FINANCIAL ASPECTS OF INTERNATIONAL APPROACHES TO PROBLEMS OF UNDEVELOPED AREAS

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I ASSUME the economic aspects properly said will be covered by the other speakers and I expect therefore to confine myself to the financial problems involved in any consideration on the development countries. As you may expect, I am speaking purely in my personal capacity and not for the organization to which I belong. Furthermore, I do not intend to bring you solutions, but only to describe to you the problems as they appear to me.

There are several aspects which may require some thoughts: one of them is, obviously, the internal financial system; another is the financial relations with the external world in its two forms —direct investment and loan capital. We shall attempt to deal with them in turn, while underlining their close relationship.

I. INTERNAL FINANCIAL PROBLEMS

Financial difficulties may have two aspects. They may be due to underlying economic conditions and be thus the effect or symptom rather than the cause. In other cases they may, on the contrary, be rather the cause than the effect.

Roughly speaking, there are five groups of economically underdeveloped areas: Eastern Europe, Middle East, Far East, Colonial Territories, and Latin America.

The first three are characterized by overpopulation. Colonial Territories present special problems. Latin America, however, is a special case for at least two reasons: (a) it is underpopulated rather than overpopulated, and further industrial developments may well have to be linked with some immigration; (b) it may well be the only case where financial troubles are sometimes the cause rather than the effect of economic difficulties. Since these

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financial troubles are a deterrent to economic development, any action likely to cure them might be said to be in itself directly productive.

All groups are very interesting and deserve individual description, but a good deal has already been published on the other groups. While Latin America is not only a special case, but also an easier and simpler one, my paper will deal essentially with it.

It is an almost constant fact that in all countries of Latin America internal credits have never developed to any considerable extent except, lately, in the Argentine. Self-financing is the exception. They suffer from chronic inflationary tendencies in spite of the fact that they have been spared by World War I and World War II. It is easy enough to ascribe these features to political unrest, but it should not be forgotten that political disturbances are just as much a consequence as a cause of low standard of living, social inequalities, and unsettled economic conditions. We can, therefore, speak of the financial structure of these countries without referring any further to the intricacies of their political life.

Inflation in South America has several causes: one of them, most often referred to, is imprudent budget practices, including heavy investment or military expenditures and inflexible taxation systems. While these reasons are undoubtedly of major importance, I venture to doubt whether they have the same significance everywhere and whether they are not intimately tied up with social structures which could only be changed by a general improvement in the standard of life.

Other causes of inflation seem to me nearly as important: one of them is the great reliance on exports which during the war especially allowed for the creation in South America countries generally of a large amount of purchasing power. Failing appropriate sterilization policies, it could not be offset by corresponding imports. The external sign of this was an accumulation of foreign exchange which is now being rapidly spent.

Another cause of inflation is probably the development policy itself, whatever the source of funds. The mere fact that internal currency is devoted to building of productive installation, including housing, means that the consumer's income is enlarged without corresponding increase in the amount of consumers goods placed at his disposal. To the extent that the consumer actually saves a corresponding amount, there is provided both an escape for consumer's outlay and a source for new investment funds. To the extent, however, that such savings do not take place, a pressure on prices of consumers' goods ensues. Lacking a sufficient supply of funds, the government or the entrepreneurs have to call on bank credits, *i.e.*, mostly Central Bank credits, for financing new investments. In other words, an investment policy carried out at a rate which is quicker than the rate of accumulation of savings, brings about both inflationary pressure on prices and monetary expansion.

This short analysis is not intended to underrate the importance of budgetary and monetary practices as a cause of the financial troubles of development countries, especially in South America. It is merely intended to bring home the fact that since development by itself, like any other investment policy, may have inflationary consequences, internal fiscal policies are of the greatest importance. The dilemma is, of course, that conservative fiscal policies may, for a little while at least, slow down the development policies which, for social or political reasons, the nation wishes to expand rapidly. The question is once more one of measure.

It should not be overlooked that in many cases savings are available locally for certain types of investments, provided the rate of return is sufficiently high. It is another feature of the development countries that in view of the numerous profitable ventures that are open to private initiative, the rates of interest are naturally relatively high, because the normal form of risk is equity rather than fixed income investment. Thus, one of the most popular forms of investment is in real estate, because of its speculative attraction. Here again, a conspicuous exception is to be made for the Argentine where things have been settled enough for a sufficient time. A relatively large market has developed in mortgage bonds (the famous "Cedulas Hipotecarias").

In some South American countries, the governments have made attempts to direct investments toward the enterprises which seem most attractive for the nation as a whole rather than the most immediately profitable. Such is the purpose of the Fomento Corporaciones and it is well known that in the case of Chile, for instance, the government undertakes the primary financing but expects to sell the equity in the newly-created enterprises to the broad public after having set them in motion.

II. External Financing

I have said before that most development countries were faced with a difficult dilemma: either maintain conservative finance practices or slow down for a while on their development schemes. The obvious way out of this dilemma is import of foreign capital. At first sight, this is a perfect solution: provided with foreign exchange, thanks to the imports of capital, the country can purchase either the equipment needed for its development plans or the consumers goods, the sale of which would restore equilibrium in an inflated market. The ideal is, of course, that the foreigner could bring both his capital and his skill and immigrate, bringing with him his accumulated savings. That is, to an extent, how the United States, Canada, Australia, New Zealand, and South America, itself, have been industrialized or developed, not to speak of the Colonial Territories.

Failing a combination of both capital and skill, import of equity capital is obviously the most natural course. Equity risk is for the foreigner as well as for the nationals the most attractive investment because of the chances of profit. At present, this movement is far from having stopped, and Mr. Stacy May is undoubtedly among those who can speak the most authoritatively of the problems involved.

The forms under which this capital can be solicited are numerous. They range from outright ownership abroad, to participations in local corporations or partnership ventures, but the conditions of exploitation are just as varied. The most profitable for the outside investor is, of course, the case where all goods extracted or raised on the spot can be sold on his own terms, either internally or especially externally. In other cases, the foreign investor may organize a national establishment and only draw therefrom royalties or fees. Finally, he may limit his demands to the payment of dividends.

The objection to the heavy participation of foreigners in the operation of a country are too well known to be repeated. There have been abuses but on the other hand, it must be realized that retaliations of too stringent a character have a deterrent effect and may completely dry up the influx of foreign capital. Under the auspices of the League of Nations first, of the United Nations now, and possibly, of the I.T.O. at a later stage, efforts are being made and will be made to find satisfactory compromises of a general character.

Loan capital is of a different character. It can flow either to enterprises or to governments. In the first case, there is no difference with a direct equity investment for the purpose of earning dividends, except that repayment of capital is expected; in the second case, the government has the impression that it does away with the danger of foreign interference based on ownership, but at the same time it involves risks which cannot be underrated. In both cases repayment of the principal must be provided over a period. It is, therefore, both more costly and more rigid than direct investment. In times of depression this rigidity may lead to defaults.

The risk to the foreign investor has been stressed often enough and it may not be necessary to comment at length on the debt record of many underdeveloped countries, but one or two points deserve mention. Firstly, most of the debts were incurred during a period of expansion; in other words, they did, to an extent, contribute to the inflationary trends; readjustments during the down slope of the cycle were, therefore, made more difficult. Secondly, the reasons why the debts were incurred were very often tied in directly with the internal financial situation. Lacking internal credits, many governments found it actually easier to borrow abroad rather than internally, sometimes because there was no capital available internally, sometimes merely because the rate of interest abroad appeared more attractive than the rate of interest on the spot. The delusive character of such a reasoning is clear enough. It could also be said that the absence of an internal public debt tradition may, in isolated cases, have been responsible for the easy acceptance of the default status or for its persistence during the depression years.

However uncautious some of the countries may have been in borrowing, however uncautious some investors may have been in lending, the need for loan capital still subsists. It cannot be assumed that in the near future the development countries will have restored their internal financial situation and stabilized their external finances to an extent sufficient for allowing them to finance their own needs. It can also not be expected that private capital will be able to flow in amounts sufficient to cover *not only* the cost of building one profitable enterprise, but the cost of supplying its site with the underlying facilities which are indispensable: transportation, public utilities, etc. Finally, foreign private capital cannot be expected to devote itself to improving the standard of life and the stability of the economies by improving the conditions of agriculture which remains one of the most important and perhaps often underrated activity in these areas. The rate of return of investment in public utilities, land reclamations, modernization of agricultural methods can rarely be estimated in accounting terms. They involve large amounts subject to concerted allocations, and can only be fruitful under cooperative or government guidance. Their remuneration is in the form of easier standard of life, better tax returns, greater economic stability.

In view of these fundamental facts, I strongly believe that loans to development countries will continue to be made in the hope that progressively they may reach the stage at which self-financing will not be an empty word.