

THE TRANSFER PROBLEM IN THE SERVICING OF FOREIGN CAPITAL  
BY THE UNDERDEVELOPED COUNTRIES

by

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## TABLE OF CONTENTS

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| Chapter                                                                        | Page |
|--------------------------------------------------------------------------------|------|
| I. INTRODUCTION . . . . .                                                      | 1    |
| II. THE TRANSFER PROCESS OF<br>FOREIGN CAPITAL SERVICING. . . . .              | 6    |
| III. THE TRANSFER PROBLEM OF<br>FOREIGN CAPITAL SERVICING. . . . .             | 28   |
| IV. FOREIGN CAPITAL SERVICING IN<br>SELECTED UNDERDEVELOPED COUNTRIES. . . . . | 66   |
| V. DEVELOPMENT PROGRAMMING AND<br>FOREIGN CAPITAL SERVICING. . . . .           | 91   |
| VI. SUMMARY AND CONCLUSIONS. . . . .                                           | 120  |

## BIBLIOGRAPHY

## CHAPTER I

### INTRODUCTION

One of the important tendencies the world has been witnessing since the close of World War II is the movement to expel poverty from the underdeveloped countries. This movement attributes its rise to a number of reasons: The revolution of expectancy for a better material life has been aroused by the demonstration effect of the high-level standard of living in developed areas. The emergence of new nations is accompanied by an urgent need for building a strong national economy. There has been a world-wide recognition of the necessity to diminish the disparity in the standard of living among nations. The desire for material betterment is made possible today through the propagation of new technical know-how on a large scale. In some underdeveloped countries a rising population pressure has to be met with accelerated production.

However, this movement has encountered various obstacles. Among them, the problem of capital financing has been the most serious. Owing to the shortage of capital from domestic sources, and low saving because of low income, the inflow of external capital has been necessitated if a higher rate of

economic growth is envisaged. The inflow of capital is required on the grounds that economic development will induce substantial increase in imports and, consequently, balance of payments difficulties because of the following reasons: (1) industrialization requires more machinery and supplies be imported than before; (2) higher money income will induce increased imports; (3) industrialization will tend to reduce exports below the former level, at least in its earlier stages, and later on the export sector is not likely to expand at a higher rate than that of imports growth; (4) import-substitution efforts will reduce the payments difficulties to some extent, but at the earlier stages, on the contrary, they may tend to increase imports.<sup>1</sup>

Hence, external capital flows into the underdeveloped countries as new saving and at the same time acts as a new supply of foreign exchange in financing increased imports.

The postwar period was characterized by growth in international indebtedness. A substantial amount of capital flowed into developed countries for the purpose of reconstruction and into underdeveloped countries for the purpose of economic development as well.<sup>2</sup> Particularly, the growth in the flows

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<sup>1</sup>Buchanan, Norman S., & Lutz, Friedrich A., Rebuilding the World Economy. New York: The Twentieth Century Fund, 1947, pp. 205-207.

<sup>2</sup>Avramovic, Dragoslav, Debt Servicing Capacity and Postwar Growth in International Indebtedness. Baltimore: The Johns Hopkins Press, 1956, p. 143.

on the public account was remarkable. During the first post-war decade the total capital imports on the public account were about 80 per cent of the total capital imports.<sup>1</sup>

Less than one-third of the capital imports on the public account was directed to regions other than Europe and North America, a greater part of these regions belonging to underdeveloped areas. Only 30.9 per cent of grants and 29.2 per cent of loans went to these regions.<sup>2</sup> While grants and loans were used principally for economic development purposes, the private capital to underdeveloped countries usually took the form of direct investment, particularly in extractive industries.

The problem of servicing foreign capital has two important aspects: First, the debtor country must be able to do without an amount of domestic income and saving equivalent to the debt service payment. Second, the debtor country must be in a position to be able to convert such saving into the required foreign exchange. These two factors must grow proportionally to the increase in debt service.<sup>3</sup>

The first aspect, which we shall call the development problem, requires the income of the debtor country to grow

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<sup>1</sup>Ibid., pp. 14-15.

<sup>2</sup>Ibid., p. 6 Table 1.

<sup>3</sup>Ibid., p. 57.

more than enough to pay the service payment. The second aspect, which we shall call the transfer problem, requires the debtor country to have sufficient foreign exchange to fulfill her servicing obligation.<sup>1</sup> The second problem tends to intensify the extent of balance of payments difficulties which prevail so often in many underdeveloped countries.

Therefore, in fulfilling successfully the international obligation of capital servicing, an equal attention must be paid to the growth of national economy, to the growth of the export sector, and to the growth of import-substitution in various sectors. The chief difficulty, however, is involved in achieving a high rate of growth in the export sector.

It is the main objective of this thesis to examine a number of aspects related to the transfer problem of foreign capital servicing. The servicing of loans on the public account will be given primary importance because of its special importance in the postwar economic development of underdeveloped countries.

Chapter II presents a review of the balance of payments adjustment process when a disequilibrium is caused by the transfer of the service payment from the debtor country to

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<sup>1</sup>Attention is called to the fact that the two problems cannot be separated entirely from each other. We single out the transfer aspect of foreign capital servicing in this thesis only for the convenience of analysis.

the creditor country. The following chapter deals with the problems in export promotion, import substitution, new supply of capital, and moderation of repayment terms with special reference to the transfer aspect of foreign debt servicing. Its aim is to state the problem and seek the probable policy suggestions for the smooth settlement of debt servicing.

In Chapter IV is a statistical survey of service payments actually paid by five representative underdeveloped countries which enables us to see the magnitude of such payments and their components. Also, an attempt is made to compare these payments to the foreign exchange earnings and the national income of the individual country.

Chapter V examines the status of foreign debt servicing in the entire scheme of the development programming. After a general view of this aspect is stated, the development plans of India and Brazil will be introduced as case studies to see how each of the two plans take the problem of foreign debt servicing into consideration. In the last chapter, important arguments in the foregoing chapters are summarized and conclusions are drawn from these arguments.

## CHAPTER II

### THE TRANSFER PROCESS OF FOREIGN CAPITAL SERVICING

#### Introductory<sup>1</sup>

As underdeveloped countries undertake their economic development with the assistance of foreign capital, remunerations for the capital services must be paid in the course of time. Interest, dividends, profits, and other charges will be paid annually. Repayment of the principal and the repatriation of invested capital may take place over a long period of time. For these external payments, corresponding external receipts must be available. If the balance of payments encounters a disequilibrium because of these payments, adjustment is called upon in the automatic process or in some artificial adjustment process or both. In this chapter we shall examine the adjustment process in transferring debt service payments.

Since public debt has been increasing in amount and significance in the financing of economic development in underdeveloped countries where central governments take the

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<sup>1</sup>This chapter is based upon discussions of balance of payments adjustment from Kindleberger's International Economics, Ellsworth's The International Economy, and Snider's Introduction to International Economics.

initiative in the implementation of development programmes, it may be adequate to concentrate our analysis of transfer process more on the debt servicing of public debt than on private capital. It is meaningful in the sense that the transfer process of public debt servicing implies various aspects which differ from the traditional explanation which is based on the automatic equilibrating forces believed to be built in the economic structure itself. Today these forces are more or less controlled or influenced by governmental operations. Therefore, we shall first enquire into the transfer process of public debt servicing, after which we shall discuss the servicing of private capital.

### Transfer Process of Public Debt Servicing<sup>1</sup>

When an underdeveloped country borrows an amount of capital on the public account from a foreign government, or international lending organization, or even from private sources, the servicing of capital will start after a certain lapse of time, the so-called grace period, usually ranging from three to six years depending upon the terms or repayment.

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<sup>1</sup>Throughout this thesis, the public capital referred to is capital borrowed on the public account, no matter from which lending organizations the government (or other governmental agencies) of the debtor country borrows. The same account applies to the private capital as well.



Aside from interest payments, amortization of capital is made over a long period of time. Amounts paid each year may be distributed equally over the whole period, or may be concentrated on the first several years, or sometimes concentrated on the later years, as arranged by the terms of repayment.

For making service payments, debtor countries have to acquire an amount of foreign exchange (as specified by the terms of payment) equivalent to the service payment. Foreign exchange may be obtained from the existing foreign exchange reserves of the country, or from some foreign financial institution, or earned through the exports of goods and services. A country may pay service payments with its foreign exchange reserves, but no country can endure payment in that way for a long time. A certain amount of foreign capital may be called upon to finance the payments for the time being. Yet at the very end, the payment will be made with the goods and services of the debtor country. There are forces in the process of making service payments which tend to create a situation making the transfer of service payment in real terms possible. In other words, after monetary payment is made, certain factors will be set in motion to facilitate the transferring of goods and services of the debtor country to the creditor country.

The process of transferring service payment varies with the different exchange rate systems. In the following, transfer process of public debt servicing will be discussed according to three main exchange rate systems: fixed exchange rate

system, flexible rate system, and exchange control. Throughout the discussion, we assume that payment is to be paid in the internationally convertible currency such as dollar or sterling. Also, it is assumed that the debtor country has no excess foreign exchange reserves, nor is there inflow of new foreign capital.

#### Fixed Exchange Rate System.

For the payment of interest and amortization of foreign debt, the government of the debtor country has to lay aside a part of its budget revenue. The amount raised for this purpose may be from an increase in tax revenue, reduction in public expenditure, borrowing from the public, or through deficit financing. Through any of the first three methods, the total income available for expenditure will be reduced. As a result, purchasing of domestic goods as well as imported goods will be decreased. Imports, then, are discouraged. Reduced purchasing of domestic goods may result in the decline of domestic goods price. Some domestic goods may be exported by virtue of increased competing power in the world market because of lowered price. Decline in imports and possible increase in exports will create a trade surplus which makes service payment in real terms possible. The amount of trade surplus thus created may be more than, less than, or equal to the service payments, depending upon the marginal propensity to import and the elasticity of demand for export goods.

Marginal propensity to import determines the degree of contraction in imports from the decrease in the income level. The higher the propensity, the more imports will be discouraged with the resultant creation of a larger trade surplus. The elasticity of demand for exports of the debtor country determines the extent of export increase from the decrease in export price. The more elastic the demand, the more exports will be achieved as the result. But if the demand is inelastic, reduction in export price will induce contraction in the export proceeds.<sup>1</sup>

In another aspect monetary transfer of service payment produces encouragement of exports and discouragement of imports as well. Under a fixed exchange rate system, the exchange rate is to be maintained at a fixed point, while internal price and income levels are expected to adjust themselves to the change in external payments. When debt service is paid, demand for foreign exchange will be in excess of supply; therefore, the exchange rate of the domestic currency in terms of foreign exchange will tend to decline. To maintain the rate at the fixed rate, a certain amount of gold or foreign exchange reserves will have to be directed to finance the gap between demand and supply.

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<sup>1</sup>It is assumed here that the supply of export goods is perfectly elastic. For the discussion of the relation between elasticity and export proceeds see pp. 17-18.

Gold and foreign assets are the important basis of the monetary supply of a country. Since we assume that there are no excess foreign exchange reserves, reduction of reserves due to debt servicing will bring about a diminution of deposit liabilities. If the reserve ratio is not to be changed legally, loans made previously will have to be called back, new loans will not be committed any more, while bank rates are raised. The consequences are, then, contraction in the money supply and reduced price level. The impact on foreign trade will be higher exports stimulated by the lowered price and lowered imports.

In order to maintain economic stability, the debtor country may not wish to reduce its money supply even if a reduction in gold and foreign exchange takes place. Instead, the legal reserve ratio might be lowered.<sup>1</sup> In this case, the supply of money will be maintained. Nevertheless, the impact of the reduced income available for expenditure through the increase in governmental revenue will create a trade surplus for the sake of the service payment transfer as stated earlier.

Hence, when the government raises revenue and remits it abroad as debt service payment, through income and price reduction in the domestic front of the debtor country, exports

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<sup>1</sup>In financing the Second Five Year Plan, for the sake of deficit financing and as a result of foreign exchange drain, India revised its Reserve Bank of India Act by reducing the reserve ratio substantially in 1956 and 1957.

are stimulated while imports are discouraged. A trade surplus will be created and the service payment will be paid in real terms. Trade surplus, thus created, may not be exactly equivalent to the amount of the service payments. Yet when the total service payment is transferred in real terms, balance of payments equilibrium is resumed.

On the part of the creditor country, the opposite changes will happen after the receipt of service payments. By the receipt of the service payment the creditor's income will increase by that amount. If its marginal propensity to import is not zero, a portion of the receipt then will be directed to the purchasing of goods and services from the debtor country. On the other hand, an increase in the purchasing of domestic goods may divert a part of goods to be exported from exportation into domestic consumption.

Also, the receipt of service payment increases the deposit liabilities of the creditor country. Unless sterilizing measures are taken an increase in deposit liabilities will lead to expansion of the money supply and raise the price level. Its impacts on the foreign trade would be discouragement of exports and encouragement of imports. As a result of service payment receipt, therefore, an import surplus tends to be created and the transfer of the service payment will be completed in real terms to that extent.

In combining the impacts on the creditor and debtor brought by the monetary payment of debt servicing, the

following may be stated: Debt servicing paid out of foreign balances of the debtor country will induce changes in income level and price level in both countries, and a trade surplus will be created so that goods and services of the debtor country will be transferred to the creditor country. When goods and service equivalent to service payments are transferred, the trade surplus will disappear and equilibrium is resumed.

When the government of the debtor country tries to raise revenue for the public debt servicing through deficit financing, the transfer process of servicing may reveal somewhat different results. Suppose deficit financing is employed and service payment is remitted abroad. Due to deficit financing, price level tends to be raised. Meanwhile corresponding to the reduction in foreign balance, the deposit liabilities of the banking system are decreased. Normally the calling back of loans and raising of bank rates must take place to absorb income which is more than the deficit financing from the expenditure so that as a net position, total monetary income available for the general public will be less than the level that existed before deficit financing. Only when such counter-acting measures are taken will the transfer of service payment in real terms be feasible as described in the earlier statement. That is, income level and, consequently, price level will be lowered which will create a trade surplus. However,

very few governments which prefer to use deficit financing are likely to take such counteracting measures.

Therefore, if service payments are to be financed by deficit financing, the uprising of the price level might more than offset the decrease in real income of consumers. As the price level stays high, exports will be hampered while imports will increase more than previously because of low prices. An import surplus instead of an export surplus is created under this situation, which makes the payments disequilibrium worse, not to speak of the real transfer of service payments.

#### Flexible Exchange Rate System.

Under this system the exchange rate is determined by the supply and demand of foreign exchange. Although the exchange rate is allowed to fluctuate freely this exchange rate system involves conscious intervention in the exchange market by monetary or stabilization-fund authorities for the purpose of limiting the range of fluctuation to a certain extent.

Under this system the process of transferring service payments is facilitated predominantly by the change in exchange rate since the adjusting forces provided by changes in income level and price levels are supposed to play an insignificant role.

When government raises revenue for foreign debt servicing, an immediate decrease in the income available for expenditure

is the first impact to be observed. Demand for both import goods and domestic goods will decline. Consequently, demand for foreign exchange by the private sector will diminish by the amount of the service payment multiplied by the marginal propensity to import. However, this is more than offset by the government demand for foreign exchange because the government demands foreign exchange equivalent to the amount of the service payment. Thus, as the net result, the aggregate demand for foreign exchange is larger than it was prior to the payment of debt servicing. A rise in the foreign exchange rate will take place which, in turn, promotes exports and hinders imports. A trade surplus thus will be created on the part of the paying country.

As just mentioned, the reduced income level because of external debt servicing will have an impact on the domestic market as well. Demand for domestic goods would become less than before as a result of the reduction in income. Usually, exchange depreciation is followed by a rise in the price level. However, due to the decrease in income the rise of price level will be offset to a certain extent. Therefore, the rise in price level might be less than the extent of exchange depreciation, so that export goods will be priced lower than prior to the depreciation. As a result, exports will be promoted.

By expanded exports and shrunken imports, trade surplus of the debtor country will make the transfer of service



payment in real goods and services possible. As soon as servicing is completed, the reason for payment disequilibrium disappears and equilibrium is restored.

Meanwhile, on the part of the creditor country, the opposite situation will take place. Suppose that service payment is received by the government. The proceeds will increase the monetary income of the country in one way or another. The government may use the proceeds for purchasing goods and services from the private sector, or may reduce the tax revenue as much as the service payment, or part of the proceeds may be handed to the needy people as transfer payment. No matter which way is chosen, the total monetary income of the creditor country will increase. As income level rises demand for domestic goods and import goods will increase. More goods and services are imported while the internal price level rises due to strengthened purchasing power. Exports are decreased owing to higher price and intense domestic demand.

On the other hand, by the influx of service payment, the exchange rate of the creditor currency is raised at the same time. Its impact on the trade is again encouragement of imports and discouragement of exports. Thus, by receiving service payment from the debtor country, impacts on the income and price level and on the exchange rate concurrently produce an import surplus which allows the debtor country to pay service payment in real terms. The monetary payment paid earlier through reduction of debtor's foreign balance will be returned.

Usually when the creditor country receives service payment, the increase in income is not limited to the amount received. Secondary and further income effect will continue to have impacts on the domestic consumption and imports. Thus, the multiplier effect serves as an important factor in helping adjust the disequilibrium brought by the transfer of service payment.

As we have seen in the above, under the flexible exchange rate system, change in the exchange rate plays a more important role than income and price changes do. The former changes directly the price of imports and that of exports so as to reflect the degree of disequilibrium immediately; thus, it also provides adjustment forces through market operation. The change in income level and the accompanied internal price change, however, seeks adjustment to the external disequilibrium through the mechanism of the whole economic structure. Its operation, hence, is indirect, slow, but fundamental.

Since foreign capital servicing will demand more foreign exchange, to what extent the process of transferring service payment is facilitated through exchange depreciation is determined by the elasticity of supply of foreign exchange. This, in turn, is determined by two variables: elasticity of demand for debtor's exports and the supply elasticity of the debtor.<sup>1</sup>

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<sup>1</sup>Ellsworth, P. T., The International Economy, New York: The Macmillan Company, 1950, p. 566.

To facilitate the process of transferring service payment, it is desirable that foreign exchange receipt will increase or at least maintain the original level as the exchange depreciates. This is equivalent to saying that demand elasticity for the debtor's exports is preferably greater than or equal to unity.

If foreign demand elasticity is greater than unity, the depreciation will bring about an increase in the foreign outlay on the debtor's exports. If foreign demand has unit elasticity, the export proceeds of the debtor will remain unchanged as its exchange depreciates. In case the foreign demand elasticity is less than unity, the export proceeds will contract.<sup>1</sup>

However, the elasticity of supply of foreign exchange depends upon the elasticity of supply of exports as well. When demand elasticity for the debtor's exports exceeds unity, it can be reflected fully in the supply curve of foreign exchange when the supply of exports is highly elastic. When demand elasticity for exports is less than unity, the supply curve of foreign exchange being negatively inclined, it is only through an inelastic supply of exports that the supply curve of foreign exchange will be moved toward the vertical position (i.e., export proceeds remain constant).<sup>2</sup>

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<sup>1</sup>Ibid., p. 562.

<sup>2</sup>Ibid., pp. 565-566.

In comparison to the fixed exchange rate system, income change and price change under the flexible rate system need not be so severe as under the former. It is explained by the fact that in the latter system, the exchange market plays an important role as a buffer mechanism of the external disequilibrium so that change in income and price level is required to a lesser extent.

#### Exchange Control System.

Under this system, a strict control over the exports and imports of goods and services and capital flow is exercised by the government. Though varying in the stringency of control, foreign exchange receipts are usually submitted to the government. External payments arising from imports of goods and services and repayment of capital services will be rationed by the exchange control agency set up by the government.

While the public budget will allocate a part of revenue for the external debt servicing, the required foreign exchange for outer remittance will be arranged by the exchange control agency. Since current account receipts will not expand substantially, service payment gives rise to the curtailment of exchange expenditure in some other items. The supply of such items will decrease consequently. A reduction in the disposable income discourages imports as well as domestic goods consumption. However, control on imports will inevitably stimulate the price of imports.

Thus, remittance of foreign debt servicing will curtail some imports and import goods price would tend to rise. Importers thereof enjoy a fairly abundant profit. A part of these import profits should be taxed for the use of export subsidy. By the export subsidy policy financed by the taxation on the importers' profit and accompanied by various encouraging policies, exports will be expanded more or less. Without substantial increase in export industries, debt servicing will become difficult year after year since the tendency of growing debt servicing is often observed.

Nevertheless, exchange control system inherently limits the operation of price mechanism. Hence, the transfer of service payments under this system is different from the other two exchange rate systems. Under the fixed rate system and the flexible rate system, monetary transfer of service payment brings about disequilibrium in the payments position and this sets in force adjustments to restore the equilibrium through the real transfer of goods and services from the debtor country to the creditor country.

However, under the exchange control system, monetary transfer and real transfer are all arranged by the control agency. As an amount of foreign exchange equivalent to service payment is rationed for the remittance, goods and services of the same amount are already or expected to be transferred to the creditor country though there is no specified purpose for any export goods and services.

Hence, under the exchange control system, service payment is paid from the current foreign exchange earnings. All the exchange receipts and exchange expenditures are designed to be in equilibrium. Market forces in the exchange market are utterly deprived of their role, which is replaced by the governmental control and allocation. As the result of service payment, change in income and sometimes changes in price level (as the result of change in demand) may take place; yet they have no direct significance to the adjustment process as they do in the other two exchange systems.

How well the process of transferring service payment will be facilitated under the exchange control depends upon several factors. In the long run, the control on exchange and trade alone will not solve the problem of the growing service payment if efforts on the expansion of exports are neglected. Productive resources must be prevented from flowing into the production of luxuries after restrictions are placed upon their importation. To achieve the effective servicing of foreign capital it is suggested that development programming will be introduced into the picture. By doing so, the expansion of exports may be given a higher investment priority, while production of luxuries will be discouraged. For the discussion on the relation between foreign capital servicing and development programming, Chapter V is assigned.

### Transfer Process of Private Capital Servicing

Private capital flows into the debtor countries in various forms. It may take the form of contractual investments including loans, bonds, and other fixed obligations; or it may take the form of equity investments which consist of preferred stock, common stock, branch accounts, etc. However, for the purpose of discussion on the transfer process of investment income, the following classification of private capital might be convenient and useful:

1. Private capital invested in export industries:

Included in this category are all investments which directly help the debtor country earn foreign exchange, no matter what types of capital they are, whether direct investment, portfolio investment, or loans. The most representative of this type is direct investment in the extractive industries whose products are exported for market abroad.

2. Private capital invested in industries other than export industries: All private capital not included in the first category falls into this category. Their products are intended for the domestic market. An example is foreign capital invested in the bond of private railroad corporation.

To classify various private capital rigidly into the two categories will inevitably encounter difficulties because a number of industries produce both for the domestic and foreign

market. In such cases, so far as the foreign service payment can be financed easily with the foreign exchange the industry earns, then such capital will be classified in the first category. The main criterion of classification then lies in whether the industries having foreign capital inflow can provide exchange for the servicing of such capital or not.

Servicing of private capital differs in characteristic from that of public capital in that it will not go through the operation of the fiscal system of the debtor country. Foreign exchange required for the servicing is obtained through the free exchange market except under the exchange control system which requires individual approval and rationing of foreign exchange.

In the following the servicing of private capital will be discussed according to the two categories of private capital just mentioned in the above, since the two reveal different processes of transfer in the private capital servicing.

Private Capital Invested in Export Industries.

Foreign private capital invested in the export industry of the debtor country contributes to the earning of foreign exchange. Though servicing of such capital will absorb a part of the earnings, yet earnings of foreign exchange will be more than the former in ordinary cases, thus, leaving a part of foreign exchange earned available for the debtor country to increase its imports or build up foreign exchange reserves.



Therefore, private capital invested in the export industries provides a sufficient supply of foreign exchange for its own servicing. The debtor country then will not suffer much from the transfer problem in servicing such foreign private capital.

Under the fixed rate system and the flexible rate system, transfer of service payment is achieved easily as just described. Since there is no exchange control, investment income is readily transferred to the creditor country out of foreign exchange earned. As service payment constitutes only a small portion of foreign exchange earned with the help of private capital, the servicing of capital does not strain the balance of payments.

Under the exchange control system, foreign exchange earned by the export industries will be submitted to the exchange control agency (wholly or partially). Foreign exchange will be rationed for individual service payment. In most cases, rationing of foreign exchange for the servicing of private capital invested in export industries never meets large obstacles because of its contribution to the exchange earning.

By and large, exchange control does not restrict the servicing of fixed obligations whose service payment usually shares a small percentage of the invested capital. For instance, outer remittances of interests on bonds and debts

are approved without any difficulty in most cases. However, remittance of equity investment income is subject to certain limitation in some exchange-controlling countries. The remittance of large private profits may be considered to be a loss to the country. Or, a large amount of remittance may be thought to strain the balance of payments. Reinvestment of earned profits might be the wishes of the debtor country government.

Limitations on profit remittances are usually expressed in percentage of the invested capital, at rates varying from ten to fifteen per cent per annum, depending upon the criteria each country establishes. For instance, in the Philippines the central bank policy is to allow the transfer abroad of profits in amount ranging from 25 per cent to 100 per cent of the non-resident's share in current profits or from 20 per cent to 60 per cent of foreign capital invested, whichever is lower, depending upon the "social productivity rating" of the investment.<sup>1</sup>

Hence, foreign private capital invested in the export industries does not provide a serious problem in the transfer of service payment, except for certain limitations on the remittance of large investment profits.

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<sup>1</sup>This rating is established with reference to the enterprise's contribution to national income or employment and to the effect of its activity on the balance of payments and on the supply of essential products. See: United Nations, The International Flow of Private Capital, 1956-58. New York, 1959, p. 97.

### Private Capital Not Invested in Export Industries.

The servicing of foreign private capital in industries other than export industries has been discussed for a long time in the literature related to the international financial problem. From the price-specie-flow mechanism of the classical school to the modern theory of income change, discussions have been focused on the process and effect of how private capital (and its service payment) will be transferred from one country to another.

As stated earlier, the transfer process of private capital servicing distinguishes itself from that of public debt by the fact that the fiscal system is not involved in the former. Thus, the description of public debt servicing in the last section holds good even to the case of private capital servicing if we exclude the operation of the fiscal system from the picture.

### Concluding Words

In this chapter we have seen how public debt servicing and private capital servicing operate under different systems of foreign exchange. Income and price change play a key role in the adjustment of disequilibrium created by the service payment for foreign capital, though varying in its effects on the transfer process depending upon the different systems. Under the fixed rate system income and price change function as a main adjusting force. Under the flexible rate system

exchange depreciation plays a role of greater importance. Under the exchange control system market forces are restricted severely in the exchange market and they are replaced by the control of governmental authority.

In the servicing of public capital, operation of the fiscal system is added to the picture, but the basic process of capital servicing is not changed.

The effect of transfer of service payment depends upon various factors such as the nature of economic organization, elasticity of demand and supply, marginal propensity to import, to consume, and so on. Hence, the operating effect of transfer process may be differentiated to some extent according to the circumstances of each country.

Transfer problem of service payment is greatly mitigated if a country has a large amount of foreign exchange reserves or an easy access to the foreign financing assistance, whether from international, intergovernmental, or private sources. This has been assumed not to exist throughout the discussion in this chapter. Yet it is important to take these factors into consideration when we look into the current capital servicing situation of a country. Particularly the availability of new financial assistance has a vital aspect not to be overlooked.

## CHAPTER III

### THE TRANSFER PROBLEM OF FOREIGN CAPITAL SERVICING

#### Introductory

In servicing foreign capital the borrowing country must be able to do without a part of its savings equivalent to its debt service payment each year and also must be able to convert them into the required foreign exchange.

In essence, the ability to transfer the debt service payment is equivalent to the ability to obtain the required foreign exchange as agreed when the debt was arranged. If the debtor country has a large amount of excess gold and foreign exchange reserves, the debt service payment can be paid out of the reserves. But, as stated before, no country can afford to exhaust its gold and foreign exchange reserves for years. Foreign exchange must be earned through expansion of exports, import substitution, or another borrowing from intergovernmental, international, or private sources.

The difficulty in debt servicing will, then, arise if a country cannot obtain a sufficient amount of foreign exchange through one of the three ways just mentioned, assuming that the country concerned has no excess foreign exchange reserves. In the long period of time debt service payment may tend to grow. Then the growth of foreign exchange available for

external debt servicing must be planned in order to keep abreast with the growth of debt service payment if difficulty in debt servicing is to be avoided.

Difficulty in debt servicing will be avoided or alleviated if terms of repayment are arranged more moderately by lowered interest rates, prolonged period of repayment than currently prevailing, and so on. The realization of such a solution in easing the burden of foreign debt servicing, however, awaits further international financial cooperation measures which are beyond the reach of borrowing country unilaterally.

In the following sections, we shall deal with the foreign capital servicing problem from four important aspects as just described. However, it must be borne in mind that any one of the four measures is in itself not powerful enough to eliminate difficulties. The debtor country should exercise its efforts on all these measures in order to gather an enormous momentum for breaking through the difficulties. The role of development programming and planning is in this sense a useful tool. We shall discuss this in Chapter V.

#### Expansion of Foreign Exchange Earnings

Since foreign debt servicing gives rise to the demand of a certain amount of foreign exchange, either more foreign exchange must be earned than before or a portion of foreign exchange

regularly earned must be saved for the purpose of debt servicing. If foreign exchange expenditure is to remain unaltered, expansion of foreign exchange earnings becomes imperative. This is achieved mainly through the promotion of exports.

In the context of economic development, expansion of exports has manifold significance. The expansion of exports will:

1. Provide foreign exchange to finance imports of development goods.
2. Finance the possible increase in imports from the expansion in the national income.
3. Finance foreign capital servicing.

Suppose that imports of development goods are financed by the external capital sources and a restriction on imports is imposed so that no increase in import (excluding imports of development goods) is to take place temporarily. Exports have to be promoted to finance the new demand for foreign exchange which rises from foreign debt servicing.

Let imports and exports of a debtor country be in equilibrium, both totaling 100 million dollars in the year when the debt is arranged. The \$100 million of new capital, it is assumed, is to flow into the debtor country in the form of development goods in installments for the first five years, \$20 million each year. Exports expand at the rate of two per cent per annum, while imports remain at the initial level. Amortization is five per cent of the total principal each year and five per cent interest is to be paid annually.

Under these assumptions, changes in exports, imports, development goods imports, service payment, balance of payments position, and total debt outstanding are shown in the following table:

| <u>Year</u> | <u>Exports</u> | <u>Imports</u> | <u>Development imports</u> | <u>Service payment</u> | <u>Payments position</u> | <u>Total debt outstanding</u> |
|-------------|----------------|----------------|----------------------------|------------------------|--------------------------|-------------------------------|
| 1           | 100            | 100            | 20                         | 0                      | 0.0                      | 20                            |
| 2           | 102            | 100            | 20                         | 2                      | 0.0                      | 39                            |
| 3           | 104            | 100            | 20                         | 3.9                    | 0.1                      | 57                            |
| 4           | 106            | 100            | 20                         | 5.7                    | 0.3                      | 74                            |
| 5           | 108            | 100            | 20                         | 7.4                    | 0.6                      | 90                            |
| 6           | 110            | 100            | 0                          | 9.0                    | 1.0                      | 86                            |
| 7           | 112            | 100            | 0                          | 8.6                    | 3.4                      | 82                            |
| 8           | 114            | 100            | 0                          | 8.2                    | 5.8                      | 78                            |
| 9           | 116            | 100            | 0                          | 7.8                    | 8.2                      | 70                            |
| 10          | 118            | 100            | 0                          | 7.0                    | 11.0                     | 63                            |
| ...         | ...            | ...            | *                          | ...                    | ...                      | ..                            |

In the first year exports and imports are in equilibrium, development goods imports are financed by new capital, and no service payment is incurred yet. Therefore, balance of payments shows an equilibrium. In the second year, exports increase 2 per cent, which is just absorbed by the service payment of 2 million dollars (10 per cent of the total debt outstanding in the first year). Consequently, payments position is still in equilibrium. By the end of the second year the debt outstanding amounts to \$39 million. In the third year exports increase to \$104 million while service payment increases to \$3.9 million, in the net producing \$100 thousand surplus in the payments. In the fourth and fifth years,



exports continue to expand, while service payment also grows with the continuous inflow of capital. As growth in exports provides additional foreign exchange more than the service payment year after year, the payments position reveals a surplus which also grows year after year. Service payment reaches the peak amount in the sixth year, then diminishes gradually as amortizations are made annually.

The illustration in the above presents a case in which growth in exports has financed successfully the transfer of service payment, though the assumption that imports are held constant for a long period of time is unlikely to be realistic. Actually, imports may start to increase after the sixth year, at a rate not high enough to create payments deficit.

It is obvious from the illustration that exports must grow more than or at least equal to the service payment each year. Especially the first year of servicing (i.e., the second year in the illustration) is important in the sense that the debtor country is undergoing a test of success whether its debt servicing capacity is adequate to meet the new international financial obligation.

If we drop the assumption that imports remain at a constant level, and assume that foreign capital will inflow at a different rate from the first case, a different picture of debt servicing will come up as the result. Suppose that imports increase at the rate of one per cent per annum, and

foreign capital of \$100 million flows into the debtor country in four installments, \$40, \$30, \$20, and \$10 millions during the first four years. The rest of the assumptions are to remain unchanged. Changes in various items will be as follows:

| Year | Exports | Imports | Development imports | Service payment | Payments position | Total debt outstanding |
|------|---------|---------|---------------------|-----------------|-------------------|------------------------|
| 1    | 100     | 100     | 40                  | 0               | 0                 | 40                     |
| 2    | 102     | 101     | 30                  | 4               | -3                | 68                     |
| 3    | 104     | 102     | 20                  | 6.8             | -4.8              | 85                     |
| 4    | 106     | 103     | 10                  | 8.5             | -5.5              | 91                     |
| 5    | 108     | 104     | 0                   | 9.1             | -5.1              | 86                     |
| 6    | 110     | 105     | 0                   | 8.6             | -3.6              | 82                     |
| 7    | 112     | 106     | 0                   | 8.2             | -2.2              | 78                     |
| 8    | 114     | 107     | 0                   | 7.8             | +.8               | 74                     |
| 9    | 116     | 108     | 0                   | 7.4             | +.6               | 70                     |
| 10   | 118     | 109     | 0                   | 7.0             | +2.0              | 66                     |
| 11   | 120     | 110     | 0                   | 6.6             | +3.4              | 62                     |
| 12   | 122     | 111     | 0                   | 6.2             | +4.8              | 59                     |
| ..   | ...     | ...     | .                   | ...             | ...               | ..                     |

In the second case of illustration, deficits in the balance of payments continue to exist from the second year to the eighth year, until the ninth year when the payments begin to turn into surplus. Deficits are caused by the increase in imports and by the inflow of a large amount of capital in the first year. Service payment culminates in its magnitude in the fifth year and then tends to decline.

To avoid payment deficits, if imports are increasing at a rate of one per cent as in the second case, exports must grow at a faster rate. Suppose now exports expand at the annual rate of four per cent and a grace period of four years

is given. Repayments start from the fifth year, each year \$10 million for interest and principal repayment until the whole debt is liquidated. This is shown in the following table:

| Year | Exports | Imports | Development imports | Service payment | Payments position | Total debt outstanding |
|------|---------|---------|---------------------|-----------------|-------------------|------------------------|
| 1    | 100     | 100     | 40                  | 0               | 0                 | 40                     |
| 2    | 103     | 101     | 30                  | 0               | 2                 | 70                     |
| 3    | 106     | 102     | 20                  | 0               | 4                 | 90                     |
| 4    | 109     | 103     | 10                  | 0               | 6                 | 100                    |
| 5    | 112     | 104     | 0                   | 10              | -2                | 95                     |
| 6    | 115     | 105     | 0                   | 10              | 0                 | 89                     |
| 7    | 118     | 106     | 0                   | 10              | 2                 | 83                     |
| 8    | 121     | 107     | 0                   | 10              | 4                 | 77                     |
| 9    | 124     | 108     | 0                   | 10              | 6                 | 71                     |
| .    | ...     | ...     | .                   | ..              | .                 | ..                     |

By virtue of a higher rate of growth in exports and a grace period of four years, as seen from the above table, the payments position of the debtor country encounters a deficit only in the fifth year. From the second year to the fourth year payments surpluses are accumulated which are more than enough to offset the deficit in the fifth year.

Therefore, other things being equal, the higher the rate of export expansion, the less vulnerable the debtor country is to the difficulty in the debt servicing. To achieve successful expansion in exports, the most important decision is to allocate sufficient capital for the export industries. Adequate investment in the type 1 industries (in J. J. Polak's

terminology)<sup>1</sup> is an indispensable investment policy for countries which develop or reconstruct with the help of foreign capital.

It is apparent from the foregoing explanation that expansion of exports plays an important role in foreign debt servicing. However, the expansion of exports is to some extent subject to influences from external factors which are beyond the control of the debtor country.

First of all, income elasticity and demand elasticity for debtor's export goods may be small, so that expansion of exports will be limited to a certain extent.

If the income elasticity of demand for the export goods of the debtor country is small, then only a tiny portion of the increased income (no matter how an increase in income is derived: from the receipt of service payment, from the secondary increase in income level through multiplier effect, or any other ways) will be directed to the purchasing of export goods. How this affects the exports of the debtor country depends upon the elasticity of supply of the world and that of the debtor country. Since the world supply is not perfectly elastic the price will rise. The production of the debtor's export goods will be increased to the point where its supply cost equates

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<sup>1</sup>Polak, J. J., "Balance of Payments Problems of Countries Reconstructing with the Help of Foreign Loans," Quarterly Journal of Economics, Vol. LVII (February 1943). By type 1 industries are meant those industries which produce goods for export or sold on the domestic market in place of goods previously imported.

the new world price.

If demand for exports of the debtor country is inelastic, the reduction in price does not lead to substantial expansion of exports. On the contrary, it might give rise to a contraction of the total export proceeds. The impacts of demand elasticity, however, depend upon the supply elasticity.<sup>1</sup>

Primary goods are often related to low price elasticity. Manufactured goods, on the other hand, enjoy comparatively higher elasticities than primary goods. However, low price elasticity to primary goods does not necessarily mean a low elasticity to the exports of a particular primary-goods-exporting country. It is possible that the debtor country can expand the production of certain primary goods at the prevailing price.

The expansion of exports will be facilitated more through the diversification of export goods. Human wants are satisfied in the order of the intensity of desire--from the basic wants to the secondary or higher wants. Through the diversification of export goods the debtor can succeed in export expansion on a larger scale.

Secondly, trade protection devices on the part of the creditor country seriously restrict the expansion of exports for the debtor country, with the result of rendering service payment difficult. Quantitative restrictions, as well as high tariff walls, prevent the real transfer of the service payment

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<sup>1</sup>See the explanation of relation between elasticity and export proceeds in Chapter II, pp. 17-18.

in the form of increased exports. The greater the level of import duties in the creditor country, the more difficulties in adjustment and the greater the worsening of the terms of trade. Imposition of higher tariff rates or quota regulation at the time of service payment especially makes the debtor country fall into a more difficult position. Aside from tariffs and quota restriction, any similar devices have the same restricting effect on the imports from the debtor country, also.

However, the creditor countries now understand the mechanism of transfer much better and would try to avoid such unreasonable restrictions. The General Agreement of Tariffs and Trade at least provides a firm basis for the efforts toward the elimination of such restrictions. Yet the elimination of restricting devices depends upon the actual circumstances of individual creditor countries. Though much reduction in the restriction cannot be expected in the short run, it is hoped that no growth in protection will take place hereafter.

Depression also constitutes a disturbing element for the expansion of exports. It brings about a fall in world foreign trade owing to reduced incomes and trade restrictions. In 1958 industrial recession in the United States, Western European countries, and Japan affected the ECAFE countries by the general decline in export earnings with the exception of

Taiwan, Laos, and the Philippines. The great depression of the 1930's caused the fall of world foreign trade to a serious degree. Owing to the reduction in the foreign exchange earnings, the fixed interest charges then would absorb a larger portion of the foreign exchange receipt, indicating that more exports than before have to be paid for foreign capital servicing.<sup>1</sup>

The adverse effect of depression has been especially severe in the primary goods producing countries. Particularly countries which predominantly depend upon the exports of one or two principal goods were affected adversely by the 1930's depression. In 11 out of 14 defaulting Latin American countries two products accounted for from 70 per cent to 98 per cent of exports; and, in six, a single product accounted for more than 70 per cent of exports.<sup>2</sup>

The prevention from the loss caused by the depression for the debtor country depends upon how well the creditor countries--many of them are creditor countries--can achieve through their countercyclical measures. The efforts for economic stability seem to be intense now in the United States

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<sup>1</sup>For instance, the dollar fixed-interest charges, which would amount to 12 per cent of dollar-exchange receipts of the world in 1929 amounted to 37½ per cent of these in 1933. See: Lakdawala, D. T., International Aspects of Indian Economic Development. London: Oxford University Press, p. 61 n. 1.

<sup>2</sup>Ibid., p. 61 n. 3.

which might be seen as an evidence of world economic stability for the time being.<sup>1</sup>

Bilateralism in trade which has been prevailing since the great depression also reinforces the difficulty in the transfer of service payment for the debtor country. Prior to the depression, world trade was such that the world could be divided into five important regions--Tropics, U.S.A., Regions of recent settlement, Continental Europe, and Non-continental Europe--and each region had a trade surplus with one or more of the other regions.<sup>2</sup> The network was shattered after the 1930's depression and its place was taken by the bilateralism in trade and payments. In trade negotiations all advantages went to countries having import surpluses, and they could force the other parties to take more of their exports; thus, reducing the surplus. This, however, gives debt servicing a serious problem. When multilateral trade was prevailing, the debtor country could pay the service payment simply by making a trade surplus of the amount equivalent to the service payment with any country including the creditor country. But with the introduction of bilateralism in trade, the service payment can be paid only through making a trade surplus

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<sup>1</sup>Burns, A. F., "Progress Toward Economic Stability," American Economic Review, Vol. L, No. 1 (March 1960), pp. 1-19.

<sup>2</sup>Ellsworth, P. T., The International Economy. New York: The Macmillan Company, 1950, p. 485.



directly to the creditor country since trade will tend to be in equilibrium with the rest of the trading countries. Also, there might be difficulties for the debtor country in making a trade surplus with the creditor country because of not having sufficient suitable goods to offer for the creditor country.

The restoration of multilateral trade and multilateral settlement is necessary for the smooth transfer process. If not, a creditor country must allow import surplus to take place with the debtor country by removing trade restrictions or making special trade arrangements. Fortunately, multilateralism has been regained recently by the announcement of the convertibility of sterling and most European currency at the end of 1958.<sup>1</sup>

In the above discussion we have come to the conclusion that foreign exchange earnings of the debtor country must grow at a sufficiently high rate to cover the service payment each year or at least in the first several years, assuming imports are to remain constant. If imports grow at all then exports will be required to grow at a faster rate or the difficulty must be mitigated through the arrangement of a grace period. For the promotion of exports and, consequently, for

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<sup>1</sup>Britain, West Germany, and France announced that their currencies would be convertible as of December 29, 1958. And most other Western European countries followed suit.

the smooth operation of transfer process, the following principles must be observed: First, on the part of debtor country, diversification of export goods must be achieved by the allocation of sufficient capital for the export industries. For the creditor country, trade restriction preventing the imports of debtor country must be removed. Depression must be avoided at all cost, and efforts on the part of the creditor countries are urgently required. The abolition of bilateralism in trade and payments should be considered as the ultimate goal of world trade for which every country is requested to strive.

Apart from these principals, the government of the debtor country is required to create favorable conditions for exports. Inflation pressure must be eliminated by all means. Overvalued exchange rates which are an impediment to exports should be corrected after a certain degree of internal price stability is assured. World market information will be provided to keep exporters well informed. The tax system will be adjusted in order to encourage reinvestment of export profits. Financial assistance and subsidies may be offered for encouragement as well.

#### Curtailment of Foreign Exchange Expenditure

If the debtor country is not in a position to earn sufficient foreign exchange for the servicing of foreign capital,

other things being equal, then the saving of foreign exchange currently available is indispensable. The basic significance of foreign exchange savings lies in restricting the importation of non-essential goods, especially luxurious consumption goods, while import substitution industries are established with a view to supplying import goods by the domestic producers.

There is no doubt that not all import goods can be substituted. There are three kinds of factors limiting the substitution of import goods; namely, physical, qualitative, and economic, though it is not always easy to isolate one kind of factor from the other.

The physical factors such as climate conditions and lack of adequate natural resources can be serious obstacles to the development of certain lines of production. This is true of cotton in Japan, of coffee and cacao in the United States and Europe.

The qualitative products can be replaced only with difficulty because of their intrinsic quality. Works of art and science are extreme examples. Also, specific beverages, ornaments, china-ware, and other objects whose trade marks are an integral part of the quality are included in this category.

The third kind of factors--economic--includes the availability of capital and technical knowledge, etc. The problem of petroleum production is in nature economic as well as

physical. Many underdeveloped countries have rich oil resources, but production is possible only after the necessary technical knowledge and capital come into the country.

Although there are factors limiting the substitution of import goods, the improvement of technology in the debtor country will gradually reduce the power of limiting forces. Productivity of a country is a lively organism which grows with the lapse of time.

Coefficient of Imports in Relation to  
Disposable Income

| Periods | Consumer goods<br>in relation to<br>consumption | Capital goods<br>in relation<br>to investment | Raw materials<br>in relation<br>to consump-<br>tion | Fuels in<br>relation<br>to con-<br>sumption |
|---------|-------------------------------------------------|-----------------------------------------------|-----------------------------------------------------|---------------------------------------------|
| 1925-29 | 12.5                                            | 57.0                                          | 3.4                                                 | 1.6                                         |
| 1946-53 | 5.7                                             | 37.6                                          | 3.4                                                 | 1.6                                         |

Source: United Nations, Economic Commission for Latin America, Analyses and Projections of Economic Development, I. An Introduction to the Technique of Programming. New York, 1955, p. 14.

Import substitution comprises changes in import coefficients. The substitution trend in the past provides us some indication of the direction of import substitution in the future. In Latin America, for example, from 1925-29 to 1946-53, the average share of consumer goods imports in relation to consumption, and that of capital goods in relation to investment were reduced from 12.5 to 5.7 per cent and from 57.0 to 37.6 per cent respectively, whereas raw materials and

fuels kept the same percentage to consumption, 3.4 and 1.6 respectively. This indicates that expansion of raw materials and fuels imports represents an ever-increasing share of total imports as the following table shows.

Average Share of Import of Consumer Goods, Capital Goods,  
Raw Materials and Fuels in Total Imports

| Periods | (percentage)   |               |               |       |
|---------|----------------|---------------|---------------|-------|
|         | Consumer goods | Capital goods | Raw materials | Fuels |
| 1925-29 | 47.5           | 33.1          | 13.1          | 6.3   |
| 1946-53 | 32.1           | 39.4          | 12.4          | 9.1   |

Source: United Nations, Economic Commission for Latin America, Analyses and Projections of Economic Development, I. An Introduction to the Technique of Programming. New York, 1955, p. 14.

While the percentage of consumer goods import decreased, all the other three items registered an increase, especially raw materials and fuels imports.

From the example of Latin America we see that substitution of consumer goods and capital goods are achieved to some extent. While these substitutions must continue, production of raw materials and fuels in the domestic field must be engaged, if possible; for instance, by the introduction of new production methods. But to what extent the process of import substitution can be continued is a question. The unduly excessive import substitution means a loss of economic interest from world trade. It will cause misallocation of productive factors if the social marginal product

of productive factors in the import substitution industries is lower than that in the export industries. In that case the productive factors should be invested in export industries.

Basically the extent of import substitution still depends upon the conditions of resources and technology of the debtor country. Substitution industries can be established only in the field where such industries can operate adequately with the least extent of state protection.

The necessity of import substitution is reinforced by the fact that the evolution of capacity for external payment may not run parallel to the movement of income. In Latin America, for example, in 1946-53 the capacity for external payment had risen by only 62.2 per cent from the 1925-29 level, whereas gross income had increased by 121.8 per cent.<sup>1</sup> The coefficient of external payment, that is, the ratio of the external payment to gross income, dropped from 26.3 per cent in 1925-29 to 19.0 per cent in 1946-53. The capacity to import, which is obtained by subtracting remittances on foreign capital and other liabilities from the capacity for external payment, decreased from 21.2 per cent of gross

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<sup>1</sup>United Nations, Economic Commission for Latin America, Analyses and Projections of Economic Development, I. An Introduction to the Technique of Programming. New York, 1955, p. 13.

income to 15.6 per cent. This fact indicates that other things being equal the efforts toward import substitution must expand in proportion to the rate of growth, if exports increase at a slower rate than income. For instance, if the income and exports grow at the rate of 5 and 2 per cent respectively, import substitution will have to increase at the rate of more than 5 per cent.

In the early stage of import substitution, however, an adverse impact on the balance of payments might be brought about by the imports of machine, equipment, and raw materials necessary for the import-substitution industries. If this part of foreign exchange can be financed by the borrowing of new foreign credit, then no strain will be imposed on the balance of payments. The establishment of import substitution industries also tends to have an impact on the related industries, which then will require the importation of necessary materials or equipment. This part of increase in foreign exchange expenditure is often overlooked. As a result the establishment of import substitution industries tends to require more foreign exchange than expected.

Thus, in the short run import substitution does not help much in the curtailment of foreign exchange expenditure. In contrast, import restrictions imposed on the nonessential goods immediately play an important role in contracting the expenditure of foreign exchange so that transfer of service

payment will be achieved smoothly. In restricting the import of nonessential consumer goods, it is required that fiscal policy or monetary policy be coordinated so that a part of income stream will be distracted from the consumption expenditure if the price level is to remain stable. This is because a rise in price level might tend to discourage exports.

The curtailment of foreign exchange expenditure and trade restriction comprise governmental intervention. They are often integrated as a part of development programme. We shall deal with this problem in Chapter V.

#### Availability of Foreign Credits and Loans

An easy access to foreign capital sources gives a great relief to the solution of external payment difficulties. In this connection, two aspects will be discussed. The first aspect is how new credits and loans help the debtor country tide over the balance of payments difficulty, with special reference to underdeveloped countries. The second is how discontinuity of capital flow affects the transfer of the service payment.

The availability of new capital, long-term or short-term, is important in the sense that exports or import substitution industries of the debtor country may not grow rapidly to yield sufficient foreign exchange for the purpose of transfer of investment service. A shrinkage in the foreign exchange earnings may happen owing to a world-wide depression.



Hence, in tiding over the temporary shortage of foreign exchange for the external payment, the debtor country has to rely on new credits or loans from external sources.

When capital flows into a debtor country in a number of installments, the interest payment for the first few installments can be paid out of the new installment of capital provided that such capital is not entirely spent on the purchase of goods and services in the creditor country. However, after the last installment flows into the debtor country, the foreign exchange needed for the servicing of investment capital must be derived from current foreign exchange earnings, from exchange reserves if there are any, or from new credits and loans. Suppose, for one reason or another, foreign exchange of the debtor country suddenly decreases and there are no excess exchange reserves, then the last resort will be the arrangement of new external credits and loans. Otherwise, suspension of investment service or a further curtailment of imports will be required.

Fluctuation in the export proceeds is another reason for the need of short-term credit. Severe fluctuations in export proceeds are observed often in underdeveloped countries. In ECAFE countries, for example, from 1948 to 1957 primary export proceeds revealed a wide range of fluctuation as the following table shows:

Fluctuation in Export Proceeds  
ECAFE Countries, 1948-57

| Ranges | Exports and Countries                                                                 |
|--------|---------------------------------------------------------------------------------------|
| 10-15% | Rice (Thailand, Burma), tea (Indonesia), tin (Malaya), and petroleum (Indonesia).     |
| 15-20% | Sugar (Philippines), tin (Indonesia), petroleum (Brunei).                             |
| 20-25% | Sugar (Taiwan), copra (Philippines), jute and cotton (Pakistan), abaca (Philippines). |
| 31-33% | Rubber (Indonesia, Malaya and the region as a whole).                                 |

Source: United Nations, Economic Commission for Asia and Far East, Economic Survey of Asia and Far East, 1957, p. 117.

While rice and tea fluctuated 10 per cent to 15 per cent as the lowest fluctuation category, rubber showed the highest fluctuation amounting to 31 per cent to 33 per cent. On the whole, the fluctuation in export proceeds was more severe than that of export price and quantity of exports.

The severe fluctuation in export proceeds of a few principal goods in the underdeveloped countries makes it urgent that easy access to credits or loans be available to them. If not, investment service will be suspended for a while; or import restriction must be intensified if it is still workable. The economic structure of the underdeveloped countries is, on the whole, fragile and inflexible. Any excess strain on its economy only results in the dislocation of the whole economic system. On the contrary, if the new credits or loans can be arranged as a temporary tideover, not only will the whole

economy be relieved, but, also, the servicing of foreign debt won't be defaulted. Of course, there is danger in extending a hand of relief to the jeopardized debtor. There is no guarantee that new credits or loans will release the debtor country from the adversity successfully. Yet, new credit must be extended from external resources.

The sources which offer such credits and loans may be international financial institutions, private banks, foreign governments, or a regional development bank. The International Monetary Fund has long been serving as the principal institution for solving balance of payments problems by providing secondary reserves for the balance of payments crisis in the form of rights of drawing on the I.M.F.'s resources. According to Article V (3), a member is entitled to buy the currency of another member from the I.M.F. in exchange for its own currency for making foreign payments. Ordinarily, a member cannot buy foreign currency for domestic currency worth more than 25 per cent of its quota during a twelve-month period; and it cannot buy foreign currencies to such an amount as would cause the I.M.F.'s holdings of its currency to be more than 200 per cent of its quota.

However, the annual drawing rights on the I.M.F. constitute a small proportion of the foreign exchange reserves of many countries. For a number of countries these ratios

are under 10 per cent of their reserves.<sup>1</sup> Thus, if balance of payments deficit on the current account causes a drain of foreign exchange reserves by more than 20 per cent, then drawing on the I.M.F. secondary reserves will meet less than half of the deficits. If the secondary reserves are of smaller percentage, the percentage of deficits absorbed by the I.M.F. reserves will be less.

In India, for example, in 1956--the first year of the Second Five Year Plan--the annual drawing right of 100 million dollars accounted for only 5.2 per cent of her foreign exchange reserves--\$1,900 million. The payments deficit on the current account this year amounted to \$481 million and the drain of foreign exchange reserves was \$417 million (drawing of \$100 million was extended to the next year). In 1957 payments deficit of \$856 million was financed by I.M.F. drawing of \$200 million (1956 and 1957) and \$484 million of foreign exchange reserves along with other means of financing. Hence, India's annual drawing right accounted for only 20.7 and 11.6 per cent of deficits in 1956 and 1957 respectively. India's deficits, however, were caused largely by the increase in imports of development goods; thus, their financing actually does not fall completely into the function of the International Monetary Fund. Therefore, although the annual drawing rights of many countries share merely a small percentage of

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<sup>1</sup>Lakdawala, D. T., op. cit., p. 165.

their exchange reserves, the function of the Fund in mitigating the balance of payments disequilibrium cannot be underestimated.

#### India's Drawing on I.M.F. Reserves

| Year                          | I.M.F. Reserves      |                | Gold and foreign exchange (end of period) | Deficit on current account | Drain of reserves |
|-------------------------------|----------------------|----------------|-------------------------------------------|----------------------------|-------------------|
|                               | Annual drawing right | actually drawn |                                           |                            |                   |
| 1956                          | 100                  | 0              | 1,900                                     | 481                        | 417               |
| 1957                          | 100                  | 200            | 1,477                                     | 856                        | 484               |
| (in millions of U.S. dollars) |                      |                |                                           |                            |                   |

There is no doubt that the investment climate in the debtor country is partly responsible for the inflow of new capital, particularly private capital. The recipient's capital absorptive capacity and ability to repay play a decisive part in inducing new capital to flow into the country.

The continuity of capital movements has been an important element in the balance of payments problems. Sudden changes in the flow of capital enormously increased the difficulties of investment service transfer. Difficulties in payments will be eased if changes in the flow of capital take place gradually, thus enabling a number of adjusting factors to have sufficient time for making adjustment.

Continuity of capital movement does not imply that a certain amount of particular capital must flow in annually.

It means rather that the total stream of annual capital flow maintains a stable level and sudden changes in the magnitude of capital are avoided. That is, short-term credits and long-term loans will be available without much difficulty at the current level, or direct investment profits are reinvested quite regularly at the past prevailing rate.

Changes in the sudden flow of capital are attributed to the following reasons:

1. Business conditions of the creditor country: Private capital movements bear a certain relation to business conditions of the creditor country. By and large, foreign investment will be active in prosperity while the reverse in a recession. The United States in the 1920's was characterized by active private investment abroad when good business conditions prevailed in the domestic market. However, the foreign investment reduced substantially when the depression came. In 1939 the loans, which doubled in 1930 from the 1919 level, again reduced to their 1919 level.<sup>1</sup> Thus, a sudden turn in business conditions will cause changes in the flow of capital.

2. Mobility of short-term capital: Short-term capital is subject to high mobility due to its sensitivity to changes in the prospect of greater profit. Unless there are restrictions, short-term capital tends to flow from less profitable

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<sup>1</sup> Lakdawala, D. T., op. cit., p. 59.

investment to the more profitable. Therefore, the more short-term capital is employed, the more changes in the flow of capital are to be expected.

3. Political, monetary, or financial policy: Changes in political or economic policies of either creditor or debtor country will affect the flow of foreign capital. Political instability of the debtor country tends to keep foreign capital from flowing in. Also, changes in trade, exchange policy, or monetary policy produce a similar effect.

Sudden changes in the flow of capital induced by one of the above three reasons soon will bring about their impacts in the following ways: The effect will be felt immediately on the balance of payments. The cessation of capital inflow which was rather regular in the past indicates the reduction of available foreign exchange. If direct investment profits tend to be reinvested in less percentage than before or repatriation of private capital is attempted, it gives rise to new expenditure of foreign exchange. No matter what form of change in the flow of capital there is, the immediate result is disequilibrium in the external payments. This makes the transfer of investment service difficult.

The sudden cessation of capital inflow also renders servicing of foreign debts difficult by bringing a setback to the industries which have been depending more or less upon the financing of foreign capital. The supply of necessary

equipments and raw materials will be cut down and the whole production will be contracted. Consequently, there will be a decrease in income and savings out of which investment service is to be paid.

From the aspect of continuity of capital movements, public capital seems to be more acceptable than private capital. With a substantial amount of public capital in the total borrowing from abroad, continuity of capital flow is likely to be ensured. Private capital is mainly motivated by profitability and safety, whereas public capital tends to seek motives other than profitability and safety. From this point of view, capital from international lending organizations is more adequate than intergovernmental loans on the grounds that in the former the influence of the interests of individual countries will be absent; and, thus, the flow of capital will not be interrupted by sudden changes in the foreign policy of the government involved. The advantage of financing capital through the international institution to underdeveloped countries is based partly on the belief that such an organization will operate successfully by standing above the individual interests of member countries so that a higher objective of economic cooperation among the developed and the underdeveloped countries will be realized.

Apart from the establishment of the international lending institution, many ways are open to the assurance of



continuity of capital movements. Guarantee of continuity may be given by the government of a creditor country on public capital. As to private capital, the government of the creditor may offer some program assuring the taking over of private investment in case private capital must return to the home country for one reason or another.

### Moderation of Repayment Terms

The moderation of repayment terms not only lessens the burden of investment service on the debtor country, but also eases the transfer problem of investment income. It seeks to reduce the burden of service payment while the contribution of foreign capital invested will be maintained at the same level. In a sense, moderated repayment terms mean a loss to the creditor. Thus, the moderation of repayment terms is principally initiated by the creditor. Without willingness and feasibility on the part of the creditor, the discussion below will be only advice or opinion. If existing lending agencies cannot afford these terms, a new institution embracing such willingness and capacity must be established.

On the moderation of repayment terms a number of aspects can be stated. They are: interest rates, maturity period, grace period, and schedule of repayment.

#### Interest Rates.

Interest rates determine the amount of interest charges to be paid by the debtor annually (or semiannually or quarterly,

as the case may be). The higher the rates, the larger the interest payment. To reduce the burden of debt servicing low interest rates, thus, are required.

Interest rates are usually higher for private capital than for public capital. However, interest rates for both kinds of capital cannot be far from the rates in the capital market. From the private investor's point of view, higher rates should be charged for capital when used abroad since some extent of risk is involved. Interest rates charged by various public financial institutions are by no means identical. Some disparity exists because of different operating policies of individual institutions.

Current interest rates charged by the International Bank for Reconstruction and Development range from 5 per cent to 6 per cent, including commission charges. These rates are higher than those prevailing during 1951 to 1956 when  $4 \frac{1}{4}$  per cent to  $4 \frac{7}{8}$  per cent were charged.<sup>1</sup> The rates differ depending upon the nature of the projects for which loans are made. Agricultural development project loans have been charged lower rates than power, industry, railways, and port projects. Maturity of loan and extent of credit risk, of

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<sup>1</sup>International Bank for Reconstruction and Development, Annual Report, various issues. The tendency of rise in interest rates from the middle of 1959 up to now in ten major countries in Europe and North America accounts for the corresponding rise in interest rates for the World Bank loans.

course, are other considerations taken into account for determining interest rates.

Interest rates charged by the Export-Import Bank are similar to those charged by the World Bank, ranging from 5 per cent to 6 per cent currently.<sup>1</sup> Some disparity in rates among debtor countries is observed. Loans to Indonesia during 1950 to 1957 were charged 3 1/5 per cent, whereas loans made to India during 1957 and 1958 were charged 6 per cent or 5 1/4 per cent. Loans to the Philippines were normally charged between 4 per cent and 5 per cent.

Disparity in interest rates is greater for loans under section 104 (e) of Public Law 480. These loans are in the form of local currency obtained from the sales of agricultural surplus. Interest of 5 per cent for Pakistan, 7 1/2 per cent for Israel and France, while 10 per cent for Mexico, was charged. The disparity may be explained by the different considerations underlying the individual debtor country based on the principle embodied in the law.

The International Finance Corporation, an affiliate of the World Bank, charges slightly higher rates than the World Bank because its main function is to make loans to private

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<sup>1</sup>Export-Import Bank, Semiannual Report to Congress, for the period July-December, 1958.

enterprise operating in underdeveloped countries. Its current rates are about 7 per cent in dollar and additional interest, payable in local currency contingent on earnings.<sup>1</sup>

The Development Loan Fund which provides soft loans to underdeveloped countries charges different rates for different types of projects. On loans for economic and social overhead projects 3.5 per cent is charged, while on loans for profit-earning projects such as manufacturing and extractive industries, interest rates are charged following the terms of the Export-Import Bank of similar projects.<sup>2</sup>

In the above we have reviewed various interest rates currently charged by the public lending institutions. These rates are approximately the same as interest rates charged on loans made by commercial banks to the public in the United States, but are lower than those charged in many underdeveloped countries.

There are a number of reasons to offer capital at low interest rates to underdeveloped countries. Economic development needs a substantial amount of social and economic overhead capital which yields its fruits only after a long period of time. Export industries in underdeveloped countries

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<sup>1</sup>International Finance Corporation, Third Annual Report, 1958-59, pp. 12-13.

<sup>2</sup>Pan American Union, Financing of Economic Development in Latin America, Washington, 1958, p. 146.

expand at a rather slow rate because of low income elasticity for primary goods. Severe fluctuation in export proceeds, heavy imports of development goods, etc., provide other reasons for the reduction of interest rates.

However, how far interest rates can be lowered depends upon the ability and the operating policies of the lending institution. Private lending institutions operated purely on the principle of profitability can hardly afford to provide capital at a lower rate than the prevailing rates at home. Moreover, additional charges for the possible risk incurred will be required for private capital unless guaranteed by a public lending organization such as the World Bank or by the government under an investment guarantee program. In this respect public lending institutions are in a good position to offer capital at low rates for underdeveloped countries.

The recent rise in interest rates from 5 per cent to 6 per cent increases the burden of debt servicing to some extent. Compared to 4 per cent to 5 per cent from 1951 to 1956 (approximately), the current rates require 20 per cent to 25 per cent more interest charges than before. It is hoped that rates will be reduced within available means. There is, of course, great difficulty in charging low rates if capital is borrowed from the capital market as in the case of the World Bank. Moreover, interest rate is a price for the use of capital. It is a means of allocating capital among various uses.

The maximum services can be attained only through an allocation based on the interest rate.

Maturity Period.

Loans made by the World Bank and the Export-Import Bank are usually repaid over twenty years on the average. Loans made by the International Finance Corporation are repaid over ten years usually. The length of maturity period, also, is determined by the useful life of projects for which loans are made.

With a view to alleviating the burden and the transfer problem of debt servicing, it is expected that the maturity period will be extended as long as possible. In effect, the prolonged maturity period produces similar effects as lowered interest rates. The annual service payment will be reduced as the maturity period is prolonged.

The extension of maturity period is justified on the grounds that amortization of capital invested will be in accordance with the growth of the repaying ability of debtor countries. The length of the maturity period should be matched to the growth in the productivity of debtor countries. For the development project whose results cannot be seen easily in a short period, such as economic and social overhead capital, the maturity period should be relatively long. On the other hand, loans made for profit-making industries may be amortized in a short period. Nevertheless, it is

advisable that earnings will be reinvested in the industries for further expansion. The results benefit both creditor and debtor since debtor will eventually repay while the burden of annual debt servicing is alleviated.

Thus, the extension of the maturity period is an important factor in assisting the transfer of service payment. Debtor countries, particularly in underdeveloped areas, will be greatly benefited if the current average maturity period can be prolonged, say to thirty years, forty years, or even fifty years.

#### Grace Period.

The repayment of loans usually starts after a certain period of time called the grace period. For loans from the World Bank the grace period has been three to six years on the average. The longest grace period was ten years for the loan made for the Belgian water transport project in 1954. The Export-Import Bank gives a similar length of grace period as the World Bank.

Here, we may also argue that the extension of the grace period will help reduce the burden of debt servicing based on the same reasons as the extension of the maturity period. Besides, time is needed before the borrowed capital can be put into the actual process of production. Again, if the capital from external sources is merely a part of the total capital needed and the capital from the domestic savings is not entirely raised, the grace period needs to be prolonged.

### Schedule of Repayment.

Roughly speaking, there have been three patterns of schedule in repaying the debt over the maturity period. One is to distribute the repayment equally over the maturity period. The second pattern is to repay rather large installments in the first several years and to diminish the annual payment gradually during the rest of the period. The third pattern is to concentrate heavy repayments on the last several years of the maturity period. When a country borrows from various sources, the aggregate annual service payment may take a somewhat different pattern than the individual pattern of repayment for each debt.

Viewing from the transfer aspect of debt servicing, the first and third patterns of repayment schedule are preferred to the second pattern on the belief that it is not advisable to place a heavy burden of repayment during the early years of the maturity period. Because in the early stage of development, with the assistance of foreign capital, export industries are unlikely to be expanded substantially; and import substitution industries are seldom operated efficiently. For this reason it is better, if possible, to concentrate repayments on the later years of the maturity period. Of course, this payment pattern will boost the interest payments slightly compared to the other two patterns. Nevertheless, if the productivity of the debtor country can expand faster because



of this, the repayment does not make a serious strain on the economy.

Though repayment schedule is ordinarily set forth in advance, it is desirable that some flexibility be allowed in the schedule. This is from the fear that an unfortunate situation which might take place in the debtor country will render debt servicing difficult. When the economy of the debtor country, for instance, falls into difficulty owing to hyperinflation, or when balance of payments position is endangered from the reduction in exports or from the deterioration in terms of trade, repayment may be reduced to the lowest amount possible under the situation through negotiation by the two parties.

On the contrary, repayment may be paid back earlier than the original schedule if the ability of the debtor country to repay expands more than envisaged. Caution, however, must be used in such a situation so that overoptimism will not hurt the economy.

Throughout the discussions in this section, the assertion has been made that repayment terms of loans should be arranged as generously as possible so as to alleviate the transfer burden of the debtor countries. The extent to which the transfer burden can be moderated depends upon the capacity and the operating policies of the lending institutions. It is desirable that development loans to underdeveloped

countries should be made at low interest rates with a long grace period and a maturity period as long as possible. Certainly this will give rise to a series of actions which need be taken in the existing or coming lending institutions.

Whether this will be successful or not rests on the cooperation of all the countries involved, particularly on the willingness of developed countries and the determined attitude of underdeveloped countries in carrying out their development.

## CHAPTER IV

### FOREIGN CAPITAL SERVICING IN SELECTED UNDERDEVELOPED COUNTRIES

#### Introductory

An inquiry into the nature and composition of foreign capital servicing in selected underdeveloped countries is attempted in this chapter. The countries selected here are Burma, Brazil, India, Indonesia, and the Philippines.

The main task of the study is to find out how much each country paid for the servicing of foreign capital over the period 1950-58, and to see the components of the service payments. The service payment will be classified into two main categories; namely, public account and private account, with a view to finding the tendency of capital flow in each sector. The classification of service payment into amortization and interests and profits also helps us to understand the nature of the capital which flowed into each country.

The service payment will then be compared with the current account receipt of the balance of payment. The investment service ratio hereof computed is defined as "the percentage of current exchange receipts, exclusive of compensatory financing, absorbed by investment income payment."<sup>1</sup> This

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<sup>1</sup> Finch, David, "Investment Service of Underdeveloped Countries," I.M.F., Staff Paper, Vol. II, No. 1, p. 60.

ratio is widely used as an indicator of the debt servicing capacity of a debtor country. The ratio reflects the capacity of the country to commit additional foreign borrowing without encountering difficulty in servicing the new debt. The investment service ratio over the period 1950-58 will be compared with those prevailing in the prewar period where data is available.

The share of service payment in the national income will be calculated, also. This ratio tells us how much of the national income must be given away so that a less amount of national income will be left for domestic consumption and investment.

### Burma

The service payment paid by Burma over the period 1950-58 fluctuated quite irregularly as the table on the following page shows. Some large repayments, both in private and public accounts, were responsible for the irregularity. Service payments for private capital averaged 15 to 20 million kyats per annum, whereas public service payments ranged from the lowest 2 to the highest 170 million kyats. As a result, total service payments ranged from 18.6 million in 1953 to the highest 189 million kyats in 1954.

If large repayments were excluded, Burma would have paid nearly the same amount of service payment for both private

**Burma's Service Payments for Foreign Capital,  
1950-58 (millions of kyats)**

| Year | Private                                |            |              | Total | Public     |              | Total | Grand total |
|------|----------------------------------------|------------|--------------|-------|------------|--------------|-------|-------------|
|      | Direct investment net profits remitted | Inter-ests | Amortization |       | Inter-ests | Amortization |       |             |
|      | (1)                                    | (2)        | (3)          | (4)   | (5)        | (6)          | (7)   | (8)         |
| 1950 | -----8.0-----                          |            | 7.4          | 15.4  | 1.1        | 3.2          | 4.3   | 19.7        |
| 1951 | -----9.8-----                          |            | 6.6          | 16.4  | .5         | 15.2         | 15.7  | 32.1        |
| 1952 | 11.9                                   | 9.0        | 25.9         | 46.8  | .5         | 2.3          | 2.8   | 49.6        |
| 1953 | 5.4                                    | 11.2       | -            | 16.6  | .4         | 1.6          | 2.0   | 18.6        |
| 1954 | 5.1                                    | 5.9        | 2.7          | 13.7  | .3         | 170.0        | 170.3 | 189.0       |
| 1955 | 7.9                                    | 2.7        | -            | 10.6  | -          | 79.1         | 79.1  | 89.7        |
| 1956 | 4.1                                    | 20.4       | -            | 24.5  | .5         | 4.2          | 4.7   | 29.2        |
| 1957 | 7.5                                    | 15.1       | -            | 22.6  | .2         | 3.4          | 3.6   | 26.2        |
| 1958 | 11.5                                   | 20.0       | -            | 31.6  | .2         | 2.7          | 2.9   | 34.5        |

Source: IMF, Balance of Payments Yearbook; U. S. Office of Business Economics, Foreign Grants and Credits by the U.S. Government, various issues.

Note: Item 5 is interest payment for the United States Government loans only. Interests for loans of other countries are included in Item 2 because of the difficulty in segregation.

and public capital. Large repayments in the public account in 1954 and 1955 were debt repayments to the United Kingdom under the Anglo-Burmese Agreement of March, 1946 (53.5 k million in 1954), to India under Indo-Burmese Agreement of March, 1954 (81.9 k million for 1954 and 75.2 for 1955), and partial payment for the purchase from the United Kingdom of a one-third share in the Burma Oil Company (33.3 k million for 1954, 0.8 for 1955, 2.7 for 1956, 1957, and 1958). Thus, amortizations were paid in a few large installments rather than amortizing over a long period, partly because of the

nature of the debt and partly because of a sudden increase in foreign exchange receipt due to the good price of rice during the Korean conflict.

On private account, service payments averaged about 15 k million from 1950 through 1955, except in 1952 when a large amount of capital repatriation was paid. In 1956 and 1957, service payments rose to more than 20 k million, and in 1958 to 31.6 million. In the first three years of the period under review, the repatriation of private capital was more than the inflow of new capital. However, the trend was reversed from 1953; that is to say, inflow of capital was more than outflow.

On the whole, interests remitted to non-resident shareholders were slightly more than the direct investment profits remitted.<sup>1</sup> This is explained by the fact that there had been a large amount of private capital repatriated to the home countries since the day of Burmese independence. Generally, private direct investment has been playing its role on a smaller scale than in the prewar period. However, a new rise in the direct investment service payment deserves our attention. The tendency of net inflow of private capital since 1955 has been responsible for the rise in private service payment.<sup>2</sup>

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<sup>1</sup>It must be taken into consideration that interests on loans other than U.S. loans are included in Item 2 owing to difficulty in segregation.

<sup>2</sup>IMF, Balance of Payments Yearbook, Vol. 2. Burma, Table 3.

Over the period under review private service payment exceeded public service payment except in 1954 and 1955. Thus, the role of private capital in Burma for her economic development was predominant and will be so in the near future unless the government borrows on a large scale from external resources.

Burma had a small service ratio to foreign exchange earnings as the table on the following page shows. Over the period 1950-58, the private service ratio was 2.0 per cent and public service ratio 2.6 per cent, the aggregate ratio being 4.6 per cent. However, the annual service ratio varied from year to year substantially because of irregularity in the service payment while foreign exchange earnings remained stable.

The aggregate ratio of 4.6 per cent for the whole period is low compared to Brazil (16.0 per cent), India (7 per cent), Indonisia (13.7 per cent), and the Philippines (11.6 per cent).<sup>1</sup> This indicates that Burma is in a position where more capital can be employed from external sources for her economic development without substantial difficulty in repaying the capital. The Government of Burma was aware of this fact. In her development plan it was assumed that an increase in the imports of

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<sup>1</sup>See later sections for Brazil, India, Indonesia, and the Philippines

Burma's Foreign Exchange Earnings, National  
Income and Service Ratios, 1950-58

| Year    | Service payments |        | Foreign<br>exchange<br>earnings | National<br>income | Service ratio (%) |      |         |         |
|---------|------------------|--------|---------------------------------|--------------------|-------------------|------|---------|---------|
|         | Private          | Public |                                 |                    | (1)               | (2)  | (1)+(2) | (1)+(2) |
|         |                  |        |                                 |                    | (3)               | (3)  | (3)     | (4)     |
|         | (1)              | (2)    | (3)                             | (4)                |                   |      |         |         |
| 1950    | 15.4             | 4.3    | 664                             | 2,744              | 2.3               | .6   | 2.9     | .2      |
| 1951    | 16.4             | 15.7   | 952                             | 3,199              | 1.7               | 1.6  | 3.3     | 1.0     |
| 1952    | 46.8             | 2.8    | 1,219                           | 3,520              | 3.8               | .2   | 4.0     | 1.4     |
| 1953    | 16.6             | 2.0    | 1,225                           | 4,033              | 1.4               | .2   | 1.6     | .5      |
| 1954    | 13.7             | 170.3  | 1,151                           | 3,917              | 1.2               | 14.8 | 16.0    | 4.7     |
| 1955    | 10.6             | 79.1   | 1,133                           | 4,216              | .9                | 6.9  | 7.8     | 2.2     |
| 1956    | 24.5             | 4.7    | 1,143                           | 4,450              | 2.1               | .4   | 2.5     | .7      |
| 1957    | 22.6             | 3.6    | 1,213                           | 4,497              | 1.8               | .3   | 2.1     | .6      |
| 1958    | 31.6             | 2.9    | 1,028                           | 4,344              | 3.0               | .3   | 3.3     | .8      |
| 1950-58 | 198.2            | 255.4  | 9,678                           | 34,344             | 2.0               | 2.6  | 4.6     | 1.3     |

Source: IMF, Balance of Payments Yearbook; IMF, International Financial Statistics, various issues.

Note: Foreign exchange earnings denote receipts from exports of goods and services plus private donations (net). Items 1 through 4 are in millions of kyats.

development goods could be achieved without much restriction on the importation of consumer goods.<sup>1</sup>

The ratio of service payments to national income, however, was not very low compared to other underdeveloped countries. The ratio over the period was 1.3 per cent, higher than India's .54 per cent, but lower than Indonesia's 1.6 per cent, the Philippines 1.8 per cent and Brazil's 2.2 per cent. If large

<sup>1</sup>Trager, Frank N., Building a Welfare State in Burma, 1948-56. New York: Institute of Pacific Relations, 1958, p. 9.



repayments in 1954 were excluded, the ratio would be around 1 per cent. In the light of Burma's rapid growth in income during the period (58 per cent), paying abroad 1 per cent of national income each year cannot be regarded as a heavy burden.

### Brazil

Brazil's service payments for external obligations over the period 1950-58 are shown in the table on the following page.

On the average for the whole period Brazil paid 147 million dollars from the private account and 108 million dollars from the public account, the aggregate payment being 255 million dollars. Annual private service payment exceeded public service payment generally except in 1955 and 1957. One conspicuous tendency to be observed is a rise in the public service payment since 1954. In 1954 the public payment doubled from the level of the previous year, and even tripled in the following three years. The last year of the period registered an amount nearly four times as much as that of 1953. The trend is explained by the intense inflow of public capital since 1953.<sup>1</sup> From this year interest charges began to be

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<sup>1</sup>Brazil received official loans during the period 1950-58 as follows:

| 1950 | 1951 | 1952 | 1953 | 1954 | 1955 | 1956 | 1957 | 1958 |
|------|------|------|------|------|------|------|------|------|
| 24   | 29   | 32   | 23   | 110  | 122  | 98   | 84   | 285  |

24 29 32 23 110 122 98 84 285 (million dollars)

IMF, Balance of Payments Yearbook.

Brazil's Service Payments for Foreign Capital,  
1950-58 (millions of dollars)

| Year | Private Account                        |            |               |       | Public Account |               |       | Grand total |
|------|----------------------------------------|------------|---------------|-------|----------------|---------------|-------|-------------|
|      | Direct investment net profits remitted | Inter-ests | Amorti-zation | Total | Inter-ests     | Amorti-zation | Total |             |
|      | (1)                                    | (2)        | (3)           | (4)   | (5)            | (6)           | (7)   | (8)         |
| 1950 | 83                                     | 22         | 14            | 119   | 7              | 81            | 88    | 207         |
| 1951 | 137                                    | 14         | 9             | 160   | 8              | 22            | 30    | 190         |
| 1952 | 99                                     | 17         | 6             | 122   | 9              | 29            | 38    | 160         |
| 1953 | 120                                    | 33         | 11            | 164   | 14             | 36            | 50    | 214         |
| 1954 | 79                                     | 42         | 7             | 128   | 23             | 80            | 103   | 231         |
| 1955 | 71                                     | 22         | 9             | 102   | 26             | 115           | 141   | 243         |
| 1956 | 70                                     | 47         | 40            | 157   | 26             | 128           | 154   | 311         |
| 1957 | 52                                     | 58         | 56            | 166   | 24             | 150           | 174   | 340         |
| 1958 | 42                                     | 33         | 127           | 202   | 24             | 169           | 193   | 395         |

Source: IMF, Balance of Payments Yearbook; U.S. Office of Business Economics, Foreign Grants and Credits by the U.S. Government, various issues; IBRD, Annual Report, various issues.

Note: Item 3 includes amortization for loans from the Export-Import Bank. Item 5 includes only interests payment for loans from the United States Government, and loans from the World Bank. Interest charges on loans from other sources are included in Item 2 because of difficulty in segregation. Item 6 includes lend-lease settlements.

doubled, and at the same time the amortization increased faster than interest charges.

On the private account the annual service payment fluctuated between 120-160 million dollars with the exception of 1955 and 1958. The highest record of 1958 was due to a large amount of amortization to the Export-Import Bank. Among components of private service payment, the trend of decline in the direct investment income is easily observed. This is

attributed to the decrease in the inflow of private long-term capital which in turn was induced by a number of factors. The increasing overvaluation of the cruzeiro at the official exchange rate made the inflow of private capital less and less attractive. The conditions for foreign private investment in petroleum exploration and refining remained uninviting. Difficulty in the regular remittance of profits arose because of exchange control.<sup>1</sup>

Brazil's investment service ratio to the foreign exchange earnings over the whole period under review was 9.2 and 6.8 per cent for the private and public accounts respectively, the aggregate ratio being 16 per cent. It indicates that each year about one-sixth of the foreign exchange earnings were directed to the servicing of foreign capital, thus leaving only five-sixths of the earnings for the expenditure on imports along with other capital receipts.

From 1950 to 1955 the service ratio had been around 12 per cent, but the ratio rose to 20 per cent in the following two years. The reasons for this were the increased service payment and the stationary level of foreign exchange receipt. The 28.2 per cent in 1958 was brought about by a rise of service payment and reduced foreign exchange earnings.

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<sup>1</sup>Institute of Inter-American Affairs, Foreign Operations Administration, The Development of Brazil. Washington: U.S. Government Printing Office, 1953, p. 55.

Brazil's Foreign Exchange Earnings, National  
Income and Service Ratios, 1950-58

| Year    | Service payments |        | Foreign<br>exchange<br>earnings | National<br>income | Service ratio (%) |      |         |         |
|---------|------------------|--------|---------------------------------|--------------------|-------------------|------|---------|---------|
|         | Private          | Public |                                 |                    | (1)               | (2)  | (1)+(2) | (1)+(2) |
|         | (1)              | (2)    | (3)                             | (4)                | (3)               | (3)  | (3)     | (4)     |
| 1950    | 11 9             | 88     | 1,404                           | 11,561             | 8.5               | 6.2  | 14.7    | 1.8     |
| 1951    | 160              | 30     | 1,834                           | 13,759             | 8.7               | 1.7  | 10.4    | 1.4     |
| 1952    | 122              | 38     | 1,436                           | 15,903             | 8.2               | 2.6  | 10.8    | 1.0     |
| 1953    | 164              | 50     | 1,659                           | 15,265             | 9.9               | 3.0  | 12.9    | 1.4     |
| 1954    | 128              | 103    | 1,773                           | 14,314             | 7.2               | 5.8  | 13.0    | 1.6     |
| 1955    | 102              | 141    | 1,531                           | 15,437             | 6.7               | 9.2  | 15.9    | 1.6     |
| 1956    | 157              | 154    | 1,652                           | 19,533             | 9.5               | 9.3  | 18.8    | 1.5     |
| 1957    | 166              | 174    | 1,574                           | 23,345             | 9.4               | 12.2 | 21.6    | 1.5     |
| 1958    | 202              | 193    | 1,401                           | 27,755             | 14.3              | 13.9 | 28.2    | 1.4     |
| 1950-58 | 1,320            | 971    | 14,314                          | 156,872            | 9.2               | 6.8  | 16.0    | 1.4     |

Source: IMF, Balance of Payments Yearbook; IMF, International Financial Statistics, various issues.

Note: Items 1 through 4 are in millions of dollars.

This is a good illustration of how a slump in the exports of a primary-goods exporting country will raise the service ratio easily with the resultant reduction of capacity to import.

The service ratio for the private account capital maintained a stable level except for an abnormal rise in 1958. In contrast, the service ratio for the public account capital showed certain fluctuations. The definite rise in the public service ratio from 1955 accounted for the rise in the total service ratio. The public account ratio for the years 1950-53

would have been lower if we exclude the lend-lease settlements.<sup>1</sup>

The service ratio to the national income over the whole period was 1.4 per cent. This ratio had been quite stable for the period. This ratio is higher than India's (.54 per cent) and Burma's (1.3 per cent), but is lower than Indonesia's (1.6 per cent) and the Philippines (1.8 per cent).

### India

During the period under review, India's service payments for external capital averaged 500 million rupees (about 105 million U.S. dollars) excluding the year of 1957 when a high service payment was registered due to repayment of U.S. lend-lease silver loan. Of the total annual service payment about four-fifths was paid for private account capital. This fact explains to us that private capital in India had been predominant over the whole period.

In the private account, investment service income had been a major item throughout the whole period, more than half of the total service payment. The constant trend of

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<sup>1</sup>Avramovic's public service ratios which exclude lend-lease settlement are as follows:

| 1950 | 1951 | 1952 | 1953 | 1954 | 1955  |
|------|------|------|------|------|-------|
| 3.6  | 1.6  | 2.5  | 4.4  | 7.9  | 19.2% |

See Avramovic, D., Debt Servicing Capacity and Postwar Growth in International Indebtedness. Baltimore: The Johns Hopkins Press, 1958, p. 190.

**India's Service Payments for Foreign Capital  
1950-58 (millions of rupees)**

| Year | Private account        |               |       | Public account |               |                        | Grand total |
|------|------------------------|---------------|-------|----------------|---------------|------------------------|-------------|
|      | Inter-ests and profits | Amorti-zation | Total | Inter-ests     | Amorti-zation | Port-folio secur-ities |             |
|      | (1)                    | (2)           | (3)   | (4)            | (5)           | (6)                    | (8)         |
| 1950 | 303                    | 192           | 495   | 4              | 27            | 19                     | 545         |
| 1951 | 296                    | 142           | 438   | 19             | 32            | 15                     | 504         |
| 1952 | 247                    | 174           | 421   | 28             | 34            | 2                      | 485         |
| 1953 | 196                    | 120           | 316   | 39             | 34            | 8                      | 397         |
| 1954 | 227                    | 93            | 320   | 39             | 29            | 6                      | 394         |
| 1955 | 277                    | 184           | 461   | 53             | 32            | 3                      | 549         |
| 1956 | 187                    | 184           | 371   | 46             | 34            | 8                      | 459         |
| 1957 | 264                    | 193           | 457   | 38             | 778           | 7                      | 1,280       |
| 1958 | 289                    | 131           | 420   | 43             | 40            | 4                      | 507         |

Source: IMF, Balance of Payments Yearbook; U.S. Office of Business Economics, Foreign Grants and Credits by the U.S. Government, various issues; Reserve Bank of India, India's Balance of Payments, 1948/49-55/56. Bombay, 1957.

Note: Item 1 includes remittances of profits, interest and dividends accruing to foreigners and remittances of interest charges on loans, except those from the United States and IBRD, obtained by the Indian government. In the 1957 figure of Item 5 is included U.S. lend-lease silver loan 744 million rupees.

repatriation of private capital is another characteristic of the private account. As in many underdeveloped countries which acquired independence after a long period of colonial rule, the repatriation of private capital took place in India, also. The recognition of importance of external capital for the purpose of economic development was still lacking during the period right after India's independence. Despite inflows of private capital, as the net position India had 89 million

rupees of net outflow of private long-term capital annually during the period 1950-55.<sup>1</sup> The repatriation of private capital invested in India before her independence accounted for a great part of private capital outflow.

In the meanwhile, public service payment had been growing slightly over the period. A 60 per cent rise is observed between 1950 and 1958. Among various components of the public service payment, government securities payments were decreasing gradually. A part of amortization was payment for purchases of U.K. railways though the amounts showed a gradual decline, also.<sup>2</sup> The component which had been increasing was interest charges for loans from the U.S. Government and the World Bank. The same trend is believed to prevail in the following years because India's loans from the two sources

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<sup>1</sup>India's private capital account during 1950 to 1955 was as follows (millions of rupees):

|          | 1950 | 1951 | 1952 | 1953 | 1954 | 1955 |
|----------|------|------|------|------|------|------|
| Credits: | 146  | 133  | 110  | 166  | 175  | 119  |
| Debits:  | -263 | -239 | -258 | -225 | -172 | -256 |
| Balance: | -117 | -106 | -148 | -58  | 3    | -137 |

Source: Reserve Bank of India, India's Balance of Payments, 1948/49-1955/56, Table 3, pp. 41-53.

<sup>2</sup>Payments for U.K. railways were: 23 (1950); 24 (1951); 16 (1952); 17 (1953); 12 (1954 and 1955 each); 13 (1956); 6 (1957) million rupees. IMF, Balance of Payments Yearbook.

have been expanding in recent years.<sup>1</sup>

Ratios of service payment to foreign exchange earnings, and national income for the period 1950-58 is shown in the table on the following page. For the whole period the service ratio to foreign exchange earnings was 5.2 and 1.9 per cent for the private account and the public account respectively. The total ratio amounted to 7.1 per cent. If we ignore the high ratio in 1957, the ratio would be 6.2 per cent. Thus, India's service ratio was relatively low if compared to Brazil, Indonesia, and the Philippines.

The low service ratio of public capital account is explained by the small inflow of capital during the period. Although the inflow of public capital has become active since the launching of the Second Five Year Plan, the servicing of such capital will not begin until the 1960's. Yet it is expected that the public service ratio will be boosted in the near future.

The ratio of service payment to India's national income was only .54 per cent for the whole period. The annual ratio

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<sup>1</sup> India's indebtedness to the U.S. Government was 332 million dollars as of June 30, 1959, whereas in 1950 (December 31) it was 172 million dollars. Indebtedness to IBRD was 444 million on June 30, 1959, while 32.8 million in 1950.

Source: U.S. Office of Business Economics, Foreign Grants and Credits by the U.S. Government, various issues; IBRD, Annual Report, various issues.



India's Foreign Exchange Earnings, National  
Income and Service Ratios, 1950-58

| Year    | Service payments |        | Foreign<br>exchange<br>earnings | National<br>income | Service ratio (%) |            |                |                |
|---------|------------------|--------|---------------------------------|--------------------|-------------------|------------|----------------|----------------|
|         | Private          | Public |                                 |                    | (1)<br>(3)        | (2)<br>(3) | (1)+(2)<br>(3) | (1)+(2)<br>(4) |
|         | (1)              | (2)    | (3)                             | (4)                |                   |            |                |                |
| 1950    | 495              | 50     | 7,702                           | 95,300             | 6.4               | .7         | 7.1            | .57            |
| 1951    | 438              | 66     | 8,917                           | 99,700             | 4.9               | .7         | 5.6            | .50            |
| 1952    | 421              | 64     | 8,063                           | 89,200             | 5.2               | .8         | 6.0            | .49            |
| 1953    | 316              | 81     | 6,852                           | 104,900            | 4.6               | 1.2        | 5.8            | .38            |
| 1954    | 320              | 74     | 6,897                           | 96,100             | 4.6               | 1.1        | 5.7            | .41            |
| 1955    | 461              | 88     | 8,241                           | 99,800             | 5.6               | 1.1        | 6.7            | .55            |
| 1956    | 371              | 88     | 8,192                           | 113,100            | 4.5               | 1.1        | 5.6            | .41            |
| 1957    | 457              | 823    | 8,929                           | 114,000            | 5.1               | 9.2        | 14.3           | 1.12           |
| 1958    | 420              | 87     | 7,109                           | 124,700            | 5.3               | 1.2        | 6.5            | .41            |
| 1950-58 | 3,699            | 1,416  | 70,902                          | 945,800            | 5.2               | 1.9        | 7.1            | .54            |

Source: IMF, Balance of Payments Yearbook.

Note: Items 1 through 4 are in millions of rupees.

ranged from .38 (1953) to .57 (1950), excluding the exceptionally high ratio in 1957. The low ratio indicates that India paid out only a small portion of her national income for the servicing of foreign capital, and left a greater proportion of income for the use of domestic consumption and investment.

India's service ratio for the period 1950-58 was lower than the ratios prevailing in the 1930's. As the following table shows, ratios for the 1930's were mostly between 10-20 per cent, about twice as high as those in 1950-58.

However, we must be careful that Finch's ratio uses only investment income payment as the numerator of the ratio,

## India's Service Ratio, by Years, 1929-39

|         | Current receipts     | Investment income payments | Investment income payment as per cent of current receipts |
|---------|----------------------|----------------------------|-----------------------------------------------------------|
|         | (millions of rupees) |                            |                                                           |
| 1929-30 | 3,615.6              | 359.0                      | 9.9                                                       |
| 1930-31 | 2,599.1              | 359.0                      | 13.8                                                      |
| 1931-32 | 1,889.3              | 360.1                      | 19.1                                                      |
| 1932-33 | 1,605.2              | 353.0                      | 22.0                                                      |
| 1933-34 | 1,823.4              | 345.0                      | 18.0                                                      |
| 1934-35 | 1,883.6              | 341.0                      | 18.1                                                      |
| 1935-36 | 1,904.1              | 336.0                      | 17.0                                                      |
| 1936-37 | 2,303.1              | 330.0                      | 14.3                                                      |
| 1937-38 | 2,189.8              | 310.0                      | 14.2                                                      |
| 1938-39 | 2,007.0              | 280.0                      | 13.9                                                      |

Source: Finch, David, "Investment Service of Underdeveloped Countries," IMF, Staff Papers, Vol. II, No. 1, p. 83.

amortization payments being excluded because of adequate comparable statistics not available.<sup>1</sup>

Thus, if Finch's ratio included the amortization payments the ratio would be higher than it is. The decline in the ratio in the postwar period obviously was from the net outflow of private capital in the form of repatriation to the home country (particularly Britain), and also from the absence of public capital inflow in a large scale until the initiation of the Second Five Year Plan.

Indonesia

Indonesia, as India and the Philippines, paid service payments for the direct investment more than for public debts.

<sup>1</sup>Finch, David, op. cit., p. 61.

On the average direct investment service payments shared more than two-thirds of the total service payment (see table on the following page). Portfolio investment played an insignificant part in foreign investment of Indonesia.

Over the period 1950-1958 the total service payment amounted to \$1,073 million, annually \$119 million. This sum is approximately equivalent to India's annual service payments which prevailed during the same period. In view of India's larger national income (about 3 to 1), Indonesia bore a heavier burden than India.

Of the large private investment income payment, the oil industry shared about three-fourths. Apart from remittance of investment profits, oil industry workers remitted their earnings of a significant amount which are not included in the figures in the table below. During 1951-57 the total worker earnings remitted abroad amounted to \$288 million, worth about 68 per cent of the oil industry profits remitted abroad.<sup>1</sup> If we include this sum in the total private service payment, it would increase by about 40 per cent. Then the total service payment per annum would be \$155 million, more than India had been paying for the corresponding period.

Public debt service payment during the period under review rose moderately from 1950 to the peak of \$38 million

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<sup>1</sup>IMF, Balance of Payments Yearbook. These remittances are included under the heading of "miscellaneous" in the current account.

**Indonesia's Service Payments for Foreign Capital  
1950-58 (millions of dollars)**

| Year | Private account                         |        |                   | Total | Public account |                   |       | Grand total |
|------|-----------------------------------------|--------|-------------------|-------|----------------|-------------------|-------|-------------|
|      | Interests and profits oil in-<br>dustry | Others | Amorti-<br>zation |       | Inter-<br>ests | Amorti-<br>zation | Total |             |
|      | (1)                                     | (2)    | (3)               | (4)   | (5)            | (6)               | (7)   | (8)         |
| 1950 | 81                                      | 16     | 3                 | 100   | 8              | 9                 | 17    | 117         |
| 1951 | 107                                     | 36     | 5                 | 148   | 8              | 13                | 21    | 169         |
| 1952 | 58                                      | 30     | 6                 | 94    | 10             | 15                | 25    | 119         |
| 1953 | n.a.                                    | 45     | -                 | 45    | 12             | 21                | 33    | 78          |
| 1954 | -----94                                 | ---    | 4                 | 98    | 12             | 26                | 38    | 136         |
| 1955 | 76                                      | 29     | 3                 | 108   | 12             | 22                | 34    | 142         |
| 1956 | 45                                      | 15     | 2                 | 62    | 11             | 17                | 28    | 90          |
| 1957 | 75                                      | 12     | 1                 | 88    | 7              | 24                | 31    | 119         |
| 1958 | 67                                      | 3      | 1                 | 71    | 7              | 25                | 32    | 103         |

Source: IMF, Balance of Payments Yearbook. Public debt interest is estimated from the public debt outstanding which is given in Higgins, B., Indonesia's Economic Stabilization and Development. New York: Institute of Pacific Relations, 1957, p. 154.

in 1954, and then declined gradually. This trend is a good reflection of the changes in Indonesia's public debts.<sup>1</sup>

Indonesia's service ratios for the whole period 1950-58 were 10.4 and 3.3 per cent for the private and public account respectively, the aggregate ratio totalling to 13.7 per cent. Both annual private and public service ratios stayed at a

<sup>1</sup>Indonesia's public external debts for 1950-57 were:

| 1950  | 1951  | 1952  | 1953  | 1954  | 1955  | 1956  | 1957  |
|-------|-------|-------|-------|-------|-------|-------|-------|
| 3,882 | 3,792 | 4,463 | 5,330 | 5,237 | 5,027 | 2,979 | 2,778 |

(million rupiahs)

Source: Higgins, B., Indonesia's Economic Stabilization and Development, p. 154.

Indonesia's Foreign Exchange Earnings, National  
Income and Service Ratios, 1950-58

| Year        | Service payments |        | Foreign<br>exchange<br>earnings | National<br>income | Service ratio (%) |            |                |                |
|-------------|------------------|--------|---------------------------------|--------------------|-------------------|------------|----------------|----------------|
|             | Private          | Public |                                 |                    | (1)<br>(3)        | (2)<br>(3) | (1)+(2)<br>(3) | (1)+(2)<br>(4) |
|             | (1)              | (2)    | (3)                             | (4)                |                   |            |                |                |
| 1950        | 100              | 17     | 831                             | n.a.               | 12.0              | 2.1        | 14.1           | ..             |
| 1951        | 148              | 21     | 1,326                           | 9,026              | 11.2              | 1.6        | 12.8           | 1.8            |
| 1952        | 94               | 25     | 956                             | 6,912              | 9.8               | 2.6        | 12.4           | 1.7            |
| 1953        | 45               | 33     | 713                             | 7,789              | 6.3               | 4.6        | 10.9           | 1.0            |
| 1954        | 98               | 38     | 814                             | 8,070              | 12.0              | 4.7        | 16.7           | 1.6            |
| 1955        | 108              | 34     | 881                             | 8,810              | 12.3              | 3.9        | 16.2           | 1.6            |
| 1956        | 62               | 28     | 845                             | n.a.               | 7.3               | 3.3        | 10.6           | ..             |
| 1957        | 88               | 31     | 844                             | n.a.               | 10.4              | 3.7        | 14.1           | ..             |
| 1958        | 71               | 32     | 647                             | n.a.               | 10.9              | 4.9        | 15.8           | ..             |
| 1950-<br>58 | 814              | 259    | 7,857                           |                    | 10.4              | 3.3        | 13.7           |                |

Source: IMF, Balance of Payments Yearbook.

Note: Items 1 through 4 are in millions of U.S. dollars.

rather stable level with certain fluctuations. Yet, precisely speaking, private service ratio registered a slight decline due to a similar trend in private investment.<sup>1</sup> In contrast, public service ratio during 1953-58 was higher than in 1950-52, indicating the increased role of public capital.

Indonesia's service ratio to national income was about 1.6 per cent for the whole period. The ratio was 1.8 per cent in 1951, which declined to 1.7 in 1952, and further to 1.6 per cent in 1954 and 1955. The 1.0 per cent in 1953 was caused

<sup>1</sup>Indonesia's direct investments were largely of Netherland ownership and have been either repatriated or nationalized by the Indonesian Government.

by the non-availability of data about the profit remitted for the oil industry, so that it should be excluded from the discussion here. As national income data is not available for 1956 to 1958, we cannot know how the ratio changed for the last three years.

Indonesia's investment service ratio (excluding amortization payments) in the 1930's registered a higher record than in the postwar period as in the case of India. (See the table below.) The highest record, which amounted to 30.7 per cent, was reached in 1938. If amortization payments were included in the numerator of the ratio, the ratio would be higher, possibly surpassing 40 per cent.

Indonesia's Investment Service Ratio, 1930-39

| Year | Current receipts                  | Investment income payments | Investment income payment as per cent of current receipts |
|------|-----------------------------------|----------------------------|-----------------------------------------------------------|
|      | (millions of Indonesian guilders) |                            |                                                           |
| 1930 | 1,220                             | 270                        | 22.1                                                      |
| 1931 | 796                               | 153                        | 19.2                                                      |
| 1932 | 562                               | 120                        | 21.4                                                      |
| 1933 | 486                               | 110                        | 22.6                                                      |
| 1934 | 521                               | 110                        | 21.1                                                      |
| 1935 | 500                               | 108                        | 21.6                                                      |
| 1936 | 627                               | 125                        | 19.9                                                      |
| 1937 | 1,025                             | 157                        | 15.3                                                      |
| 1938 | 717                               | 220                        | 30.7                                                      |
| 1939 | 808                               | 179                        | 22.2                                                      |

Source: Finch, David, "Investment Service of Underdeveloped Countries," IMF, Staff Papers, Vol. II, No. 1, p. 83.

### The Philippines

The service payments made by the Philippines for external debts during the period 1950-58 are shown in the table on the following page.

As the table shows, Philippine annual service payment was about 70 million pesos during 1950-52, but it rose to twice as much for the following years except in 1957 when a large amount of amortization was committed. Of the total service payments, more than 80 per cent were directed to the servicing of private direct investment annually. Direct investment service doubled its amount from 1953 (though partly because of change in the coverage of item), reflecting an increase in the inflow of private direct investment.<sup>1</sup> The main investor is the United States which has invested heavily in sugar, coconut, and abaca plantations, mining and lumber operations, and public utility enterprises.

On the private account, direct investment profits were the main and largest component which shared 90-100 per cent of the private service payment. Interest payments were small during 1950-52, and reduced almost to a trivial amount during the following three years, but have risen considerably since

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<sup>1</sup>United States direct investment in the Philippines, for instance, was 95 million dollars in 1943 (value outstanding). It increased to \$149 million in 1950, and \$266 million in 1956. Source: U.S. Balance of Payments Statistical Supplement, 1958, p. 152.

Service Payments of The Philippines, 1950-58  
(millions of pesos)

| Year | Private account                   |                   |                      |              | Public account    |                      |              | Grand total |
|------|-----------------------------------|-------------------|----------------------|--------------|-------------------|----------------------|--------------|-------------|
|      | Direct invest-ment profits<br>(1) | Inter-ests<br>(2) | Amorti-zation<br>(3) | Total<br>(4) | Inter-ests<br>(5) | Amorti-zation<br>(6) | Total<br>(7) |             |
| 1950 | 52                                | 4                 | -                    | 56           | 4                 | -                    | 4            | 60          |
| 1951 | 62                                | 2                 | -                    | 64           | 4                 | 7                    | 11           | 75          |
| 1952 | 55                                | 1                 | -                    | 56           | 3                 | 19                   | 22           | 78          |
| 1953 | 116                               | -                 | -                    | 116          | 4                 | 19                   | 23           | 139         |
| 1954 | 116                               | -                 | -                    | 116          | 4                 | 46                   | 50           | 166         |
| 1955 | 135                               | -                 | -                    | 135          | 3                 | 12                   | 15           | 150         |
| 1956 | 133                               | 8                 | -                    | 141          | 3                 | 14                   | 17           | 158         |
| 1957 | 127                               | 14                | -                    | 141          | 3                 | 75                   | 78           | 219         |
| 1958 | 105                               | 9                 | 1                    | 141          | 3                 | 22                   | 25           | 139         |

Source: IMF, Balance of Payments Yearbook; U.S. Office of Business Economics, Foreign Grants and Credits by the U.S. Government, various issues.

Note: Item 1 includes reinvested earnings on U.S. direct investment for 1950-52 and estimates of all reinvested earnings of foreigners for 1953-57.

1956. Amortization payment registered only 1 million pesos in 1958. From the change in the components of private service payment it is concluded easily that a part of private capital started to inflow since the middle of the period in the form of loans rather than as direct investments.

On the public account, service payment increased slightly during the period. The payment generally maintained a stable level except in 1954 and 1957 when large amortization payments were made. The increased sum of principal repayment in 1954 was due to the repurchase of Manila railroad bonds



by the Rehabilitation Finance Corporation. Another large repayment in 1957 was the repayment of loans from the Philippines' banks to U.S. banks. On the whole, public service payments shared a small percentage in the total service payments. This may be explained by the fact that Philippines received the bulk of public external assistance in the form of grants (e.g., U.S. Government expenditures) rather than as loans.<sup>1</sup>

The total annual service payment of 150 million pesos (U.S. \$75 million) is approximately three-fourths of what India was paying during the same period. Comparing the resources of the two countries, the burden of service payments of the Philippines was substantially higher than India's. This is shown in the difference in service ratios.

The Philippines service ratio to the foreign exchange earnings for the whole period under review was 11.6 per cent, of which 9.2 per cent and 2.4 per cent were for private

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<sup>1</sup>Philippino external capital receipts on the public account during 1950-58 were (millions of pesos):

|                                  | 1950 | 1951 | 1952 | 1953 | 1954 | 1955 | 1956 | 1957 | 1958* |
|----------------------------------|------|------|------|------|------|------|------|------|-------|
| U.S. Government expenditures     | 210  | 210  | 262  | 278  | 244  | 253  | 227  | 217  | 86    |
| ECA/MSA/FOA/ICA grants           | -    | 6    | 14   | 38   | 36   | 40   | 64   | 50   | 23    |
| ICA loans                        | -    | -    | -    | -    | -    | -    | -    | 18   | 19    |
| IBRD loan                        | -    | -    | -    | -    | -    | -    | -    | -    | 8     |
| Export-Import Bank loan received | -    | -    | -    | 15   | 12   | 12   | 5    | 1    | 6     |

Source: IMF, Balance of Payments Yearbook.

\*Note: 1958 figures are for the first and second quarters.

The Philippine's Foreign Exchange Earnings, National  
Income, and Service Ratios, 1950-58

| Year    | <u>Service payments</u> |        | Foreign<br>exchange<br>earnings | National<br>income | <u>Service ratio (%)</u> |     |         |         |
|---------|-------------------------|--------|---------------------------------|--------------------|--------------------------|-----|---------|---------|
|         | Private                 | Public |                                 |                    | (1)                      | (2) | (1)+(2) | (1)+(2) |
|         |                         |        |                                 |                    | (3)                      | (3) | (3)     | (4)     |
|         | (1)                     | (2)    | (3)                             | (4)                |                          |     |         |         |
| 1950    | 56                      | 4      | 975                             | 5,922              | 5.5                      | .4  | 5.9     | 1.0     |
| 1951    | 64                      | 11     | 1,175                           | 6,487              | 5.4                      | .9  | 6.3     | 1.2     |
| 1952    | 56                      | 22     | 1,075                           | 6,554              | 5.2                      | 2.0 | 7.2     | 1.2     |
| 1953    | 116                     | 23     | 1,194                           | 7,015              | 9.7                      | 1.9 | 11.6    | 2.0     |
| 1954    | 116                     | 50     | 1,170                           | 7,145              | 9.9                      | 4.2 | 14.1    | 2.3     |
| 1955    | 135                     | 15     | 1,151                           | 7,624              | 11.7                     | 1.3 | 13.0    | 2.0     |
| 1956    | 141                     | 17     | 1,145                           | 8,414              | 12.3                     | 1.5 | 13.8    | 1.9     |
| 1957    | 141                     | 78     | 1,119                           | 8,818              | 12.6                     | 6.9 | 19.5    | 2.5     |
| 1958    | 114                     | 25     | 1,225                           | 9,232              | 9.3                      | 2.0 | 11.3    | 1.5     |
| 1950-58 | 939                     | 245    | 10,229                          | 67,211             | 9.2                      | 2.4 | 11.6    | 1.8     |

Source: IMF, Balance of Payments Yearbook; IMF, International Financial Statistics.

Note: Items 1 through 4 are in millions of pesos.

account and public account respectively. The ratio was about twice as high as India's service ratio, revealing a fact that, in the Philippines, out of foreign exchange earnings twice as much as India's ratio had to be paid for the servicing of external debt.

A trend of the rise in the annual service ratio for private capital is readily observed. From the 5 per cent level during 1950-52, the ratio doubled for the rest of the period. The high ratios during 1955-57 were partly owing to the decline in foreign exchange earnings.

Ratios of public service payments would average 2 per cent, if the low ratios in 1950 and 1951 and the exceptionally high ratios in 1954 and 1957 were excluded. The fluctuations in the ratio seem to come from the changes in current receipts rather than from changes in public service payments.

The ratio of service payment to national income was 1.8 per cent for the entire period. The ratio was low for the first three years because of low service payments. The average ratio for the rest of the period was about 2 per cent, which was the highest among the underdeveloped countries selected in this chapter.

## CHAPTER V

### DEVELOPMENT PROGRAMMING AND FOREIGN CAPITAL SERVICING

#### Projection of Foreign Capital and Its Servicing

The fundamental role of programming in economic development is to lay down a comprehensive picture of the development path by a systematic description of various factors relevant to the development and the policies thereof suggested. The purpose of programming consists in the establishment of a scheme provided for various sectors as a guiding framework within which efforts of development will be gathered as an enormous momentum to break through the vicious circle of economic backwardness.

By and large, there are three steps in the process of programming: aggregate projection, sectoral projection, and elaboration of aggregate projections. In the following the three steps will be stated briefly.

In the aggregate projection, first of all, the probable targets of economic growth are established after a careful diagnosis of the national economy with respect to past trends and probable future trends. Then the amount of investment necessary to implement targets will be calculated, and through a comparison of the volume of this investment with that of

domestic saving, the foreign capital inflow is estimated. Similarly, the growth of the capacity to import has been postulated, and by a comparison of this latter with the probable demand for imports, the amount of substitution required to carry out the programme will be established. During this process, assumptions are made for a number of factors. The growth rate of the population is assumed to be stable at the rate most probable from past trends. Incremental capital-output ratio, marginal propensity to import, and marginal propensity to save will be assumed to be stable, also, or change under a certain hypothesis.

The second step, sectoral projection, aims at the ascertainment of the rate and type of development to be pursued by each sector of the economy, and tries to determine what investments and other measures will be required in order to attain the objectives set for the individual activities. The basic element in calculating sectorial projections is an estimate of the community's demand for goods and services. Demands for goods and services of final consumption, for intermediate products, and for capital goods are calculated one group after another. The next step is a study of the manner in which that demand will be satisfied; that is, the study of supply. The procedure is usually to study the possibilities of import replacement in a particular sector of consumption so as to reduce imports in that sector to a minimum, and

then to make a similar study in regard to intermediate goods. The predicted foreign exchange resources will be distributed only to those goods not produced within the country. The supply of capital goods is ordinarily associated with a great need for imports, which will be financed by the predicted foreign exchange resources not covered by the first two groups.

The last step of programming is to compare the result of sectoral projections with the aggregate projection for the purpose of elaboration of the programme. Thus, consistency between resources and uses is assured in this last step.

The problem of foreign debt servicing constitutes an important phase in the development programme if it is to be settled smoothly. Most development programmes take this into account with varying emphasis. Countries which rely upon a large amount of foreign capital, and whose export industries are weak, or whose foreign exchange reserves are meager are required to pay special attention to this problem. Nevertheless, in a few development programmes due consideration of this problem is lacking. It may be because of a simple impression that service payment shares only a small proportion of foreign exchange expenditure or that it can be financed easily by a new flow of capital. Sometimes, excessive enthusiasm for high development targets shifts the attention of planners from the problem of foreign debt servicing.

In the development programmes, the amount of service payment can be derived readily from the related data. As stated

earlier in the aggregate projection, foreign capital requirement is calculated by subtracting domestic saving from the investment required for the target rate of growth. The difference between import requirement and what can be financed by the foreign exchange receipt will be the demand for foreign capital. Then the service payment due can be calculated by applying the probable rate of return for the service from experience in past years. In this way service payment for each year of the plan period is estimated. This constitutes a demand for foreign exchange as imports of consumer goods or capital goods.

Following the estimate of demand for foreign exchange resources by foreign debt servicing, the problem of how the demand will be satisfied comes next. If the service payment can be paid out of the predicated foreign exchange each year, after taking into consideration the possibility of export expansion and import substitution, the transfer problem of the service payment may well be regarded as easily solved. However, if the service payment gives rise to an excess demand over the limited supply of foreign exchange, the development plan is requested to revise the original plan by accelerating the growth of the export sector, or intensifying the efforts of import substitution in the field of consumer or capital goods production, or resorting to new foreign capital. Thus, the development plan is required to

maintain consistency between the uses and earnings of foreign exchange so that inconsistencies in this field will not retard the implementation of the whole plan.

To put the relations mentioned in the above into a few formulas, we shall get the following:

1. Capacity for external payments = Exports of goods and services (quantum of exports x terms of trade) + inflow of capital and donations.
2. Capacity to import = Capacity for payments - outflow of capital and donations - remittances of interests and profits.
3. Import substitution = demand for imports - capacity to import.

Hence, if the service payment (remittance of interests and profits plus amortization) is held constant, a decline in capacity for external payments will necessarily bring about a decline in the capacity to import. In that case, if the demand for imports remains constant, import substitution must be increased. If the service payment tends to increase, either the capacity for external payment must increase--mainly through the expansion of exports--or imports must be curtailed through import restriction or import substitution.

In formula 3, it is assumed that capacity to import is identical with the actual imports. Provided that the actual imports deviate from the capacity to import, the amount required for the import substitution will be changed. Also, if the actual imports exceed the capacity to import, disequilibrium will be brought to the balance of payments by



creating a deficit which must be financed through new foreign credit or a drain of foreign exchange reserves. In case the actual imports are less than the capacity to import, the surplus will be added to the foreign exchange reserves.

Although consistancy is an important principle in formulating a development plan, feasibility of the plan is far more important. If a plan which meets the requirement of consistancy is difficult to carry out in the actual world because of miscalculation in the available resources of the country and those from external sources, the difficulty still cannot be avoided. In estimating foreign exchange resources a certain degree of flexibility is necessary. Particularly for the primary goods-exporting country, the estimation of export proceeds implies a certain degree of uncertainty. Suppose the foreign exchange receipt has a high possibility of fluctuation, say, up to twenty per cent, the transfer of the service payment is subject to difficulty at any time if the export market becomes unfavorable.

The existence of sufficient foreign exchange reserves plays an important role in this respect. Countries with sufficient reserves must manage to maintain their reserves. To finance the development goods imports by a considerable amount of foreign exchange reserves and, thus, reduce the reserves to a minimum point is an unwise action. The more export proceeds fluctuate, the more must foreign exchange

reserves be preserved for use in an emergency. Therefore, sufficient attention must be paid to foreign exchange reserves in the formulation of the development plan. Through the wise use of foreign exchange reserves, the servicing of foreign debt will be settled smoothly.

In the following sections we shall look into two representative development plans which have been formulated and put into practice. The main point of discussion will be centered on the transfer aspect of foreign debt servicing. More specifically, the questions we shall ask are: (a) To what extent does the development plan appear to take account of the problem of future debt service? (b) To what extent do the investment plans consider the export sector? (c) To what extent do they allow for debt service in any projections of the balance of payments?

### India's Second Five Year Plan

India is one of the underdeveloped countries which endeavors fervently to raise her per capita income through development programming. Following the successful First Five Year Plan, the Second Plan was launched in April, 1956, which places emphasis on the development of heavy industries in contrast to the First Plan's emphasis on agricultural production. The Second Plan is important in the course of India's long range economic plans on the grounds that the problem of financing began to meet difficulties during the first year of

the Plan. The heavy import content of the Plan has induced great difficulty in the balance of payments and a severe drain of foreign exchange reserves as well.

The total capital outlay for the public sector in the Second Plan was estimated to be 48 billion rupees, more than double the actual outlay of 19.6 billion rupees in the First Plan (April 1951 to March 1956). One of the apparent characteristics of the Second Plan from the First Plan is an increase in the need of external resources for financing the Plan. As the table below shows, in the First Plan only 9.5 per cent of the total outlay was financed by external resources, whereas 16.7 per cent was estimated in the Second Plan, which would probably turn out to be 24.3 per cent, judging from the first two years' record due to a possible decline in the total outlay and an increase in external assistance.<sup>1</sup>

The Ratio of External Assistance to the Total Public Outlay

|                         | Total public outlay  | External assistance | Latter as percentage of former |
|-------------------------|----------------------|---------------------|--------------------------------|
| The First Plan (actual) | 19,600               | 1,880               | 9.5%                           |
| (planned)               | 48,000               | 8,000               | 16.7%                          |
| The Second Plan         | (revised) 42,600     | 10,380              | 24.3%                          |
|                         | (millions of rupees) |                     |                                |

<sup>1</sup>India Planning Commission, Appraisal and Prospects of the Second Five Year Plan. New Delhi, May, 1958, p. 17.

The rapid increase in external assistance (loans and grants) started from 1956. IBRD loans and U.S. loans have been the main source of new capital. As a result official

Official Loans and Grants Received by India  
(millions of rupees)

|                        | 1950 | 1951 | 1952 | 1953 | 1954 | 1955 | 1956 | 1957 | 1958 |
|------------------------|------|------|------|------|------|------|------|------|------|
| IBRD loans             | 95   | 48   | 27   | 17   | 9    | 20   | 140  | 497  | 732  |
| FOA/ICA loans          | -    | -    | -    | -    | -    | 11   | 237  | 1295 | 902  |
| Other U.S. food loans  | -    | 380  | 526  | -    | -    | -    | -    | -    | -    |
| U.K. loan              | -    | -    | -    | -    | -    | -    | -    | -    | 224  |
| U.S.S.R. loans         | -    | -    | -    | -    | -    | -    | 11   | 113  | 377  |
| West Germany loan      | -    | -    | -    | -    | -    | -    | -    | 6    | 342  |
| Canadian Gov't. loan   | -    | -    | -    | -    | -    | -    | -    | -    | 155  |
| ECA/MSA/Foa/ICA grants | 21   | -    | 39   | 162  | 118  | 445  | 373  | 253  | 146  |
| Colombo plan grants    | -    | 14   | 76   | 17   | 28   | 73   | 68   | 91   | 185  |
| Other grants           | -    | -    | -    | -    | -    | -    | 2    | 1    | 1    |
| Total                  | 116  | 442  | 668  | 196  | 155  | 549  | 831  | 2256 | 3064 |

Source: IMF, Balance of Payments Yearbook.

external liabilities expanded rapidly in the following years, while private external liabilities remained at a rather stable level. By the revised estimate at the end of the second year of the Plan the total external assistance was figured at 10,380 million rupees.<sup>1</sup> Assuming two-thirds of this amount will be in the form of loans, at least 6000 million rupees will be added to the original external debt. In March, 1958, the total external debt was about Rs. 6 billion.

<sup>1</sup> External assistances are 380 million rupees for 1956-57, 1,000 for 1957-58, 3,000 million each for 1958-59, 1959-60, and 1960-61. The total amounts to Rs. 10,380 million.

If Rs. 2 billion will be added to the total debt each year for the fiscal years 1958-59, 1959-60, and 1960-61, at the end of 1959, 1960, and 1961 the total official external

India's External Liabilities  
(millions of rupees)

|                          | 1955         | 1956         | 1957         | 1958         | 1959         | 1960          | 1961          |
|--------------------------|--------------|--------------|--------------|--------------|--------------|---------------|---------------|
|                          |              |              |              |              | (estimated)  |               |               |
| Private<br>(non-banking) | 4,700        | 5,070        | 5,560        | 5,900        | 6,100        | 6,300         | 6,500         |
| Banking                  | 570          | 610          | 480          | 520          | 540          | 560           | 580           |
| Official                 | <u>2,010</u> | <u>2,250</u> | <u>4,510</u> | <u>6,520</u> | <u>8,000</u> | <u>10,000</u> | <u>12,000</u> |
| Total                    | 7,280        | 7,930        | 10,550       | 12,940       | 14,640       | 16,860        | 19,080        |

Source: Reserve Bank of India, Bulletin, June, 1959, p. 666.

obligation will be 8, 10, and 12 billion rupees respectively. The aggregate liabilities, private and public, will amount to 19 billion rupees, assuming private liabilities will increase only slightly during the period.

The rise in the official external debt implies a rise in the service payment. Suppose that the interest charges are 5 per cent for public debt and banking debts and 8 per cent for private liabilities (most of them are direct investment), then the service payments for the period during 1956 to 1962 will be estimated as shown in the table on the following page.

The actual service payments were 464 million rupees for 1956, and 1,282 million for 1957. If we exclude the 744

India's Service Payment, Estimation, 1956-62  
(millions of rupees)

|          | 1956       | 1957       | 1958       | 1959       | 1960       | 1961       | 1962       |
|----------|------------|------------|------------|------------|------------|------------|------------|
| Private  | 376        | 406        | 445        | 472        | 488        | 504        | 520        |
| Banking  | 28         | 30         | 24         | 26         | 27         | 28         | 29         |
| Official | <u>100</u> | <u>113</u> | <u>225</u> | <u>326</u> | <u>400</u> | <u>500</u> | <u>600</u> |
| Total    | 504        | 549        | 694        | 824        | 915        | 1032       | 1149       |

million rupees repayment of U.S. lend-lease silver loan from the 1957 service payment, the estimation in the above table would generally hold good.

Therefore, from the tendency of capital flow into India during the Second Plan period, we may predict that the total service payment for the year 1961--the fifth year of the Second Plan--will be doubled from the level of 1956. Of which, service payment for public debt will increase four times as much as 1956's amount, thus accounting for the largest part of the increase in total service payment. In comparison to the current account receipt of 8,929 million rupees in 1957, the service payment of 1956 and that of 1961 share 6.1 per cent and 12.8 per cent respectively. Though the service ratio doubles in 1961, the service ratio of 12.8 per cent is not substantially high when compared with the situation in other countries.<sup>1</sup>

<sup>1</sup>Many countries have investment service ratio below 10 per cent, some between 10 to 20 per cent, and a few over 20 per cent. See Avramovic, D., Debt Servicing Capacity and Postwar Growth in International Indebtedness. Baltimore: The Johns Hopkins Press, 1958, pp. 98-99, Table XVI.

On the problem of foreign debt to be incurred in the Second Five Year Plan and its servicing, the Planning Commission was rather optimistic though they expected a certain extent of strain on India's balance of payments. The statement read:<sup>1</sup>

To sum up, on current account, the total deficit over the five years is likely to amount to Rs. 1100 crores. On capital account, amortization payments on the U.S. wheat loan and I.B.R.D. loans contracted in the past would be more than offset by the receipts from the U.K. Government on account of sterling pensions. Some of the new loans and credits obtained during the second plan period will also entail some repayments, but these can be allowed for by reckoning these credits on a net rather than a gross basis. On balance, capital commitments on government account are not expected to have any significant effect on the payments position. On private capital account, allowance has to be made for repatriation of capital invested in the country. Here again, while there would be some repatriation of capital, new private capital will flow in and the overall impact on balance of payments may be reckoned on a net basis.

In the above statement we get these points: First, the servicing of the loans contracted in the past can be covered easily by the receipts from the U.K. Government sterling pensions. Second, the servicing of new loans and credits and repatriation of private capital matter only on a net basis. Third, on balance, the public debt account will not make a heavy strain on the payments position. From these points our impression is such that the problem of the servicing of foreign debt will not be very serious, at least in the Second

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<sup>1</sup> Government of India Planning Commission, Second Five Year Plan, New Dehli, 1956, p. 102.

Plan period. Even though there would be an additional demand for foreign exchange resources for the purpose of debt servicing, the new inflow of foreign capital would more than offset the service payment and, thus, no significant effect will take place on the payments position.

This optimistic view was soon broken as India's balance of payments has fallen into serious current account deficits since 1956. The inflow of new capital was slow, contrary to expectation. As a result nearly 2 billion rupees of foreign exchange reserves were lost. In 1957 the deficit was greater (4,906 million compared to 1956's 3,217 million rupees) and another 2.6 billion of reserves were drained. The deficits and drain of foreign exchange reserves were induced by a sharp increase in imports of development goods which were not financed by a substantial amount of foreign capital and rapid expansion in exports.

In the Second Plan the estimation of balance of payments was made as shown in the table on page 104.

Over the five years, exports will rise moderately from an estimated level of Rs. 5,730 million in 1956-57 to Rs. 6,150 million in 1960-61, an increase of 7.8 per cent for the whole period. The annual rate of the growth of exports, thus, is only 1.5 per cent. The above figures are estimated under two assumptions: (a) Terms of trade in the next five years will remain, on the average, the same as they have been in



India's Balance of Payments on Current Account  
(1956-57 to 1960-61)

| Item                                                  | (Rs. crores) |             |             |             |             | Aver-<br>age | Total |
|-------------------------------------------------------|--------------|-------------|-------------|-------------|-------------|--------------|-------|
|                                                       | 1956-<br>57  | 1957-<br>58 | 1958-<br>59 | 1959-<br>60 | 1960-<br>61 |              |       |
| 1. Exports (f.o.b.)                                   | 573          | 583         | 592         | 602         | 615         | 593          | 2965  |
| 2. Imports (c.i.f.)                                   | 783          | 886         | 990         | 895         | 786         | 868          | 4340  |
| 3. Trade balance<br>(1-2)                             | -210         | -303        | -398        | -293        | -171        | -275         | -1375 |
| 4. Invisibles (ex-<br>cluding offi-<br>cial donations | 60           | 55          | 51          | 46          | 41          | 51           | 255   |
| 5. Total current ac-<br>count balance<br>(3+4)        | -148         | -248        | -347        | -247        | -130        | -224         | -1120 |

Source: The Second Five Year Plan, p. 95.

Note: Crore signifies 10 million.

1955-56 (first nine months). (b) Inflationary pressures will be held firmly under control. However, take 1952 as the basis, terms of trade which were 104 in 1956 deteriorated to 95 and 96 for 1957 and 1958 respectively.<sup>1</sup> Hence, there still exists a possibility that export proceeds might not grow even at such a low rate.

As the last table shows, India's imports rise substantially over the first four years, thus, resulting in a negative trade balance of about Rs. 13,750 million over the period. Since exports grow at 1.5 per cent per annum and imports grow faster than exports, the deficits can be financed only through the inflow of new capital on a large scale and the drain of foreign exchange reserves.

<sup>1</sup>ECAFE, Economic Survey of Asia and the Far East, 1958, p. 199.

India's foreign exchange reserves, which had been an important resource for financing external payments, however, was reduced to a minimum point at the end of 1958. India, who had Rs. 11 billion of foreign external reserves at the time of independence, has been losing them since then. On the eve of the First Five Year Plan, the reserves were around Rs. 8.5 billion. During the First Plan, drawing down on the foreign exchange reserves was about 1.4 billion, lower than the expected amount of Rs. 2 billion. In the Second Plan, the total drawing down of the Reserves Bank's foreign exchange assets since April 1956 to the end of March 1958 works out at Rs. 4,790 million.<sup>1</sup> Though in the first half of 1959 the reserves showed a slight increase, they were at the minimum level to back up the note issue of Rs. 17.5 billion and foreign trade of over 13 billion annually.

India's Foreign Assets, 1950-59  
(billions of rupees)

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| 1950 | 1951 | 1952 | 1953 | 1954 | 1955 | 1956 | 1957 | 1958 | 1959 |
|------|------|------|------|------|------|------|------|------|------|
| 8.74 | 8.21 | 7.46 | 7.63 | 7.71 | 7.75 | 6.48 | 4.15 | 3.07 | 3.31 |

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Source: IMF, International Financial Statistics, April, 1960.

Now, as we have seen, India's exports expand only at a low rate, imports increase sharply, and foreign exchange

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<sup>1</sup>Government of India Planning Commission, Appraisal and Prospects of the Second Five Year Plan. New Delhi, May, 1958, p. 15.

reserves are drained to the critical minimum point. Although service payment takes up about 7 per cent of the foreign exchange receipt, which may be considered low if there is no heavy payments deficit, the growing share of foreign debt service payment must be taken into serious consideration together with other items of import requirements.<sup>1</sup> For this purpose the expansion of exports at a higher rate than prevailing now must be achieved by every means. The Planning Commission admitted this and said, "It has been recognized that the expansion of exports is vital to the tempo of development that can be secured and calls for sustained efforts and a degree of sacrifice on the part of the country."<sup>2</sup> Therefore, in 1957 a number of steps were taken with a view to building up the drive for exports. Several export promotion councils and the Export Risks Insurance Corporation were set up. The Foreign Trade Board and the Directorate of Export Promotion in the Ministry of Commerce and Industry were established, also. Export quotas have been progressively liberalized and export control regulations were relaxed. Most export duties have been abolished or substantially reduced except tea, hard cotton waste, and manganese ore.

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<sup>1</sup>Planning commission expects that the service ratio will rise to one-fourth of the foreign exchange earnings by 1957. See: Patel, S. T., "Export Prospects and Economic Growth: India," Economic Journal, No. 275, Vol. LXIX (September 1959), p. 490.

<sup>2</sup>Planning Commission, Reappraisal of the Second Five Year Plan, A Resume, September, 1958, p. 12.

The transfer problem of service payment appears not too serious at the Second Plan period because of a new inflow of capital on a large scale. However, as stated in the first section, ultimately the real transfer of service payment must be achieved through the expansion of exports or import substitution.

In this connection, Patel suggested an interesting proposal in his articles, "Export Prospects and Economic Growth: India." He contended that the assumption that exports of pre-industrial countries must be expanded to finance the rising volume of investment goods imports is valid only for a few petroleum-producing countries, which account for less than 5 per cent of the population of the pre-industrial world. Therefore, he suggested that it is necessary for these countries to accelerate the rate of domestic capital output.<sup>1</sup>

The Third Five Year Plan, which is to start in April 1961, seems to pay more attention to the servicing of foreign debt since the importance of this problem is being realized widely. Nevertheless, in the Third Plan the financing of service payment is to come from external resources. In addition to the foreign exchange requirements of Rs 20 billion, 6 billion is required for the servicing of liabilities already incurred. In other words, the debts contracted before 1961 can be serviced only through an inflow of more foreign capital.

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<sup>1</sup> Patel, S. T., op. cit., pp. 505-506.

However, the contribution of foreign capital in the building of India's productive capacity cannot be underestimated. In several years India will have a high productive capacity, which she has never had. At that time the servicing of foreign debt will be easily within her capacity.

Inevitably, the difficulty is in forecasting foreign exchange requirements and earnings over a period of five years. Likewise the forecasting of the service payment over the five-year period and its means of financing implies some degree of uncertainty. The Indian Second Five Year Plan is no exception in this respect. The difficulty in availability of foreign exchange gives rise to a strain on the payments position and a large drain of foreign exchange reserves. However, India's service payments have not been suspended, though they were financed by a new flow of capital. The servicing of foreign debt through the real transfer of Indian products will be realized in the future when India's productivity is enhanced to a high level as envisaged in her Five Year Plans.

#### The Economic Development of Brazil

The projection on the future development of Brazil's economy was made in an excellent study by the joint working group of the Banco Nacional do Desenvolvimento Economico of Brazil and the Economic Commission for Latin America of

the United Nations.<sup>1</sup> In Part I of the study the macro-economic analysis of Brazil's economy from 1939 to 1954 lays a sound basis for the various projections to be followed. The future trends of income, consumption, investment, capacity to import, production for the domestic market are, thereby, calculated for the period 1955-62 with certain hypotheses on the product-capital ratio, terms of trade, and inflow of foreign capital. In Part II the projections go further into each sector, the result being maintained consistent with the aggregate projection.

The ECLA study is characterized by two aspects from India's Second Five Year Plan. First, the former's macro-economic analysis is a scrupulous work and statistically reliable. Hence, the whole projection is based on sound statistical evidences, though some of the hypotheses may not turn out to be facts and thus, needing slight modifications in the course of development. In contrast, India's Second Plan is rather weak in its statistical study of India's economy. Many guesses and approximations are implied in the Plan. Apart from the description of some achievements during the First Plan, the Plan seems to be focused on the setting up of targets and devising relevant policies in words and logic rather than relying on sound statistical data.

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<sup>1</sup>United Nations, Analyses and Projections of Economic Development, II. The Economic Development of Brazil. New York, 1956. Hereafter, it will be referred to as ECLA study for the sake of convenience.

Second, a substantial proportion of the ECLA study is directed to the analyses and projections of external resources, perhaps because of Brazil's trade-orientation in past centuries. In this respect, India's Plan is less prominent in the study of her exports though the export sector is weak and needs strengthening.

As just stated, the ECLA study pays considerable attention to the aspect of external resources. The strategic factors determining the rate of growth of Brazil's economy are believed to be in the following three variables: (a) domestic saving, (b) fluctuations in the terms of trade, and (c) the net inflow of foreign resources.<sup>1</sup> Particularly, the third factor is regarded as vitally important to the development of Brazil's economy. To quote:<sup>2</sup>

Fundamental importance may also attach to the inflow and outflow of resources. One of these movements (remittances abroad for the servicing of capital) is of vital interest as a balance-of-payments problem. Another (that of long-term capital) merits special emphasis on account of its potential significance.

According to the past experience of Brazil's economy, the contribution of foreign capital has been small and intermittent. To say that foreign capital contributed slightly is not identical with saying that foreign capital did not flow into Brazil at all. It implies that inflow has been

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<sup>1</sup>Ibid., p. 3.

<sup>2</sup>Ibid.

more than offset by outflow. In any one decade of the last half-century the inflow of real goods and services has never exceeded the outflow. Hence, it was projected in the ECLA study that "there is nothing to indicate that past trends will be to flow abroad in coming years."<sup>1</sup>

The net outflow of capital and related services was due mainly to the following facts: First, the net inflow of private long-term foreign capital (excluding reinvested profits) has remained at a substantially low level because of the overvalued official exchange rate, strong incentive for capital flight, and a bad investment climate for the petroleum industry. Second, the annual inflow of loan funds did not significantly exceed \$40 million in any one year until 1954. On the whole such official financing was substantially smaller than the outpayments for the amortization of Brazil's "old" external debt, the repayment of other official loans and the settlement of the "lend-lease" account. Third, the sum of profit remittances on private foreign investments and interest payments on account of the official debt have been substantially greater than the inflow of long-term capital.<sup>2</sup>

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<sup>1</sup>Ibid. The doubt about the correctness of this projection has been increasing since 1956 when private capital inflow started to flow into Brazil on a larger scale. The public capital reinforced the inflow in 1958. See: IMF, Balance of Payments Yearbook, Vol. II, Brazil.

<sup>2</sup>Joint Brazil-United States Economic Development Commission, The Development of Brazil, Institute of Inter-American Affairs Foreign Operation Administration, Washington, D.C., 1953, p. 55



On the whole the tendency of net outflow of external resources seems likely to prevail during the period of projection 1955-62. However, another tendency of new development cannot be overlooked. Since 1954 the inflow of external resources has been rising rapidly. As the next table shows, inflow of capital and donations was less than the total of the outflow of capital and donations and remittances of interests and profits until 1956. Even so, the net outflow has been getting smaller and smaller. In 1955 and 1956 the margins were only 8 and 12 million dollars respectively. In 1957 the total net inflow of capital to Latin America is estimated at 1.660 million dollars, about 60 per cent above that of 1956 (\$1050 million). Hence, it might be reasonable to consider that the capital movement might turn out to be a net inflow to Brazil in the last few years.

The projection of service payment constitutes an integral part of the aggregate projection on the future development of Brazil's economy. The ECLA study provides an aggregate projection over the period 1955-62 which is reproduced on the following pages. The hypotheses underlying the projections are as follows: (1) \$500 million of new capital will be obtained from international credit institutions, in five annual installments of \$100 million from 1955. The capital obtained this way is supposed to be totally reinvested. (2) The rate of saving will rise gradually from 11.0 per cent in 1955 to 13 per cent in 1957 and stay stationary thereafter.

Brazil's Foreign Capital Movements and Related Services  
1950-56 (millions of dollars)

| Items                                | 1950 | 1951 | 1952 | 1953 | 1954 | 1955 | 1956 |
|--------------------------------------|------|------|------|------|------|------|------|
| Inflow of capital and donations      | 1    | 80   | 99   | 143  | 201  | 213  | 270  |
| Outflow of capital and donations     | -142 | -22  | -53  | -22  | -115 | -103 | -137 |
| Remittances of interests and profits | -110 | -157 | -165 | -167 | -137 | -115 | -145 |
| Net outflow <sup>1</sup> (-)         | -251 | -99  | -119 | -46  | -51  | -8   | -12  |

Source: ECLA, Economic Bulletin for Latin America, Vol. III, No. 2, October, 1958, p. 53.

(3) The productivity of capital will rise gradually from 0.53 (product-capital ratio) in 1955 to 0.57 in 1959, then stay stationary thereafter.

Item 10 of the table is for the projection of inflow or outflow of resources. While foreign contribution is assumed to flow in 2.9 billion cruzeiros annually for the first five years (hypothesis 1), subheadings A and B project the servicing of public debt and investment income respectively. The servicing of public debt is derived from known data, whereas income from private direct investment is calculated from Item 9 (net saving), assuming that each year 4.8 per cent of saving will be absorbed by the investment income.

<sup>1</sup>Attention must be paid to the fact that net outflow does not mean that foreign capital does not contribute to the economic development of Brazil. Remittances of interests and profits include payments for the services of capital invested in Brazil in the past.

**Brazil's Development Programme, Combination of Hypotheses  
1955-62, (Billions of cruzeiros at 1952 prices)**

|                                    | 1954  | 1955  | 1956  | 1957  | 1958  | 1959  | 1960  | 1961  | 1962  |
|------------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| 1. Reproducible capital            | 752   | 789   | 826   | 874   | 930   | 991   | 1,055 | 1,119 | 1,191 |
| 2. Product-capital ratio           | 0.54  | 0.53  | 0.54  | 0.55  | 0.56  | 0.57  | 0.57  | 0.57  | 0.57  |
| 3. Product                         | 409.2 | 418.2 | 446.0 | 480.7 | 520.8 | 564.9 | 601.3 | 637.8 | 678.9 |
| 4. Effect of the terms of trade    | -7.7  | -3.3  | -     | -     | -     | -     | -     | -     | -     |
| 5. Gross income                    | 416.9 | 421.5 | 446.0 | 480.7 | 520.8 | 564.9 | 601.3 | 637.8 | 678.9 |
| 6. Depreciation                    | 21.8  | 22.9  | 23.9  | 25.3  | 27.0  | 28.7  | 30.6  | 32.4  | 34.5  |
| 7. Net income                      | 395.1 | 398.6 | 422.1 | 455.4 | 493.8 | 536.2 | 560.7 | 605.4 | 644.4 |
| 8. Rate of net saving              | 10.2  | 11.0  | 12.0  | 13.0  | 13.0  | 13.0  | 13.0  | 13.0  | 13.0  |
| 9. Net saving                      | 40.2  | 43.8  | 50.6  | 59.2  | 64.1  | 69.7  | 74.2  | 78.7  | 83.8  |
| 10. Inflow or outflow of resources |       |       |       |       |       |       |       |       |       |
| A. Servicing of the public debt    | -     | -7.7  | -3.5  | -3.3  | -3.1  | -4.8  | -6.2  | -2.4  | -1.1  |
| B. Income from direct investments  | -     | -2.1  | -2.4  | -2.8  | -3.1  | -3.3  | -3.6  | -3.8  | -4.0  |
| C. Foreign contribution            | -     | 2.9   | 2.9   | 2.9   | 2.9   | 2.9   | -     | -     | -     |

|                        | 1954  | 1955  | 1956  | 1957  | 1958  | 1959  | 1960  | 1961  | 1962  |
|------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| D. Total               | -3.0  | -6.9  | -3.0  | -3.2  | -3.3  | -5.2  | -9.8  | -6.2  | -5.1  |
| 11. Net investment     | 37.2  | 36.9  | 47.6  | 56.0  | 60.8  | 64.5  | 64.4  | 72.5  | 78.7  |
| 12. Expenditure        | 413.9 | 414.6 | 443.0 | 477.5 | 517.5 | 599.7 | 591.5 | 631.6 | 673.8 |
| 13. Consumption        | 354.9 | 354.8 | 371.5 | 396.2 | 429.7 | 466.5 | 496.5 | 526.7 | 560.5 |
| 14. Rate of investment | 9.4   | 9.3   | 11.3  | 12.3  | 12.3  | 12.0  | 11.3  | 12.0  | 12.2  |

Source: United Nations, Analyses and Projection of Economic Development, II. The Economic Development of Brazil, p. 35, Table VIII.

Notes: For hypotheses see the text. Item 3: calculated from 1 and 2; Item 5: calculated from 3 and 4; Item 6: calculated from 1 (2.9 per cent); Item 7: calculated from 5 and 6; Item 9: calculated from 7 and 8; Item 10A: known data; 10B: data calculated from 9 (4.8 per cent); Item 11: calculated from 9 and 10; Item 12: calculated from 5 and 10; Item 13: calculated from 6, 7, and 12; Item 14: calculated from 11 and 7.

The total service payment, as the table shows, is high in 1955 (9.8 billion), then decreases in 1956, but rises again to the level of 1955 in 1960, and is followed by a decline. The servicing of public capital and that of private reveals a distinct difference. Over the period, the public debt servicing tends to shrink except for an intermediate rise in 1959 and 1960. The servicing of private direct investment, however, keeps rising constantly. Thus, while public debt servicing exceeds that of direct investment from 1955 to 1960, it is projected that the tendency will be reversed in 1961 and 1962.

Though difficulty is always involved in the projection of service payment for a period as long as 8 years, yet the significance of integrating service payment in the aggregate ~~programming~~ cannot be underestimated. Since the projection is rather conservative in estimating only \$500 million of foreign contribution for the whole period, if the inflow of capital can be intensified, the rate of investment and, therefore, the rate of growth will be raised.

Now we shall see how the ECLA study of Brazil's economy takes the development of the export sector into consideration. It goes without saying that the promotion of exports is identical with the raising of the capacity for external payment on which the servicing of foreign debt relies.

The main characteristic of Brazil's exports in the post-war period is the reduction in quantum which, however, is

made up by a raise in the price. Between 1948 and 1953, coffee exports declined by 11 per cent, and the total of all other exports fell by 60 per cent. The total trade between 1946 and 1954 registered a 31.3 per cent reduction in the quantum of exports and a 158 per cent improvement in the terms of trade.

Hence, the recovery of the export quantum undoubtedly is one of the most important objectives to be established in a development program for Brazil. The target set for the expansion in the quantum of exports is to recover the level of 1946 (peak registered during 1939-54), 45.8 per cent above that of 1954, or 21.7 per cent above that of 1951. The expansion process will be divided into two stages. The first stage which covers the period 1954-57 aims at reaching the level of 1951. This stage is regarded as the spontaneous recovery which means that according to the experience of 1952, 1953, and 1954, the level of 1951 will be reached easily through built-in forces. The rate of growth is 6.5 per cent per annum. The target of the second stage is to raise exports another 21.9 per cent above that of 1951. If the annual rate of the first stage will continue to prevail, target of the program will be reached in 1960. Once the target is reached, it is assumed that the quantum of exports will grow at 2 per cent per annum, the historical rate of growth registered during the period 1901-50.

The minimum program production shown in the table will bring an end to the declines in export production as happened between 1939 and 1952. Thus, a period of parallel expansion in production for the domestic and foreign markets will be realized. This is shown by the stable percentage of exports in the gross product.

Following the projection of exports, the U.N. study goes on to project the probable imports for the period 1955-62. The purpose is evidently to calculate the capacity to import so that consistancy will be secured between the uses and resources of means for external payment.

**Brazil: Hypothesis of a Minimum Programme: Production for Export and for the Domestic Market**

(Billions of cruzeiros at 1952 prices)

| Year | Gross product | Exports | Production for domestic market | Exports as a percentage of the product |
|------|---------------|---------|--------------------------------|----------------------------------------|
| 1954 | 409.2         | 42.0    | 367.2                          | 10.3                                   |
| 1955 | 418.2         | 44.7    | 373.5                          | 10.7                                   |
| 1956 | 428.0         | 47.6    | 380.4                          | 11.1                                   |
| 1957 | 450.3         | 50.7    | 399.6                          | 11.2                                   |
| 1958 | 475.8         | 54.0    | 421.8                          | 11.3                                   |
| 1959 | 502.8         | 57.5    | 445.3                          | 11.4                                   |
| 1960 | 530.9         | 61.2    | 469.7                          | 11.5                                   |
| 1961 | 560.0         | 62.4    | 497.6                          | 11.1                                   |
| 1962 | 592.8         | 63.6    | 529.2                          | 10.7                                   |

Source: ECLA Study, p. 48.

For the projection of exports and imports, the ECLA study presents two projections for each, on the basis of two different hypotheses: initial hypothesis and minimum programme hypothesis. Take projection of exports for example, the

projection under the initial projection assumes that exports will grow only at the historical rate of 2 per cent after the level of 1951 is reached in 1957 through spontaneous recovery. On the other hand projection under the minimum programme hypothesis assumes that the spontaneous recovery rate (6.5 per cent) will continue to prevail until the level of the 1946 volume is reached in 1960. The two projections clearly provide two possible paths of development--spontaneous and minimum programme--so that the actual development probably can fall within the level between the two limits set by the two paths (of course, higher rate of growth is possible through intense efforts). The flexibility in the projection is, thus, one of the merits to be credited to the ECLA study.

After reviewing the ECLA study with special reference to the aspect of the transfer problem of foreign capital servicing we feel that this study undoubtedly presents a good approach to the related techniques of programming in coping with the problem of foreign debt servicing. The study suggests to underdeveloped countries the urgent necessity of statistical study of the national economy as well as the necessity of introducing such programming techniques into these countries.



## CHAPTER VI

### SUMMARY AND CONCLUSIONS

The transfer process of service payment was discussed according to three principal exchange rate systems. Under the fixed exchange rate system, changes in income and price constitute the main forces in the adjustment of the balance of payments disequilibrium. Under the flexible exchange rate system, the fluctuation of exchange rate tends to equilibrate the demand and supply of foreign exchange. However, how well the changes in the exchange rate will adjust the disequilibrium which is caused by the transfer of service payments depends upon the demand and supply elasticity of the debtor's exports. Under the exchange control system, transfer of service payment is made possible through the rationing of foreign exchange.

In many cases, the adjusting forces existing in the three different exchange rate systems are not powerful enough to achieve the expected transfer of service payment. In other words, automatic adjusting forces of the fixed and flexible rate systems and artificial controls of the exchange control system must be assisted by some other measure to fulfill the transferring of service payments. The exports must be expanded and import-substitution must be established.

Fiscal and monetary policies should be adopted in order to create favorable conditions. Above all, development programming and planning must be introduced for the more effective manipulation of the transfer problem in the servicing of foreign capital.

The expansion of exports is of primary importance to the debtor country. For this purpose, a large amount of capital must be directed to the export sector. Various measures of promoting exports need be adopted. However, there are several obstacles to the promotion of exports in underdeveloped countries. The nature of export goods--primary goods--hinders the expansion of exports due to the inelastic demand for primary goods. For this reason, diversification of exports is necessary in the long run. Nevertheless, the elasticity of demand may be quite elastic for an individual primary-goods exporting country. But the advantage of elastic demand might be offset by an inelastic supply of exports.

The restrictive measures on imports by the creditor country also discourage the exports of the debtor country. To a certain extent these measures have to be removed for the benefit of a smooth transfer of service payments. Other factors hindering the expansion of exports such as instability of primary goods prices and recession in the developed countries must be eliminated or prevented by every means.

Import-substitution plays an important role in the servicing of foreign capital from the long run point of view.

If a debtor country wishes to develop with the assistance of foreign capital, the foreign exchange expenditure must shift gradually from the imports of consumer goods to the imports of capital goods and the payments of investment service although the total exchange requirement will keep growing.

Therefore, coefficient of consumer imports must gradually decrease. This is possible through import-substitution provided that domestic demand is to remain unchanged. In the later stage of development the production of capital goods must be started and accelerated. Though import-substitution tends to consume large foreign exchange in the early stage, its contribution to the increase of productivity is far greater.

Availability of new credits and loans is important to underdeveloped countries. They serve as a buffer to the balance of payments difficulty, and as an additional supply of saving and foreign exchange. The continuity of capital inflow is necessary lest the pace of development should be interrupted in underdeveloped countries. Sudden changes in the flow of capital tends to strain pre-industrial economy which is weak and fragile.

The moderation of repayment terms of loans is one of the ways to alleviate the burden of foreign capital servicing. The lowered interest rates, prolonged maturity period, prolonged grace period, and repayment schedule matched to the growth of productivity will benefit the debtor country to a extent. It is easily recognized that moderation of repayment

terms alone will not help the economic development. It must be coordinated with some other important aspect, such as effective planning in the allocation of capital resources.

The annual service payment and the ratio of investment service to foreign exchange earnings and the national income of Brazil, Burma, India, Indonesia, and the Philippines over the period 1950-58 are as computed:

|                 | Average annual<br>service payment<br>(in millions of<br>U.S. dollars) | Investment service ratio to<br>Foreign exchange earnings | National<br>income |
|-----------------|-----------------------------------------------------------------------|----------------------------------------------------------|--------------------|
| Brazil          | 254.5                                                                 | 16.0%                                                    | 1.4 %              |
| Burma           | 10.6                                                                  | 4.6%                                                     | 1.3 %              |
| India           | 119.0                                                                 | 7.1%                                                     | 0.54%              |
| Indonesia       | 119.0                                                                 | 13.7%                                                    | 1.6 %              |
| The Philippines | 66.0                                                                  | 11.6%                                                    | 1.8 %              |

Among the five underdeveloped countries, Brazil paid the largest share for the servicing of foreign capital annually; Burma paid the smallest; India and Indonesia paid less than half of Brazil's share; and the Philippines paid one-fourth of Brazil's share. On the average, all the five countries serviced private capital (particularly private direct investment) more than public capital.

The ratio of service payment to foreign exchange earnings is highest for Brazil, followed in order by Indonesia, the Philippines, India, and Burma. Burma paid so small an amount for foreign debt servicing that she will be able to service more capital without great difficulty.

The ratio of service payment to national income is highest for the Philippines, followed by Indonesia, Burma, and India.

It is fully recognized in this thesis that development programming is of vital importance to the successful servicing of foreign debt borrowed for the purpose of economic development. The development plans are required to undergo necessary projections on the amount of service payment to be incurred over the period of plan and on the probable sources of foreign exchange. Service payments for old debts, of course, have to be taken into consideration as well. On the financing side of the servicing problem, the most important projection will be the greatest possible extent of export expansion. This is because, in the long run, the debt and its interest charges must be paid with goods and services of the debtor country.

The case study of India's Second Five Year Plan has disclosed the fact that India's Plan did not give as much consideration to the foreign debt servicing problem as it should have done. There were no estimates of service payments. The financing of foreign debt servicing was stated only in vague terms. Assuming new inflow of capital, the Indian Planning Commission expected that the service payments would matter on a net basis only. When the estimate of foreign capital requirements had turned out to be misleading, the problem of

servicing foreign capital had become all the more inconsistent with the actual situation. India's Plan did not appear to be emphasizing the significance of the aspect of export expansion for the purpose of meeting the future increase in the external payment--including foreign debt servicing.

In contrast, ECLA's Brazil study presented a far more comprehensive consideration of the problem of foreign capital servicing. It is partly because this factor has long been playing a strategic role in the economic development of Brazil. Hence, the servicing of foreign capital was given an adequate position in the entire scheme of national economy projection for the period of 1955-62. The expansion of the export sector was given equal attention as well. Also, capacity to import was projected from the probable capacity for external payment by subtracting the estimated annual service payment. Imports, thus, would be kept consistent with capacity to import to avoid a balance of payments difficulty.

The following conclusions can be drawn from the present study. First, the importance of foreign debt servicing must be recognized fully by the underdeveloped countries which attempt to attain rapid economic growth with the assistance of foreign capital. Without a careful and comprehensive study of the national economy, with respect to the ability to absorb and the ability to repay, it is easy to fall into difficulty from too ambitious an external borrowing.

Second, the techniques of development programming should be introduced to underdeveloped countries more actively than has been done in the past. The knowledge of development programming is as important as that of technical know-how. The underdeveloped country can minimize the waste and diseconomy only through the due use of programming techniques.

Third, the supply of capital to underdeveloped countries for their economic development is of great importance. Now is the time when such action must be taken on a large scale. And such supply must be on very moderate repayment terms. Because on the prevailing repayment terms, low ability of the underdeveloped countries to pay would limit the amount of possible further borrowing.

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