrial banking system, etc.

/A. Direct Use

A. Direct Use of Budgetary Funds

In Puerto Rico we find that the development programme has been financed mostly from Insular treasury surpluses accumulated during the war years. (Page 251). Need for using government funds is underlined by the view expressed that strong and unorthodox measures for agricultural expansion are very risky and that large-scale ventures in agricultural development, such as are needed to change practices and establish new crops quickly, are liable to great losses. (Page 263).

If in the course of development such unorthodox measures must be employed and great risks of loss must be taken, and possibly losses deliberately incurred as an inducement to economic development, it is obvious that no private institutions or private savings are appropriate for this purpose, and that public funds have to be used.

In Chile we find that there is an important group of enterprises wholly-owned or mainly-controlled by the State but administered independently, including the State railways, the national electricity undertaking (ENDESA), the oil industry, the national iron works etc., and that their capital is either wholly contributed by the State, or that at least the large majority of the permanent capital is directly taken up by government funds, either from the State budget or through the development agencies. Similarly, loans for this group of industries, have invariably been granted by State agencies, generally at rates of interest lower than current market rates. (Page 118). Financing of the main development corporation from the general State budget has had to be instituted as financing from the yield of specific taxes on copper[1] became insufficient. (Page 125). Wide use is made of direct government funds from the general budget for financing economic development without the intermediary of private institutions. (Fund-Chile, Table 4, page 17). The government development institutes in Chile are stated to invest directly 12 per cent of the resources of Chile. The government of Chile is described as being the largest single investor in the country. (Pages 20-21).

In Egypt, it is stated that the government itself has recognized the inability of small investors to obtain necessary capital through direct investment or bank advances, and therefore established a fund that was utilized in providing loans for approved Egyptian industrialists. Taxation is also described as a direct method of channeling savings to investment in Egypt. In addition, the Government draws on the accumulated savings in its reserve fund, and savings from taxation have frequently been employed in granting loans to agriculture. Government funds have also been used to help private banks on various occasions. (Fund-Egypt, page 8).

1/ See also page 326

/In the

In the United Kingdom Colonies, the category described as basic equipment, including roads, health facilities, schools and universities, public building, etc., has been generally provided through government channels. Similarly, a large part of the public utility services has been increasingly provided from government funds, and direct government funds have been used in the United Kingdom Colonies through the system of colonial grants from the United Kingdom budget and more recently through the newly formed Colonial Development Corporation and the Overseas Food Corporation. (Pages 295-296).

For the Philippines, too, it is stated that the larger part of financing has to be done by the Government through Government-owned corporations directly engaged in various enterprises. (Page 245).

B. Specific Government Funds Involved

The various kinds of direct government funds mentioned in the paper for financing economic development include accumulated government balances, proceeds of general taxation and the yield of specific taxes or royalties.

1. Accumulated government balances

The use of accumulated government balances is specially important in the United Kingdom Colonies where it is stated that many dependent territories have accumulated balances held in cash or short-term sterling investments in excess of what is needed as a prudent reserve against ordinary fluctuations in revenue, and that they plan to spend such excess reserves on capital works in the next few years. (Page 295).

In Puerto Rico the utilization of government surpluses for financing of economic development is described as the most encouraging aspect in the financing of Puerto Rico's development. It is further stated that 35 per cent of the total government income between 1941 and 1949 was devoted to economic expansion. (Page 270).

2. Proceeds of general taxation

In the special conditions of Puerto Rico, it is stated that there is need to counteract the tendency towards increasing concentration of wealth by high taxation of income. Thus the use of government funds obtained by direct income taxation is favoured. The promotion of savings is declared to be difficult, apart from contributing to further concentration of wealth. It is stated that the basic work for creating a tax system which combines high taxation of incomes with encouragement of private investment is at present being done. (Page 274).
It is also stated, however, that the period of current surpluses of

/government

government revenues is now over and that there is little possibility of annual appropriations of the size needed for a financial aid to industries programme. (Page 256). Thus there is declared to be a shift from the use of direct government funds towards the provision of financial inducements (especially tax exemptions and guarantees) and aids by other means towards promotional activities.1/

In Chile, too, it is reported that the State has at its disposal substantial funds which it obtains under the tax laws in force and which it uses to cover schemes for the development of production. (Page 116)

For the United Kingdom Colonies, we find that in some territories, notably the former Straits Settlements, practically the whole of the "social capital" of roads, buildings, and other forms of basic public services, involving large expenditures, have been made entirely from revenue without incurring any loan or capital charges. It is a principle of policy in the United Kingdom Colonies to derive as much as possible from taxation for the finance of economic development. (Page 295). Within taxation there is a tendency to replace specific taxes and royalties such as export taxes "by more scientific general income taxes." (Page 302)

3. Specific taxes or royalties

The use of specific taxes or royalties for financing economic development is also frequently discussed. Illustrations may be drawn from Chile where the tax on copper provided the main source of Treasury contributions to the Development Corporation, and from the United Kingdom Colonies where royalties on mineral extraction and export taxes on primary produce are an important source of revenue for colonial governments. Some drawbacks of this method of financing economic development are, however, apparent.

Thus, in the case of Chile, it is stated that this method of financing has the grave defect that the Corporation was made dependent on the revenue from a highly unstable activity like the copper industry. This is logically incompatible with the principle that the Corporation's work should be conducted on a stable and permanent basis. (Page 125). The tax on copper is levied at the rate of 50 per cent of any additional income earned from an increase in the selling price of copper above the basic pre-war levels. In the early stages of the war, however, when copper prices were fixed, and again more recently when they have fallen back the yield of this tax was disappointing. (Fund-Chile, page 14). In addition to the copper tax, the Corporation was also allocated the yield of sur-charges on taxes on inheritance and gifts. (Page 24).

1/ See pages 328-330

/As has been

As has been mentioned, however, the policy now is to abandon the earmarking of specific taxes for economic development and to make general budgetary appropriations where government funds are directly used.

> In the United Kingdom Colonies also royalties and speicific taxes have proved to be too "rough and ready." The tendency now is to develop flat percentage mining royalties into more complex sliding scales which approximate the royalty system to general taxation. Even so, however, the objection is made to the system that the amount of profit available for reinvestment by individual commercial enterprises is correspondingly reduced. It is said that partly for this reason, governments are being advised to consider entering themselves into fields formerly regarded as reserved for private enterprise. (Pages 302-303).

It is apparent that where government funds are directly used in the manner described in the preceding section, there is correspondingly less need for creating specific institutions of a banking nature. In such cases the provision of financial services for economic development becomes merged with general state administration, either in addition to or more usually in substitution for a non-existent private or public banking system. The method of using government funds directly either from general revenue or else from specific taxes, may be defined as a method of short circuiting the need for specific financial institutions.

> Haiti provides an illustration of a country where budgetary funds have generally not been used for the financing of economic development, in spite of apparent deficiencies in the private banking and financial structure. Government surpluses have generally been used for debt redemption rather than financing of development. (Haitian Report).

III. GOVERNMENT FINANCIAL INDUCEMENTS OTHER THAN DIRECT INVESTMENT OF GOVERNMENT FUNDS

A. Tax Remissions

Closely related to the direct use of government funds are government inducements given in the form of exemptions from taxation or other dues. Such inducements are often given in order to compensate for the absence of credit facilities. They may be defined as a negative use of public funds by not collecting funds which would be collectible under general tax laws or administrative procedures. The use of such government inducements is widely reported.

> In Chile, examples are the exemption of new buildings from real estate taxes, exemptions from customs duty, exemption of the nitrate industry from taxes since 1932 and exemption of the steel mill at Concepcion for a period of 20 years. (Fund-Chile, page 13). General exemption from excess profits taxation and certain reinvestment of profits obligations for ten years were granted to enterprises created after January 1942. (Page 15).

> In Puerto Rico, the method of tax inducement is particularly important. In fact, the "tax holiday" which consists in the exemption of new industries established after 1947 from property, income and municipal taxes is now declared to be the major government method in assisting in the financing of new enterprises. It is reported that during the years 1948 and 1949 the Industrial Development Company has relied mainly on this tax incentive for the establishment of industries. The tax holiday applies also to a selected list of existing industries which establish new units capable of increasing the output of these firms. (Pages 255-256). The Government of Puerto Rico has also granted tax exemption for the bonds of its Agricultural Company. (Page 262).

Even tax exemption, however, has its limitations in effectiveness.

> This is illustrated by a statement in respect of Mexico where that the public has failed to absorb government funds in spite of their tax-exempt features which raise their yield even above that of other available private fixed interest-bearing securities. This failure of tax exemption is attributed both to a fear, dating from the revolutionary experience, that the government may default, and to distrust for anything that is government sponsored. (Fund-Mexico, page 63).

> For the United Kingdom Colonies, however, it is reported that no special inducements have been adopted, such as guarantees of an interest on principal, or tax exemption, or other special privileges, except in rare special cases. (Page 299).

/In Haiti

In Haiti, too, it appears that no special tax inducements have been adopted nor have any other special privileges or guarantees been given. On the contrary, it is stated that the business community complains of a lack of sympathy on the part of fiscal authorities and sudden and arbitrary new taxes thwarting new industries. (Haitian Report).

B. Government Loans

In Chile, loans by the Development Corporation are made, and although they average three years, they may extend up to ten years in the case of activities regarded as of national importance, whether commercial, industrial, agriculture, or mining. (Page 125).

In Puerto Rico the Industrial Development Company has developed a special Aid to Development of Industry Programme in which lending to private entities plays a considerable part. A special type of such loans is in granting a mortgage loan on factories built by the Industrial Development Company and transferred to private enterprises. This has been done for eight firms and the loans amount to 8.7 million dollars, at low interest rates (3-1/2 to 4-1/2 per cent); the loans range from 7 to 30 years. The Development Company is also making loans of working capital although only two such cases are recorded. (Page 255). The Development Company has been criticized for excessive liberality in the terms of its loans and it has even been contended that this has actually retarded progress because new industrialists insist on as good terms as the early ones. The liberal policy of the Company is, however, defended as perhaps the only way to attract responsible firms to a new area. It is declared to be difficult in the initial stage to attract the industries desired on the basis of usual bankable transactions. (Pages 258-259). Puerto Rican Government Development Bank has also, in the past, made long-term real-estate loans, but this policy has since been changed and loans are now made only for industrial purposes, with minor exceptions. It may be specially noted that according to Puerto Rican experience, an alert industrial loan department of a government agency can provide invaluable financial guidance to borrowing industrialists before and after obtaining the loan. It is planned to place these services on a permanent and effective basis. (Page 267).

In Egypt the Treasury provided funds in order to extend loans at a rate of interest not exceeding 6 per cent and repayable within 5 years. These loans were extended through the medium of the Bank Misr. The procedure in granting these loans is, however, described as being extremely cumbersome because of the division of functions between the government departments concerned and the Bank Misr. (Fund-Egypt, page 15). The Ministry of Commerce and Industry also made small loans to graduates of technological schools to help them to start small workshops of their own. The rate of 6 per cent at which loans were granted from government funds were much below the rate at which bank loans could be obtained. (Page 18).

/C. Inducements

C. Inducements other than Loans

The main fund of experience in this respect is provided by Puerto Rico, where the emphasis is gradually shifting from the use of direct Government funds to other kinds of inducements and promotional activities.

In Puerto Rico, among the non-loan activities mentioned are the building of factories which are subsequently leased to select industrialists under very favourable terms, giving the lessee an option to buy the plant within a certain period. This lease was applied both to well-known national firms and to local industries. Leases of property granted amount to 7 million dollars, most of it being for a hotel enterprise. (Page 255)

This type of transaction amounts, of course, to a government loan to the enterprise of the capital cost of building a factory which otherwise would have had to be borne by the enterprise itself. The avoidance of such capital costs will often be specially valuable to firms in their first years when otherwise it would be very difficult to obtain credit, in the absence of an established profits record. It is interesting to note that the Development Company was criticized for excessive liberality in the terms of its leases in the same way as in respect of its loans.

In Egypt, a special type of financial government service is reported in that the Ministry of Commerce sells machinery to small manufacturers on the installment system. (Fund-Egypt, page 15).

D. Government Policies in Channelling Credit into more Desirable Types of Investments (Selective Credit Policy)

The need for channelling finance into different channels from those which they would normally take is generally recognized as one of the functions of government in controlling financial institutions in under-developed countries. This need arises directly out of the tendencies - many of which have been discussed previously in this digest - for investors to be attracted to types of investment which may yield quicker, higher or safer returns than investments desirable for economic development, but which tend to interfere with the financing of more essential projects. Government declarations of intention of guiding finance into preferred projects and sectors are common to practically all the papers submitted. It is universally reported that governments tried to divert financing from real estate, commodity speculation, etc. The methods used and described are the organization of public financing institutions whose investment policy can be directly controlled by the government, the prescription by law or statute of particular directions of investment by private financial institutions, the holding out of particular inducements to banks for investments in preferred sectors, and finally the sale of government securities to private individuals or banks and the use of money thus raised for investment in preferred projects. Government securities may also be substituted voluntarily or by compulsion, in bank portfolio as legal liquidity reserves, thus enabling the government to raise money for preferred projects.

In Chile, commercial banks are authorized under law to count certain types of credit instruments as legal reserves, any part of which they may be required to lend to the Development Corporation over a five-year period. (Fund-Chile, page 39).

Similarly in Mexico, to increase credit for certain selected activities, the banks have been given an opportunity to invest part of their reserve requirements in national securities and agricultural credit. (Fund-Mexico, page 22).

The use of another selective policy can be well illustrated by the case of Mexico, where in 1943 the re-discount rate for loans made for agricultural purposes was cut to 3 per cent, while re-discount rates on commercial loans were maintained at 8 per cent. Doubts, however, are expressed on the effectiveness of this selective measure. At the same time, private banks were required to have a loan portfolio of which at least 60 per cent must be for specific productive purposes, thus illustrating direct qualitative control. Similarly for Mexico, we find that the Central Bank has also attempted to persuade all the institutions of the credit system to give, in granting loans, priority to the development of productive activities. (Page 211)

/In Puerto Rico,

In Puerto Rico, the Industrial Development Company is subject in its capital investment projects to prior review and approval by the Puerto Rico Planning Board which determines whether they are in accordance with master plans for the Island. All requests by the corporation for capital funds must be made through the Planning Board. (Page 253)

This is an illustration of selective allotment of funds through the use of government-established agencies.

In the Philippines where the same difficulty in selling government bonds to the general public is reported as in the case of Mexico, in spite of the "admitted advantages" of government securities, the government has tried to channel credit into desirable agricultural development by providing special discount facilities at the Central Bank for the small unit banks formed to provide credit to the Rice Growers Association. (Page 248).

IV. ACTIVITIES OF GOVERNMENTAL INDUSTRIAL BANKS, ETC.

For Puerto Rico, it is reported that the powers of the Government Development Bank include that of discounting paper liable for discount by the Federal Reserve System as well as the lending of money to other banks and trust companies. (Page 265). The activities of the Development Bank as listed by its balance sheet as of 30 June 1949, are about equally divided between industrial and commercial loans on the one hand, and housing loans on the other hand. Real estate loans were only a little more than one-quarter of all industrial and commercial loans. It is, however, estimated that of the loans classified as industrial and commercial, less than one-half were for manufacturing purposes. (Page 286). Real estate loans by the Development Bank have now ceased. It is also worth noting that the suggestion has been made that the combination of fiscal and industrial functions of the Bank has led to an undue neglect of long-term loans for industrialization, which is in the process of correction. In the paper presented, however, the cautious approach by the Bank is approved in view of initial risks. As of 30 June 1949, an estimated 14 per cent of the total loans outstanding were for manufacturing industries. (Pages 268-269).

In Egypt, the government has created an industrial bank with a capital of L.E.1,500,000 of which 51 per cent has been subscribed by the State. This bank, however, has not yet started operations so that no experience is available. (Page 157). Of the initial capital of the industrial bank, about 30 per cent has been subscribed by the banks, and 20 per cent by the public. It is one of the features of the industrial bank that it proposes to follow up the expenditure of the loans which it grants or the guarantees which it gives in order to ensure that they are spent on productive purposes. (Fund-Egypt, page 16). It is indicated that the state industrial bank will fill an important need both by direct lending and by the provision of guarantees of loans and debenture issues. (Page 23). There also exists a State Agricultural Bank incorporated in 1931 with a capital of L.E.1 million. This is described as having filled a serious gap in the financial mechanism left by the dearth of agricultural credit for small farms, and to have displaced loans by cotton merchants, sugar manufacturers, and individual capitalists. (Page 14).

In the Philippines, the pre-war Agricultural and Industrial Bank was absorbed by a new Rehabilitation Finance Corporation with an authorized capital of P 300,000,000. (Page 245).

/In Chile, the

In Chile, the formation of a unified Investment Bank by a merger of the present specialized industrial, agricultural and savings institutions has been prepared, and a draft law drawn up in 1947. (Page 136). The present specialized institutions, namely the Agricultural Credit Institute, the Mining Credit Institute, etc., were formed in the late twenties. These institutions were originally designed to do economic planning as well as to provide finance, and although they have contributed materially to economic development and extension, and improvement of the credit system, it is pointed out that they have been working according to different plans, often not well co-ordinated, and have gradually withdrawn from the planning field. Furthermore, in spite of the legislation behind them they actually only provide current working capital rather than resources for new development. (Fund-Chile, page 21).

In Mexico the most important national bank in the industrial field is the Nacional Financiera, with a number of more specialized credit institutions attached to it. It is worth noting that apart from development of enterprises by investment and loans, the Nacional Financiera also acts as an intermediary to foreign sources of finance such as the International Bank, and also is charged with the development of a broader securities market and the improvement of the existing stock exchange. As of 31 December 1947, investments made by the Nacional Financiera outweighed loans made by it by more than two to one. The activities of the specialized financieras, however, concentrated almost entirely in the granting of loans, and for the national banking system taken as a whole loans tend to be more important than investments. One noteworthy feature in the finance of the Nacional Financiera is the issue of Participation Certificates which provide to the investors of such certificates a fixed rate of interest although the assets of the Nacional Financiera itself are largely in investments rather than in loans. To the investor these certificates provide the advantage of redemption at sight and at par. Thus they enable the individual investor to finance industrial development through the Nacional Financiera without involving personal risks. Half of these certificates are held by private investors and private firms. A list of the investment portfolio of the Nacional Financiera contains practically all the large industrial corporations of Mexico. Although great efforts were made to channel Financiera credit to industry, it is stated that some indirect credit such as rediscounting operations for the financieras has leaked into the commercial field. (Fund-Mexico, pages 38-42).

/To help

To help finance industrial enterprises which would have some difficulty in obtaining the necessary finance through established institutions, the Government of India established in 1948 an Industrial Finance Corporation with an authorized capital of Rs. 10 crores. The capital of this corporation is partly held by the Government and partly by the Reserve Bank of India, scheduled banks and insurance companies, investment trusts and similar institutions as well as co-operative banks. The capital of the corporation has been guaranteed by the Central Government as to the repayment of the principal and the payment of annual dividends. The corporation is permitted to guarantee or grant loans to industrial concerns. An attempt is being made to establish similar corporations though on a smaller scale in the Provinces. (Page 175).

V. CENTRAL BANK PROBLEMS

Apart from the use of current revenue and accumulated balances, governments of under-developed countries may provide finance for economic development by credit creation through their central bank. Such credit creation may consist either in the direct advance of funds from the central bank, government or government-owned agencies, or else in credit creation through the private banking system, by increasing the liquidity of private banking institutions thus inducing larger investments, by lowering rates of interest thus inducing larger demand, or by open market policies - i.e., by the buying of securities from the general public and thus increasing the amount of money in circulation.

It appears from the reports that central banks in the under-developed countries concerned are rather less differentiated than they are in the more industrialized countries. Credit control through the central banking system is often inextricably mixed with fiscal functions on the one hand, and ordinary commercial banking on the other hand. The methods of credit control by central banks in under-developed countries are also generally restricted by the absence of a developed private capital and money market, and by lack of development of a market for government securities. This limitation of credit policy on the part of central banks is stressed in most of the papers.

The Central Bank of the Philippines is authorized by its enabling act to advance directly to the Philippine Government up to P 200,000,000 for self-liquidating income projects. Over half of this sum had already been advanced, some of it to enable the government to amortize a loan from the United States Reconstruction Finance Corporation. (Pages 242-243). The Central Bank is also designed to improve agricultural credit facilities by offering the full discount facilities to the various farmers' co-operatives. (Page 248).

In Puerto Rico, it appears that the Government Development Bank is designed to combine some functions of a central bank with the major functions of an industrial bank. The Bank is operating under very broad powers. Its fiscal powers include the function of lending money to the Insular Government or any of its instrumentalities. (Page 264.)

The Central Bank of Mexico went through a series of reorganizations. The Government now holds 51 per cent of paid-up capital and appoints 5 of the 9 directors. It has now become the centre of the Mexican banking system and the mainstay of the government's financial policy. (Page 210). The Mexican Central Bank has also combined the normal duties of credit control with direct assistance to government development programmes, thereby filling a gap due to the insufficiency of savings and of the resources of other credit institutions. (Page 211). It has applied qualitative credit control in inducing priority in productive activities on the part of private institutions, and also quantitative control to reduce the impact of inflation, by raising the cash reserve requirements of private institutions. It has also been the main support of the market for government bonds by being ready to buy them at any time with a discount of only one half of 1 per cent and also intervene in the market for private securities to avoid wide fluctuations. (Fund-Mexico, page 4). It has taken about 90 per cent of the government bonds issued. Although no definitive statement can be made of the extent to which private institutions might have stepped into the investment and specialized credit picture if the Bank of Mexico had not done so, it is said that Mexico's industrial development would have been far smaller. (Page 11). The importance of the Bank of Mexico in the banking structure is illustrated by the fact that its total assets are not much less than those of all private institutions taken together, and that its investments are more than twice those of all private institutions. It has rediscounted over one-third of all the loans made by private banks. (Page 12, table 3).

The Central Bank of Chile also combines the functions of credit control with those of financial accommodations to the government agencies, and engages in general banking activities. Its functions have been greatly extended since it was originally establihsed as a result of the Kemmerer Mission. The difficulties of credit control are attributed to such obstacles as the cyclical behaviour of the balance of payments, the lack of a well developed capital market, and the chronic dependence of the Treasury on the Central Bank credit. Legislation and staff are declared to be satisfactory even though the legislation appears to be in need of

/systematization.

systematization. The Bank has been relieved of its obligation to carry specific reserves. Its policy of lowering discount rates has contributed to a gradual lowering of the interest rate charged by the commercial banks, but at present, in spite of the very low rediscount rates of the Central Bank, it is stated that commercial banks charge on the average around 9.5 per cent on their credit operations. Generally rediscount policy appears to be ineffective not only in influencing commercial bank policy but also in affecting business conditions. A policy of selective credit control is suggested instead. The Central Bank seems to be caught between congressional expansionist pressure and the power of the commercial banks, and it is said that there is little scope for Central Bank open market operations. (Fund-Chile, pages 37-42).

VI. GOVERNMENT BORROWING

The papers as a whole present a picture of considerable difficulties in the issue of government securities unless these can be compulsorily marketed to the Central Bank or to the commercial banking system. In general, local issues of government bonds to the general public are difficult, and sometimes considerable inducements have to be offered to the holders of such securities. Generally speaking, no fully organized market exists by which owners would have been spontaneously assured of being able to liquidate their holdings if required.

The position in the United Kingdom Colonies is of a somewhat special nature since it has always been common practice for colonial governments to raise public loans. In the past these loans have been raised predominantly in the United Kingdom where a highly organized market for such securities exists. There have been some local issues, particularly in the more advanced territories such as the Straits Settlements and Hong Kong, and today there is an increasing tendency to look to local borrowing. A programme of colonial loans to be issued over the next few years has been agreed and in November 1948 the Government of Trinidad was able successfully to issue a loan of £3,000,000 at 3 per cent. This is a much lower rate than is reported for under-developed countries generally. (Pages 296-297).

In the Philippines, the Rehabilitation Finance Corporation - a government agency - has powers to issue ₱300,000,000 in bonds guaranteed by the Government of the Philippines. (Page 245). But it is not stated whether use has been made of this authorization and with what result. In the development of a securities market, it is stated that the government has to take the lead and market its own securities first. The Central Bank of the Philippines will soon be geared for launching internally an intensive campaign to encourage investments in local bonds

/and it is

and it is expected that better publicity for the accounting and utilization of the proceeds of these bonds will greatly aid in obtaining full support from the public for this cause. (Page 250). At present the market for government securities is described as undeveloped and the locally held part is entirely held by institutional industries. This is attributed to the difficulty of disposing of government bonds except at a large discount due to the lack of an active securities market. In July 1949 there were only 147 private holders of peso government bonds. (Page 248). The new bonds to be issued are in smaller denominations, as low as P 20, in order to encourage people of modest incomes to buy government securities. It is felt that the real appreciation of the advantages of investment in government and corporate securities will come gradually. (Page 249). In the Philippines as well as in Mexico government securities, to a certain extent, have been made eligible as part of the required legal reserve against deposits, in order to promote their sale and create a market for government securities. (Page 247).

In Puerto Rico, public corporations secured through bond issues $72 million but it is not stated how many of these are held by Insular private investors. (Page 251).

In Mexico much of public developmental expenditure between 1939-1948 was financed by the issuing of securities that were taken up by the Central Bank, the Nacional Financiera, and other national institutions, and only "on a lesser scale" by private institutions and private investors. The attempt is now being made to prevent a further increase in the public debt by limiting the amount of new issues by the Central Government to the amortization of existing issues. Further, it is stated that municipalities may float only loans which produce a direct increase in their revenue. The certificates of the Nacional Financiera which have been previously described also partake in many of their features of the nature of government bonds. The failure of the private market in government bonds to develop is attributed to more profitable commercial investments and fears of political instability. (Fund-Mexico, page 16). On the other hand, the view is also expressed that the lack of an organized market for government securities in Mexico which is a source of complaint on the part of the private banking system is also partly due to the failure of the private banking system itself to create a market for these bonds by substantial purchases. (Page 22).

In Chile, it is stated that the lack of condidence in government finance and the inadequate volume of savings from the public at large have been factors limiting the development of a market for government securities. (Fund-Chile, page 42). The commercial banks have shown little willingness to invest in government securities or bonds. Their reluctance to invest in government bonds is explained by the more profitable opportunities available elsewhere. (Page 45). The most general bond issue carries a 7 per cent nominal interest rate but since it is quoted at 85 the effective yield is 8.2 per cent. Even this level has only been reached with the help of government support and at the present high rate of inflation, the report states that even 8.2 per cent yield involves a capital loss. The government bonds are tax free and redeemable at maturity upon presentation to the Treasury of the Central Bank. In spite of their high yield and tax exemption, government bonds cannot compete successfully with real estate business investments and even with mortgages. It is noted that returns on industrial shares are about 10 per cent and no capital losses are incurred in these outlays. In spite of these difficulties, the Chilean domestic market for government bonds is described as well developed, in comparison with most other Latin American countries, except Argentina and Uruguay. (Page 61).

In Egypt, the government has been authorized by parliament to finance the big Asswan Dam project by floating a domestic loan. (Page 160). In order to encourage banks to hold government securities, it is stated that the Central Bank (not now existing) would have to minimize sharp fluctuations in their value and assure immediate market-ability. (Fund-Egypt, page 13).

For India, it is reported that the State relied upon public borrowing by the Central Government and loans to Provincial Governments, which were in direct charge of schemes of agricultural development. Almost all the irrigation schemes have been productive and provincial Governments have found in additional taxation the means to repay the interest and principal of the loans they raised from the Centre for their initial financing. (Page 170).

VII. PRIVATE BANKING INSTITUTIONS: COMMERCIAL BANKS

A. Commercial Banking Policy

In Chile, it is stated that there are no investment banks, i.e. banking institutions which effect the initial investment and hold the shares until they can claim the support of individual investors; although on specific occasions and to a limited extent the commercial banks have performed this function subject to the furnishing of commercial guarantees. Commercial bank credit available is stated to be too expensive for financing the initial cost of investment in new firms or extensions of old firms since the prevailing rate of interest is approximately 10 per cent and thus the initial cost would be equal to 20 to 30 per cent of the initial investment, allowing for a time lag of 2 to 3 years between the initial investment and the possibility of beginning re-payment. (Page 119).

These high charges would evidently rule out the commercial banking system as a source of initial finance.

/As a result

As a result, in Chile the function of taking up the shares of new private enterprise has largely devolved on the Development Corporation, and to the Industrial Credit Institute. The credit institute has specialized on medium term credit at a low rate of interest to manufacturers in general because bank credit was too expensive for most industrial enterprises and not all industrialists were in a position to offer collateral acceptable to the banks. This attempt to substitute for the weaknesses of the commercial banking system has, however, been criticized as leading to the building up of an excessive bureaucracy. (Fund-Chile, page 31). Another attempt in utilizing the commercial banking system for other than short-term loans was by inducing them to hold as part of their liquidity reserves the sums which they were required to lend to the Development Corporation. It is, however, pointed out that such advances are not subject to the text of rediscountability, and that by including them in the reserves of the commercial banks the power of using credit control by changes in the discount rate on the part of the Central Bank is diminished. (Page 39). In general, it may be said that Chilean commercial banks restrict their advances to short-term self-liquidating commercial loans. (Page 45).

In the United Kingdom Colonies too, banks do not normally provide a source of long-term capital but their function in the promotion of new enterprise appears to have been more pronounced than in Chile. It is stated that they have provided floating capital required for financing current business operations as they grow over the years, and also that they have helped to introduce local promoters to sources of long-term finance in London. Moreover, it is stated that a tendency is feasible for existing commercial banks to form special subsidiaries with the object of making loans to local enterprise for substantially longer periods than would be contemplated by the normal commercial bank. It is pointed out, however, that there are limitations to the resources in these new sources of long term finance. (Pages 298-299).

It may be noted that there are a number of industrialized countries (specially the United Kingdom) where the commercial banks confine themselves to the supply of working capital and short-term loans, although in others again (specially in the United States and Germany) banks have taken a more active part in the promotion of new industries and the supply of long term capital.

In the Philippines the commercial banking system has been recently reorganized, mainly in the direction of reducing the degree of foreign control and by relating the capital requirement to risk assets of the banks. Government securities were made part of the required reserve - this presumably with the object of extending the market for government securities. To increase the usefulness of commercial banks as sources of industrial finance, the maximum maturity of their loans was extended from five to fifteen years. (Pages 246-247).

In India, working capital is generally provided by the banking system; the banks either make loans or give short-term credits through current account over-drafts to meet the current finance needs of industries. Banks in India generally do not finance investment capital although they do carry small portfolios of industrial securities. (Page 174).

In Mexico too, commercial banks have concentrated on short-term loans. Of the total resources only a very small proportion is in industrial securities, and of the total loans more than 90 per cent are for terms of less than one year. The reasons adduced are the higher profits of short-term operations, the lesser risk, more rapid repayment and legal liquidity requirements. In an attempt to induce greater participation of commercial banks in long-term industrial credit, the law was amended to authorize commercial banks to count "installation and repair loans," given for periods of two to five years, as an investment of deposits and not as made from their own capital, thus reducing the effect on their legal liquidity status. (Pages 216-217). In practice, however, the commercial banks have not used their capacity to extend medium term credit (one to three years) to the full extent permitted by law. Similarly, although the requirement for commercial banks now is to divert 60 per cent of their loans into actual productive purposes, it is stated that the accuracy of the statements made by the commercial banks have been found difficult to accept because when, after paying out high dividends, businesses borrow for working capital funds which might have been drawn from their own earnings, the Bank loan is in effect a consumption loan. (Fund-Mexico, page 5).

This illustrates one of the difficulties of selective credit control on the part of governments through the commercial banking system.

For Mexico, it is also stated that the concentration of the commercial banking system on short-term credit has supported commodity speculation and the building up of commodity inventories. (Fund-Mexico, page 25).

The case of Egypt provides an example of commercial banking taking an active part in the finance of industrialization. The Bank Misr was specifically founded for that particular purpose.

It was hoped that the Bank Misr, in Egypt, by participating in the capital of industrial concerns would give the general public a lead and thereby be able to withdraw or greatly reduce its financial commitments. But in the light of subsequent experience this is described as a "pious hope". It is stated that the danger involved in combining direct industrial participation with deposit banking are by no means imaginary. Experience has demonstrated with unmistakable certainty the grave consequences for a deposit bank to become involved in industrial entanglements particularly when the participation is of a speculative character. The Bank Misr at present still controls and provides direct assistance to industrial concerns, and lately it has been engaged in the formation of a rayon yarn manufacture plant. With the exception of the activities of the Bank Misr, commercial banks have been hampered in the granting of credit by the risk that reserves of both local and foreign exchange, would fall as a result. (Page 154).

This illustrates the difficulty of an active credit policy on the part of commercial banks where they cannot be certain that the extended credit will return to them in the form of increased deposits.

> Even so, deposit banking in Egypt has greatly extended recently and bank deposits now exceed notes in circulation. Apart from industrial participation, the Bank Misr also undertakes a large loan business, at rates of interest ranging from as low as 2½ per cent to Alexandria dealers up to 6 per cent to country merchants and much higher rates for small cultivators and industrialists. The foreign banks operating inside Egypt have participated in the risk capital of enterprises only to an extent which is described as negligible. On the other hand, it is stated that some companies are persistently indebted to these banks so that the banks, in effect, supply medium-term or long-term credit by means of a succession of short-term loans. It is worth noting that the Bank Misr is actively promoting enterprise had to perform many services which in a more developed capital market are usually provided by company promotors, issuing houses and underwriters. It is also worth noting that as a result of its heavy industrial commitments the Bank Misr became involved in a financial crisis in 1939 and had to be supported by government loans and guarantees and be put under the control of a Government Commissioner. Finally, it is stated that the Bank Misr was also the medium through which foreign investment took place under a regime of shared participation in the original capital of the new companies. (Fund-Egypt, pages 18-20).

B. Bank Balances Held Abroad

A special problem of commercial banking policy in under-developed countries is that with its international connexions the commercial banking system may become a means by which deposits and funds are invested and held abroad instead of being utilized in the economic development of the under-developed country itself. This is a specially important problem where the commercial banking system is itself foreign-owned.[1/]

1/ See page 320

/In Egypt,

In Egypt, it is stated that the bulk of savings is represented by balances held abroad, principally sterling balances. (Page 161). It is part of a suggested banking reform that commercial banks should be required to invest locally a large part of their resources and gradually to raise the proportion of domestic portfolio to total assets. The importance of this is illustrated by the fact that as of 1 January 1949 the National Bank of Egypt held twenty times more foreign securities than Egyptian securities. It is anticipated that to induce Egyptian Banks to undertake domestic investment it would probably be found necessary to require banks to sell foreign exchange holdings above prospective liabilities and working balances. (Fund-Egypt, pages 12-13).

In the Philippines, the investment outside the country of deposits received by branches with head offices abroad is now prohibited. (Page 246).

In Mexico, too, it is stated that although rates of interest in Mexico are much higher than in the adjoining United States, considerations of safety have had more interest than those of profit, so that the net movements of funds has been rather from Mexico, a high interest country, to the United States, where interest rates are lower. (Fund-Mexico, page 16). Mexican investors tend to engage in currency speculation by holding bank balances abroad even at the cost of substantial interest rates. (Page 2). In April 1948, Mexico residents had over one hundred million dollars in United States banks. (Page 53). It is further stated that voluntary savings are still exported. (Page 235).

In Haiti, the Royal Bank of Canada, the only independent commercial bank there, keeps a substantial amount of U.S. currency in Haiti, and the bulk of its assets are held in the New York office. The accumulated liquid savings of Haiti (as represented by the assets of the banks) are described as held in foreign exchange or on deposit abroad. (Haiti Report)

VIII. PRIVATE INSTITUTIONS OTHER THAN COMMERCIAL BANKS

Among other private institutions which play a considerable part in the money and capital markets of under-developed countries apart from the commercial banks, the following are dealt with to some extent in the documents submitted: finance companies, investment trusts, insurance companies, mortgage banks, and credit co-operatives.

Finance companies are established in Mexico and their functions include the promotion and financing of enterprises as well as the issue and distribution of public and private securities and the granting of credits of all types to enterprises. The activities of these specialized private institutions have been considerably expanded in recent years. (Pages 218-219).

/Trading

Trading companies are of special importance in the United Kingdom Colonies where their financing function as well as their historic function in being the forerunners and founders of banks is stressed. (Page 298).

The existence of investment trusts is mentioned for Egypt as being eminently suitable for under-developed countries where the public is ignorant of the intricacies of investment and their present absence is stated to have adverse effects. (Fund-Egypt, page 7).

Similarly in Chile, it is specifically mentioned that there are no investment trusts that could perform a useful function in investigation, purchasing, and holding securities, and in providing diversification and reducing risks for investors. (Fund-Chile, page 46).

In industrialized countries, investment trusts have generally developed at a very late stage in the development of capital markets when investment in securities had reached large groups of the population and when the multiplicity of securities had become confusing and costly for the small investor.

Insurance companies are a very important type of institution in many under-developed countries since savings in the form of life insurance premiums is often relatively more developed than other forms of voluntary savings.

Insurance companies in India now form an important channel for the mobilization of the savings of the people and dominate the domestic field. (Page 173).

In Egypt, insurance companies have favoured investment in government and public utility securities, Egyptian and foreign, but the part of their resources used for the finance of industry and trade is described as "negligible". It is, however, expected that the increase in their funds, the low yield on gilt-edged securities and legal requirements may induce insurance companies to increase the share of their funds employed in the finance of industry on the security of industrial property. (Fund-Egypt, page 22).

In Chile, the funds of insurance companies have suffered from the inflationary position, but on the other hand have been supported by legal requirements for employees to take out policies. The insurance companies, however, invest a very large part of their assets in real estate, mainly apartment buildings, rather than finance of industry. (Fund-Chile, pages 55-56).

In Mexico, insurance companies play an important part and are rapidly expanding. At least 30 per cent of their reserves must be invested in domestic securities, and not more than 50 per cent in real estate. However, of the total security holdings, less than one-fifth appears to have consisted of private bond issues or general and commercial bonds. It is stated that insurance companies should thus be considered rather as institutions specializing in the promotion of construction activities. They have not provided the capital market with all the help which they have been in a position to give. (Fund-Mexico, page 56).

Mortgage banks are mentioned in Mexico, but their assets are largely absorbed by building construction which they have effectively promoted. Less than 5 per cent of their activities are rural, and most of it is in Mexico City. Their capital is raised by the issue of mortgage bonds and mortgage certificates of 8 to 10 years duration at 7 per cent interest. (Fund-Mexico, pages 32-33).

It may be assumed that the activities of the mortgage banks have been concentrated on residential and office construction rather than industrial building.

A commercial organization peculiar to India is the Managing Agency System which consists of partnerships or private limited companies, formed by a group of individuals with substantial financial resources and business enterprise. Besides serving as marketing and purchasing agents, these agencies promote joint stock companies, employ their own funds and arrange for widespread financing by acting as guarantors. The financial assistance rendered is usually either in the form of direct loans, or as guarantors for advances made by Joint Stock Companies. The motive activating these diverse functions has been the "shyness" of capital, the lack of investment trusts and industrial banks, and the lack of enterprise and experience in management in the earlier stages of development. One of the serious shortcomings of the system, has been that provision of finance is accompanied by too much control over enterprise and too high a share of profits. Although the system is still in general use, its influence has declined somewhat as alternative sources of finance have been developed. (Pages 175-176).

Credit co-operatives are often a by-product of agricultural or other industrial co-operatives or similar forms of organization. Independent credit co-operatives, however, also exist as a feature of the capital market of some under-developed countries.

/In Chile,

In Chile, there are a few co-operative credit unions. (Fund-Chile, page 46).

In Egypt, co-operative societies have subscribed capital to the State Agriculture Bank and although these societies have so far played a minor role in the provision of credit to small farmers, it is stated that their recent reorganization may permit them to act as intermediaries between the agricultural bank and the peasants. (Fund-Egypt, page 14).

In the United Kingdom Colonies, we also find that the development of co-operative credit institutions has been encouraged by Colonial Governments, especially in Malaya, Ceylon (during its colonial period), Cyprus and the West India Colonies. Officers have been sent for special training in co-operative work in India, the United Kingdom and in various European countries and members of the Colonial Service have been encouraged to specialize in this branch of work. In Cyprus, co-operative credit institutions have been very successful in reducing the volume of agricultural indebtedness. (Page 304).

The co-operative credit movement in India has been a principal positive factor in combatting the worst evils of private usury. With resources comprising about 15 per cent of the total requirements for agriculture, it supplies short-term finance for the small working capital needs of the farmer and, through co-operative land-mortgage banks, provides long-term finance for land improvements. The network of Provincial Co-operative Banks, District Co-operative Banks and primary co-operative societies furnishes the base for broader attention not only to problems of finance but also to the over-all organization of the cultivator's agricultural requirements. (Pages 168-169). Elsewhere it is stated that in the conditions of India, it has been found that in general the co-operative solution is more suitable for relatively backward and small individual enterprises which require protective care, and the wide extension of commercial financing facilities is better adapted to meet the requirements of larger and well-managed enterprises. (Page 178).

In Mexico, credit unions assist in a number of fields, with the function of providing credit for their members by small loans repayable in no more than five years. The volume of their credit transactions, except for the agricultural unions, is described as relatively small. (Fund-Mexico, page 36). Agricultural credit unions are much more important and on the reorganization of the National Bank of Agricultural Credit in 1930, credit unions for independent farmers were found to serve as intermediaries between the banks and the borrowers. The formation of local credit unions was also an important part of the policy of decentralizing the agricultural credit system. Thirty-seven such credit unions are now in operation in Mexico. (Page 221).

IX. COLLECTION OF SAVINGS

The promotion and collection of savings is an important feature in the financial machinery of under-developed countries. The reports are agreed on the fact which needs no elaboration that savings in under-developed countries are low, partly because of low incomes, partly because of high propensity to consume and import on the part of upper income groups, and partly because of lack of banking habits and banking facilities. The report on Egypt goes as far as to say that with proper encouragement, organization and collection, domestic savings "will be sufficient to provide the necessary capital for economic development." (Page 161). But the reports generally draw attention to the structural obstacles to sufficient rates of savings which cannot be overcome merely by measures in the field of financial organization.

> In Puerto Rico it is estimated that 70 per cent of the population can save very little and that savings can only be expected from the upper income groups. Postal savings amounted to only 8 million dollars while private savings deposits in banks were $50 million (30 June 1949). (Pages 273-274).

> For the Philippines, it is stated that only a minor portion of the savings finds its way in the form of savings deposits into the banking institutions; the rest is hoarded. The idle national savings could be profitably employed if a sufficient number of banks and a well developed money market could be established to channel this liquid capital into various industries. (Page 245).

> In Mexico it is stated that the commercial banks by means of sight and time accounts have concentrated savings and funds which were formerly hoarded or merely handled on a very small scale. Similarly, the savings banks which are part of the private banking machinery have rapidly grown and collected 334 million pesos in savings (December 1948). (Page 218). The mortgage certificates are also mentioned as a method of increasing the volume of individual savings; their circulation had reached 225 million pesos in 1948. (Page 219). The National Urban Mortgage and Public Works Bank was established in 1933, having among its principal functions to act as a support agency for savings banks, and to review the savings plan of savings institutions. The savings banks themselves

have grown considerably in recent years from only four in 1936 to 81 head offices and 170 branch offices in December 1948. (Page 218). A special feature in Mexico are the Policy Savings Banks (capitalization companies) which combine features of savings banks, life insurance policies and lotteries. Their funds are invested mainly in loans, investment taking a small place. Their operations in the investment of their funds are stated to have provided a stimulus to consumption. (Page 220).

In a number of cases, the organization of specialized savings banks, either private or governmental is recorded.

In Egypt, there are no specialized savings banks, but savings deposits with the banks and post office savings banks in 1947 had reached L.E.40 millions. (Fund-Egypt, page 14). Total bank deposits which constitute an indication of savings since the velocity of circulation is low in Egypt (page 18) had reached a level of L.E.270 millions by 30 June 1949. (Page 160).

In the United Kingdom Colonies, it is said that it has always been the policy of local governments to promote individual savings. Nearly all the territories have local savings banks. In a few cases these are operated by a commercial bank. There is no attempt to use local savings directly for local capital purposes; rather deposits are placed in general sterling investment. Government savings banks are usually operated in conjunction with the post office and are officially stated to have accompanied the provision of post office facilities almost as a matter of course. The co-operative movement also supplies a valuable means for stimulating and directing savings in British colonial territories. (Page 302).

In Haiti, the Royal Bank of Canada pays no interest on savings deposits since it does not feel able to find profitable employment in Haiti for the funds it already has. The Banque Nationale de la Republique d'Haiti pays only $1\frac{1}{2}$ per cent on small balances, declining progressively with an increase in balances. It is stated that there is no systematic effort to encourage savings. (Haiti Report).

X. ORGANIZATION OF STOCK EXCHANGES IN UNDER-DEVELOPED COUNTRIES

An organized stock exchange has a useful part to play in a developed system of financing economic activity since it enables the investor to contribute to the funds of enterprises, take reasonable risks and at the same time be assured of the chance of selling and liquidating his investment at short notice and without undue sacrifice if he should desire or be forced to do so. It is realized, of course, that the organization of the stock exchange, at least in its general forms, is not a suitable part of the financial machinery in countries where the ownership of plant and industries is entirely nationalized.

The papers throw some light on the problems which arise in this connexion in under-developed countries. All of them tend to emphasize the relative weakness of the stock exchange organization and its failure to provide sufficient encouragement for would-be investors to save and to channel their savings into productive enterprises.

> For the Philippines, it is stated that one of the reasons why private investors have purchased government bonds only in limited amounts is the lack of an active securities market which could absorb the bonds at current prices in case investors want to liquidate the holdings. (Page 248). Further it is stated that the Manila Stock Exchange which is the only one in the country, trades so far predominantly in mining securities rather than in securities of non-speculative ventures. The Philippine authorities are aware that the healthy growth of a securities market in the Philippines can be encouraged only if there is a certain assurance of market support. (Page 250).
>
> In the United Kingdom Colonies some flotations of capital by local registered companies are stated to take place but the larger concerns normally raise their long-term finances through issues in London. (Page 297). Similarly, it is stated that the financing of new mining developments takes place if necessary by a public issue in the United Kingdom. (Page 299).
>
> In Puerto Rico there is a project for the establishment of an Insular stock exchange by the Industrial Development Company in co-operation with private organization, but it is stated that the project has progressed very slowly thus far. (Page 273).
>
> In Egypt, stock exchange activities are well developed, especially since the conclusion of hostilities when profits were no longer large enough to be the sole source of finance. The practice has been to promote industrial enterprises through the flotation of joint stock companies. The Egyptian public is described as "investment minded", and it is stated that most companies floated since the war were greatly over-subscribed. (Page 156). The initial capital is generally subscribed by company promoters who hold the securities until a public issue is made. The sale is very often to existing shareholders, especially when the statutes provide for pre-exemptive rights. The shares are closely held; the securities of the smaller companies are not quoted but are dealt in privately over the counter. (Fund-Egypt, page 8).

The difficulties of using the stock exchange mechanism for placing smaller issues are not peculiar to under-developed countries although the comparative smallness of the circle of investors represents an additional difficulty. Similar difficulties are, however, experienced by smaller enterprises in industrialized countries with a highly developed stock exchange system.

/Interest

Interest in stock exchange dealings in Egypt has increased during and since the war as a result of the general growth in liquidity. It is stated that security investment could be further encouraged by the simplification of procedure, elimination of fiscal discrimination against corporations and the abolition of the transaction tax. Greater publicity about corporations, definition of duties and responsibilities of sponsors, directors and auditors, and investigatory powers by the Office of Corporations are also suggested. Other limiting factors at present are the use of the French language, the scarcity of Egyptian nationals at the stock exchange and the inside information available to dealers. (Fund-Egypt, pages 9-10). Some of the stock exchange dealings are financed by the commercial banks. (Page 18).

Egypt is clearly an illustration of an under-developed country where the investment habit and the preference for corporate securities are growing.

In India, the bulk of finance for fixed capital of industries is raised through public issues or private placements. Public issues are made generally through invitation to the public to subscribe to capital. Private placements are made with influential capitalists. In either case the stock exchanges in India, particularly the important ones like those in Bombay, Calcutta and Madras, provide the facility of transfer of capital, and the existence of a chain of stock exchanges facilitates the flotation of new capital. In May 1943, the Government instituted control of flotation of new issues of capital (though small amounts were exempted from such restriction) first with a view to directing savings into war loans, and latterly, with a view to preventing the mushroom growth of industries and excessive competition for scarce resources. (Page 174).

In Mexico, the main exchange is at Mexico City, with a subsidiary exchange in Monterrey. Although the area of influence of the Stock Exchange has been on the increase, it is stated that most shares are negotiated outside it or on the open market. A law relating to the securities market is now in preparation. (Pages 220-221). The stock exchange is under the control of a Securities Commission. Generally the stock exchange is under-developed and does not reflect the level of economic activity. Total transactions in Mexico City in most weeks are less than 1 million pesos. Only a small group of people is involved and shares are frequently not listed or withdrawn from the market, or held within a close group of original promoters to avoid sharing with others the high profits of their investments. Corporations prefer to finance their needs in the money market rather than issue stocks. (Fund-Mexico, page 4). The volume of annual transactions during the whole of 1947 was only 1-1/2 per cent of the total of listed securities. The total number of issues listed at the stock exchange in June 1948 were 356, of which two-thirds were stocks and one-third bonds. Only about one-third of the listed securities were industrials, the great majority of them stocks. By value the industrial securities also represented less than one-third of the Total. The

/effect

effect of the stock exchange in Mexico is also limited by the fact that many industrial enterprises are not incorporated, or have less than the minimum legal capital. The banks have done little to support the security market and, in particular, do not extend credit on the collateral of securities. The smallness of the markets has also made for violent price fluctuations. (Pages 65-67).

In Chile, too, the securities market is stated to be very narrow and offers little opportunity for corporations to obtain development funds. (Page 115). On the other hand, the stock exchange is described as performing an important secondary function in further distributing securities of firms which are already known and have some reputation. (Page 119).

In Haiti, there is no organized stock exchange. (Haiti Report).

XI. PROFITS AS A SOURCE OF FINANCE FOR DEVELOPMENT

Finance of economic development does not necessarily require specific institutional machinery. In the highly developed countries, a very high proportion - often the bulk - of capital formation takes place spontaneously by the almost automatic retention or plowing back of profits and personal savings into individuals' own businesses and farms. Such plowing back of profits does not necessarily go into extension of existing firms only, and profits in private savings are not necessarily applied to the extension of the same enterprise. The starting up of new plans or new lines of production is also often financed through retained profits. Indeed, it may be said that such spontaneous capital formation through retention of profits and direct investment of savings without specific institutional intervention compensates in industrialized countries for many of the weaknesses of financial institutions. The papers throw some light on the position in this respect in the under-developed countries concerned.

In Egypt, it is stated that direct capital formation by private savers or by entrepreneurs who draw on family savings and those of friends, as well as the direct investment of retained earnings by companies, have long accounted for the greater part of capital formation. This is attributed to the prevalence of individual proprietorships and ownerships as well as unwillingness of banks to grant medium or long-term credits. It is noted that in Egypt almost all companies' statutes provide for a fixed appropriation to reserves varying from 5 to 10 percent of profits, and it is stated that the directors usually exceed this ratio. (Fund-Egypt, pages 7-8). As a result, a large proportion of earnings is kept in reserve as is evidenced by numerous issues of bonus shares capitalizing the surpluses thus accumulated. The high profits made during the war have further increased this source of finance; even though an excess profits tax was imposed during the war, many concerns are now entitled to a refund. (Page 23). During the war, it is stated that every industrial activity was profitable and such profit was large enough for the extension. (Page 156).

In India, domestic financing of railway expansion has, in the past, been provided out of the profits of the working of railways which are a productive asset. (Page 172).

In the United Kingdom Colonies, there is a steady and not insignificant flow of capital investment through the plowing back of local business profits for the initiation of new enterprises out of local savings. It is stated that many of the largest concerns now operating in the British dependent territories have been built up from very small beginnings, starting with profitable trading operations, gradually enlarging by local investment of a substantial proportion of the profits and going on to the acquisition of plantations, mining interests, etc. (Page 298).

For the Philippines, it is stated that the direct reinvestment of farm surpluses is the normal procedure there, preventing both the development of a securities market as well as co-operative efforts. (Page 249).

In Puerto Rico, the Government Development Company is stated to utilize the accumulated profits from its cement factory in support of its industrial aid programme by way of loans, leases, etc. (Page 256).

In Chile, the law of December 1943 compels firms to reinvest excess profits, i.e. profits exceeding 15 per cent, either in expanding their own plant or in other productive enterprises or in bonds of the Development Corporation. Firms may, however, avoid such reinvestment commitments either by providing housing facilities for their employees, or else by liquidating their own obligations. Further, new enterprises created after January 1942, mining enterprises and enterprises producing materials used by the mining industry are exempt from this reinvestment provision. (Fund-Chili, page 15). It is estimated that 40 per [illegible] total savings of Chile are invested directly by private corporations and individuals. (Page 21). It is also to be noted that the Development Corporation itself has an income from profits on its operations and from interest and dividends on securities representing its investments and these profits are treated as being currently available for the extension of the operations of the Development Corporation. The interest on the Development Corporation bonds which firms can take up out of excess profits as an alternative to direct reinvestment carry a rate of interest of not more than 5 per cent. (Page 116).

/Since

Since normal profits in Chile are stated to be in the neighbourhood of 15 per cent, it appears that most firms would prefer to reinvest their excess profits directly.

> In Mexico, too, the general rate of profits is stated to be very high and to have paid very high rates of interest to banks (between 8 and 18 per cent including all charges), but also to pay out very high dividends up to 40 per cent. (Fund-Mexico, page 3). In addition to paying out high dividends, business profits have also been widely invested in building and thus have been diverted from reinvestment. The main reason for this diversion appears to be that the banks readily grant real estate loans at rates of interest less than the profits from rents, and thus by diverting profits of business into building, business firms can add to their profits and at the same time attract bank credits. It is said that this movement of profits into construction, and the use of bank loans for working capital purposes, has probably been the greatest inflationary force in Mexico during the last ten years. Reinvestment of profits is stated to be almost certainly less important than in more developed countries as a result of their withdrawal for high dividends and diversion to real estate. (Fund-Mexico, pages 54-55).

It would thus appear that reinvestment of profits is much less important in Mexico than it is in Chile.

XII. AGRICULTURAL CREDIT PROBLEMS

> In Chile, the Agricultural Credit Institute was established in 1927 in order to reduce the rates of interest charged to agriculture. The average rate for credits given by the Agricultural Credit Institute, including commission and expenses, is 6 per cent, which is considered extremely low according to Chilean standards and compares with much higher charges by the banks. It is stated that lower rates of interest are offset by long delays in granting credits and a certain degree of favouritism in their allocation. The Institute has numerous agencies located throughout the country and supplies both medium and short-term credit. The Institute has been criticized, however, for lack of adequate control of the ultimate use of the credits granted, particularly to large farm owners, and also for failing to grant credit to small agricultural co-operatives. Much of the credit is said to have leaked out into consumption loans such as building of apartment houses or travelling abroad. (Fund-Chile, pages 28-29).

/In Egypt

In Egypt, also a special government agency was established in the Credit Agricole d'Egypte. This institution is expected to specialize on medium and short-term loans for small farmers in the direction of developing a more diversified agricultural production. Its purposes also include advances to co-operative societies. In order to facilitate the operations of the Credit Agricole, it was found necessary to exempt it from the provisions of the law forbidding foreclosure in the case of small farmers. Over one-quarter of the total loans of the Credit Agricole during 1948 are stated to have gone to co-operatives. (Pages 150-152) The existing private banks granting loans secured by mortgages are stated to cater solely for large landowners because of the law forbidding foreclosure on holdings of five acres or less, and because of the cost and inconvenience of dealing with a large number of clients. (Fund-Egypt, page 14).

Mexico is noteworthy as having established, side by side with the National Agricultural Bank, a special national bank for financing the communal land holdings (ejidos). Both of these organizations are stated to have operated with insufficient funds. (Page 215) Commercial and private banks in general are stated to take little interest in making agricultural loans. The reason given is the legal prohibition to mortgage land, the riskiness of crops, extreme division of property which increases collection difficulties and the ignorance of banking habits by farmers. The Mexican Government has tried to induce agricultural credit operations on the part of commercial banks by requiring them to have 60 per cent of their loan portfolio in productive loans which includes agriculture. Agricultural and livestock credit constitutes little more than 10 per cent of total loans made by Mexican commercial and savings banks. (Fund-Mexico, pages 25-28).

In India, the farmer relies for financing partly upon his own resources and savings, which in recent years of high prices have been large enough to look after his normal needs as well as to repay his debts. (page 167) However, projects are under way which are beyond the individual agriculturist's resources, such as the improvement of land by means of consolidation of fragmented holdings which have raised the costs and reduced the efficiency of cultivation. Such consolidation will require a considerable increase in the facilities of financing long-term improvements if the process is to yield results in better agriculture and increased productivity. (page 171) The co-operative credit movement has made some approach to the agriculturist's problem of credit and finance.[1]

[1] See page 345

XIII. HIGH RATES OF INTEREST

The papers give an idea of the high rates of interest prevailing in under-developed countries. Among the figures mentioned, often incidentally, the following may be noted.

> In Chile, the initial cost of financing investment is stated to be approximately 10 per cent. (Pages 119-120). Bills are discounted at rates exceeding 9 per cent and the charge on overdrafts is around 10 to 12 per cent. (Fund-Chile, page 28). Firms can pay such high rates of interest because the normal rate of profits is stated to be around 15 per cent. (Page 45).
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> In Haiti, private mortgage loans are said to be available at 12 per cent per annum. Interest rates on bank loans range from 6 per cent for loans on staple exports to 9 per cent for loans of mortgage securities, and 12 per cent for small advances to civil servants. Loans from private sources are stated to be at 2 to 3 per cent per month or even more. Loans by private middle men to farmers are said to be effective rates of 100 per cent or more, and repayment is usually exacted in kind, especially in coffee when the coffee crop is gathered. (Haiti Report).
>
> In Mexico, interest rates are said to range from 8 to 18 per cent according to loan period, inclusive of charges. (Fund-Mexico, page 3). Even the State Agricultural Bank charges 11 per cent for its loans to individuals, and 9 per cent to credit societies. Even this, however, is low compared with the rates charged by private lenders who may extend credit at a rate of 5 per cent per month or more, and in addition charge the difference in price between the seed supplied to the farmer at the time of the loan and the price of such seed at the time of the harvest. (Page 47).

The effective rates charged by private money lenders are often even higher than that, and the absence of other facilities as well as ignorance have promoted the growth of private money lending with many abuses in under-developed countries countries. 1/

1/ See also pages 310-311