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# INTERNATIONAL INVESTMENT AND DOMESTIC WELFARE

*SOME ASPECTS OF INTERNATIONAL BORROWING  
AND LENDING IN THE POST-WAR PERIOD*

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TO MY  
FATHER  
AND THE MEMORY OF MY  
MOTHER

## PREFACE

THIS is an essay on international economic policy with particular reference to the postwar period. As such it deals with controversial issues on which a complete consensus is not to be expected. Nevertheless some common ground of understanding and agreement is an indispensable preliminary to the framing of policy issues. And it is mainly toward this end that the essay moves: it tries to contribute something to the understanding and appreciation of the basic elements that compose the international investment problem after the war. The volume does not pretend to be a complete analysis of all aspects of the postwar international investment problem. It is an essay, not a treatise.

Most of the manuscript was written in New York City between February and August, 1944. I am afraid that it still carries traces of the pressure under which it was written and which a variety of interruptions in the ensuing months have prevented me from eliminating altogether. For these I apologize to the reader and beg his forbearance. Yet if the volume has anything to say it had perhaps better be said now and not after all the tumult and controversy have become academic.

My obligations are numerous and some of the heaviest must remain unacknowledged. I am indebted first of all to the Social Science Research Council for a grant-in-aid which materially assisted my work. Mr. H. M. Ditisheim and Miss E. Frysick served as research assistants for several months under what must have been trying circumstances for them. I thank them sincerely. I should also like to thank Dr. Walter Hausdorfer and his staff of the Business Library of Columbia University whose many kindnesses extended far beyond what an author has any right to expect.

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As always, of course, the author is alone responsible for what finally appears in print.

N. S. B.

*Berkeley, California*

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**PART ONE**

**RECONSTRUCTION, ECONOMIC DEVELOPMENT, AND FOREIGN BORROWING**

PART ONE

THEORY OF THE EARTH AND ITS HISTORY

AND ITS CONNECTION WITH THE HISTORY OF MAN

# INTRODUCTION

## I

THE end of the present world conflict will bequeath a task of relief, rehabilitation, and reconstruction which promises to exceed anything of a similar nature ever undertaken. Moreover, reconstruction will be something more than the distribution of "K" rations and bowls of soup. The destruction and impairment of factories, industrial plants, railways, harbors, gas and electric works, and all the rest of the means of production by which civilized peoples provide themselves a living will have to be made good.

Reconstruction will be a manysided problem. But on the economic side it essentially consists in restoring an incurred diminution of real capital resources. The realized impairment to real capital will be especially great in three respects. First, bombing raids and advancing and retreating armies will have destroyed (and stolen) much real capital equipment in a simple physical sense. Any recent photograph from the battlefronts makes this fact abundantly clear. Second, real capital resources will be depleted severely, even though not physically destroyed, because they have been undermaintained in the waging of total war. Accumulated depreciation and obsolescence of industrial equipment will be substantial and will have to be made good before efficient production, and hence adequate consumption, is again possible. The third and final type of impairment to real capital resources will be the low level to which the real working capital of the economy—stocks of raw materials, goods-in-process, and finished goods of all kinds—is likely to have fallen by the time the war ends. Stocks of raw materials and finished goods in an amount largely dictated by technical considerations are a prerequisite to a high level of output in

an economy. This problem was serious enough in Europe after the last war. Its magnitude will be much greater after the present conflict. Hence it is the diminution of real capital resources through outright destruction, through undermaintenance, and through the consumption of inventories, which reconstruction will seek to restore.

The means available to carry through the tremendous job of economic reconstruction after the war are three in number: gifts and reparations from abroad, loans from other countries, and the resources and productivity of the country or territory needing reconstruction. At the very outset of reconstruction, that is, immediately after hostilities cease, the primary reliance will be upon outright gifts from abroad because, at least in many areas, the local economies will be too disordered even to provide a minimum of food, clothing, and medical care. This is the phase of direct relief. The armed forces and UNRRA (United Nations Relief and Rehabilitation Association) have the responsibility for this stage of reconstruction.

It is reconstruction beyond the phase of direct relief, however, that is our concern in the pages that follow. Here there must be a clear recognition of the nature of the task as a problem of real capital accumulation: a restoration of real capital resources in order to raise the national output from the low levels that afford only a poverty standard of living to the population. The smallness of the national product will be a rough index of the deficiency of productive facilities imposed by the war.

Capital accumulation on a large scale for reconstruction raises the question of assistance from abroad in the form of loans and possibly reparations.<sup>1</sup> Without loans from abroad the rate of capital accumulation for reconstruction is limited by the level of national income and its division between consumption and savings. Foreign borrowing allows capital accumulation for reconstruction to proceed more rapidly and/or with less restriction of consumption than is possible without it. Foreign borrowing can hasten and ease economic reconstruction.

<sup>1</sup> Reparations are at least as much a political and moral problem as an economic question. These are not sharply distinguishable to be sure but the fact should be kept in mind.

Borrowing abroad, however, raises the problem of repayment. And presumably there is a relationship between the repayment problem and the kinds of real capital accumulation that reconstruction will require. Consequently there is a connection between the basic economic characteristics of reconstruction as a task in real capital accumulation and the degree to which it is assisted by borrowing abroad.

## II

Economic reconstruction will not be the only occasion for borrowing abroad to hasten real capital formation at the end of the war. It is also anticipated in many quarters that there will be international lending and borrowing to push the industrialization and general economic development of regions having a low per capita productivity and standard of living.

The ostensible object of economic development (including industrialization) is to raise real incomes through improving the means of production at the disposal of the people. Like economic reconstruction it is, from one point of view, a deliberate program of accelerated real capital accumulation. And again, as with reconstruction, the process can be facilitated by foreign lending. A recent writer visualizes international investment for purposes of economic development in the following terms: <sup>2</sup>

This flow of capital would undoubtedly take a variety of forms. Under favorable conditions, important amounts would go as direct investment by private firms of the lending countries for establishment of processing plants based on local raw materials, branch factories or assembly plants, distributing and technical service agencies, and the like. Other capital would be loaned to governments, to public development corporations, to private firms, or to mixed public-private corporations through the sale of securities in the financial markets of the advanced countries. Producers of equipment or their bankers would advance some capital to the newly developing countries in the form of long-credit terms, a process which might be facilitated by government funds, nationally or through an international agency. Other capital, which might be a large fraction of the total in the unsettled years of transition following the war and in the initial stages of opening a new region to comprehensive development, would be advanced by national or international public agencies.

<sup>2</sup> Staley, Eugene, *World Economic Development*, Montreal, International Labour Office, 1944, p. 36.



How much international investment of the sort described in the quotation is likely, appropriate, or necessary for the improvement of living standards in low-income areas is of course a large question.

But economic development loans are not entirely a question of who puts up the funds or who provides the guarantees; it is as well the process and the result that the loans are intended to achieve. Broadly speaking, the basic reasons for the low per-capita productivity in the underdeveloped areas are excessive population in relation to the land area and real capital available, and the low level of skills, proficiencies, and general knowledge possessed by the population at large. Making foreign exchange balances available to such countries is only one step towards improving their standards of living. In between the provision of the foreign balances and the attainment of higher standards of living factories must be built, roads constructed, harbors dredged, and the whole face of the economy refashioned.

The relation of these changes to the financial means by which they are achieved is perhaps not as simple and straightforward as might be supposed. This is especially true where there is foreign borrowing calling for repayment. Here again, as in borrowing for economic reconstruction, there is a connection between the borrowing and the kinds of and amount of real capital accumulation that economic development must assume if it is to raise real incomes.

### III

As indicated in the table of contents, Part One of the study is an attempt to analyze the problems of economic reconstruction and industrialization in relation to foreign borrowing. In the main the emphasis in Part One is upon the borrowing country with only passing reference to the problems of the creditor nation. The discussion begins in Chapter II with a brief analysis of the composition of real capital in order that we may have some landmarks from which to survey the problems of reconstruction and economic development. Since reconstruction and economic development are, from one point of view, problems of real capital accumulation, it seems useful to examine the composition and certain other pertinent characteristics of real capital resources. In this manner a