

**SERVICING UNITED STATES DIRECT
FOREIGN INVESTMENT**

by

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A THESIS

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INTRODUCTION

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Foreign investments have been a traditional means for less-developed countries and areas to obtain resources from abroad and to develop more quickly than if there were no outside assistance. The types of investments and the conditions under which they take place have changed considerably, however. Today the governments of most capital-importing countries, and especially those from the less-developed areas of Latin America, Africa, and Asia, impose terms on the foreign investor in an attempt to ensure that investments from abroad make the greatest possible contribution to the economic welfare of the host country. The less-developed countries which actively promote economic growth and attempt to minimize unemployment judge the contribution of foreign investments by their effects on the attainment of these national economic objectives.

The form which foreign investments take has changed over the years, also. The predominance of loans by private individuals and institutions and governments and private portfolio investments has been replaced by direct private foreign investments and loan capital of international lending institutions and governments. The greater importance of direct investments in the overall structure of foreign investments during the postwar period has resulted in increasing interest and study of the benefits and costs of these investments. Judgments which have been formed by capital-importing countries on the relative costs and benefits of direct foreign investments are reflected in their legislation and

attitudes toward these investments.

The criteria which are applied by capital-importing countries are based on both political and economic considerations. For example, direct private foreign investment is rejected for political reasons by some newly independent countries almost entirely on the basis that such investment smacks of colonialism. Similarly, other capital-importing countries are hesitant to welcome private direct foreign investments because foreigners may gain control of particular sectors of the economy and thereby endanger the host countries' economic and political independence. While these political arguments must be taken into consideration because they condition the attitudes towards servicing United States direct foreign investment, this study proposes to analyze the attitudes and arguments which are based on economic considerations and which are amenable to economic analysis.

A prominent economic argument in the literature on foreign investments which has been used to emphasize the costs of direct foreign investments, particularly from the United States, is that the service of direct foreign investments often presents serious economic problems to capital-importing countries in two principal respects. First, it is maintained that income remittances by United States companies abroad, particularly those in manufacturing, impose heavy foreign exchange payments and lead to balance of payments difficulties for the host countries. The practices of United States investors in maintaining majority or 100 percent control of their investments and the rapid growth of their subsidiaries through retained earnings are cited as reasons for future income payments in foreign exchange which are considered to be out of proportion to the benefits which

are contributed by these companies to the host country. The argument is applied especially to the United States companies abroad which produce primarily for local markets. Second, it is asserted that the adjustments in the balance of payments and the domestic economy which are needed to service these investments are antithetic to the economic policies and objectives of most capital-importing countries. It is felt that the income payments accompanying United States direct foreign investments are inflexible and similar in this respect to the interest and principal payments on loan capital, and also that they are not responsive to changes in the foreign exchange receipts of the host country. It is argued that in order to service direct foreign investments the host country may be forced to restrict imports or reduce consumption and investment below acceptable levels in order to release the resources needed to pay for income remittances. Thus, it has been stressed that the resources which must be transferred out of the host country in order to pay for income remittances to United States investors and the adjustments in the balance of payments and domestic economy which are required to bring about this transfer impede efforts to promote economic development and to maintain high levels of employment and balance of payments equilibrium. Furthermore, it has been maintained that these problems have not received adequate consideration and that the costs of these investments often have been underestimated.

The discussions in the economic literature which have emphasized the problems to the host country of servicing United States direct foreign investments have been piecemeal in that they have focused on individual aspects of the servicing of these investments; often the discussion has been relevant only for one particular country or for one specific type

of investment. In addition, another serious shortcoming has been that discussions have not integrated the problems for the host countries of servicing United States direct foreign investments with the problems accompanying alternative means for achieving accelerated economic growth. By focusing on the foreign exchange impact of United States direct foreign investments, often there has been inadequate attention directed to the nature of the contribution by these investments to national product and national income and the relation of this contribution to the ability of the host country to adjust to a net capital outflow.

In order to give a more comprehensive and systematic assessment of the costs and benefits of United States direct foreign investments and the problems associated with the service of these investments, it is the purpose of this study:

1. To review the discussions which are concerned with the problems of servicing these investments and to review the policies and legislation which has reflected the attitudes which stress the costs of U.S. direct investments;
2. to arrive at an understanding of the issues of economic policy which are raised by these arguments and attitudes;
3. to define the costs and benefits of United States direct foreign investments;
4. to investigate the experiences of United States companies abroad and to determine what statistical material is available to measure the foreign exchange payments and receipts which result from the establishment and operations of these companies for the purposes of assessing the magnitude and character of the transfer problem;

5. to investigate the adjustment process which accompanies the service of United States direct foreign investments, with special emphasis on the institutional framework which conditions this process;

6. to compare the problems for the host country which accompany the adjustments with alternative ways of financing foreign investments, particularly loan capital;

7. to apply the analytical tools which have been developed to the attitudes and arguments which were presented earlier in order to put the arguments into perspective and to evaluate their significance; and

8. to suggest criteria which might be applied by capital-importing countries to obtain direct foreign investments on the best possible terms with regard to the servicing of these investments.

Throughout this study emphasis will be given to the diverse forms which United States direct foreign investments have taken in recent years. The service of licensing agreements, concession agreements, and joint ventures differs from that of more traditional United States private direct investments in the form of wholly-owned subsidiaries. These other forms of United States direct investments are examined to evaluate what impact they will have for the investment service problems of capital-importing countries compared to the impact of the operations of subsidiaries of United States concerns.

CHAPTER ONE

ATTITUDES AND ARGUMENTS WHICH STRESS THE COSTS OF UNITED STATES DIRECT FOREIGN INVESTMENTS

Introduction

The role of international capital movements in furthering reconstruction, assisting economic development, and promoting foreign policy and humanitarian goals has been a vital one during the postwar period. The emergency loans and the more coordinated Marshall Plan program was instrumental in assisting Europe to reconstruct the war-torn economies. Capital, both private and public, has been directed into those countries making a sustained effort to achieve higher levels of living from comparatively poor economic conditions. Public grants and loans, as well as governmental initiative in promoting private foreign investment, played their part as an element of policy in the struggle between the Communist and non-Communist power blocs.

The extreme scarcity of international capital during the early postwar years, and in some respects for the entire period since the end of World War II, raised much discussion about the need for promoting the flow of international capital and the forms by which it could make the greatest contribution to economic growth and development. The principal controversy has revolved about the relative merits of loan capital and equity investment and how each bears on the economic development process. This controversy has had economic, political, and

social bases which cannot be completely separated from each other. However, it is possible and necessary to make some distinction between attitudes based on political and social considerations and attitudes which are derived from basically economic criteria.

There is a need, also, to differentiate between the political considerations which influence the attitudes toward foreign investments of the less-developed, former colonial countries and those which affect the attitudes of prominent capital-importing countries such as Canada and Australia. For example, some former colonial countries reject private capital if the foreign investor retains any control over the disposition of funds or the operations of an enterprise on the basis that this amounts to economic and political imperialism. As a result, many newly independent countries have rejected or severely limited the volume of private foreign investments and have attempted to obtain foreign capital in the form of loans from international lending institutions and government grants. The Canadian position, on the other hand, was expressed by Prime Minister Diefenbaker in a speech at Dartmouth College on September 7, 1958. "There is an intangible sense of disquiet in Canada over the political implications of large-scale and continuing external ownership and control of Canadian industries....Canadians do not wish to have their economic, any more than their political, affairs determined outside Canada."¹ The differences in political attitudes is one of degree, but undeniably the attitudes in both circumstances condition the legislation and policies which apply to foreign investments.

¹J. M. Smith, "Foreign Investment in Canada," Behind the Headlines, XVIII (September, 1958), p. 3.

Thus, political and social considerations may override any other determinants of the attitudes toward foreign investments, and they at all times condition those arguments and attitudes which have a more discernible economic basis. While the political and social elements of the attitudes must be recognized, and they contribute to an understanding of the attitudes which have a firmer basis in economic considerations, this study does not propose to evaluate the political and social interests and objectives of capital-importing countries. It does, however, acknowledge their existence and attempts to relate them to the arguments and attitudes which are amenable to economic analysis. For example, it is recognized that governments will continue to play an active role in their economies in order to promote the political, economic, and social goals of their countries. The prevalent attitude was stated by the Mexican Ambassador to the United States. "No one questions that in each country the promotion of economic development--a complex process implying investment, diversification, organization, technique, and effort--is the foremost responsibility of that country. Our peoples would never agree to relinquishing that responsibility. For while we must have economic progress as a condition for social advancement, we demand and defend the right to achieve it in ways consonant with our liberties and our way of life."¹ It is also necessary to recognize that countries which actively promote economic growth and which attempt to minimize unemployment judge the contribution of foreign investments by their effects on the attain-

¹Antonio Carrillo Flores, "Unsolved Financing Problems," International Development Review, II (May 1960), p. 15.

ment of these national economic and social objectives.

Within these limitations, the purpose of this chapter is to summarize the attitudes, arguments, and legislation which indicate how the capital-importing countries regard the costs of servicing United States direct foreign investments. This summary will provide an indication of what the term, "the costs of investment service," is generally conceived to mean. Supplementary data and characteristics of United States foreign investments which help to explain the attitudes and arguments will be presented.

In addition, the study is limited primarily to a consideration of countries for which foreign capital represents a fairly significant proportion of overall investments and transactions in the balance of payments. These countries include not only most of the less-developed countries in the non-Soviet world, but also such countries as Canada and Australia which have attained higher levels of income but for which capital imports and investment service continue to play a substantial role in the balance of payments and general economic position. The absolute volume of income payments and capital imports is not the relevant criterion; rather, it is the proportion of national income and international receipts and payments represented by capital inflows and the service payments on these capital imports.

The Attitudes and Arguments

The attitudes and arguments which stress the costs of servicing direct foreign investments have not appeared in the literature in any orderly fashion. Some arbitrary classifications are presented here in order to examine the arguments more systematically. The principal costs

of servicing United States direct foreign investments which have been advanced in the literature on foreign investments are:

(1) the volume of dividend remittances are too high relative to the inflow of capital which accompanies direct investments;

(2) income payments in many cases are not flexible and not responsive to changes in the foreign exchange receipts of the host country;

(3) the orientation of production toward the local market by many United States companies abroad and the service of these investments cause problems of adjustment for the host country;

(4) the pattern of growth of United States companies abroad often minimizes the "foreign" contribution of United States direct foreign investments; and

(5) there is increased vulnerability for the local economy when international transactions of United States companies become a significant item in the balance of payments of a capital-importing country.

The Volume of Income Remittances

It frequently has been argued that the volume of dividend remittances which are paid to foreign investors are too high relative to the value of their investments.¹ Income remittances represent that portion of national income accruing to non-residents which must be paid for in the long run by a net export of goods and services, except to the extent that a country can resort to foreign exchange reserves and additional capital imports to meet these payments. Capital-importing countries attempt, of course, to

¹E. T. Penrose, "Foreign Investment and the Growth of the Firm," The Economic Journal, LXVI (June 1956), pp. 220-235, and A. D. Arndt, "Overseas Borrowing - The New Model," The Economic Record, XXXIII (August 1957), pp. 247-260.

obtain foreign capital at the lowest terms possible.

There are two principal reasons why it is argued that income payments are too high relative to the inflow of capital. First, it is maintained that direct foreign investments have a relatively high rate of return compared with the rates which must be paid on long term loan capital from institutions such as the International Bank for Reconstruction and Development (IBRD). Capital from the IBRD has been available at rates varying between 4 and 7 percent; for the 1950 period earnings as a percentage of the book value of all United States direct foreign investments for all areas has averaged annually 14 percent. (Appendix Tables I and IV). The higher rate of return on the book values of direct foreign investments is pointed to by representatives of less-developed countries as indication that the costs of these investments are greater than that of loan capital.¹

The second reason which is offered for the relatively high volume of income payments accompanying United States direct foreign investments is the preference by United States investors for 100 percent ownership of their foreign subsidiaries. It is argued that if equity in foreign investments were shared with local investors to a greater extent, earnings on these investments would not result in such a large volume of income remittances in foreign exchange because part would be paid out to local investors.²

¹The appropriateness of using the book values of United States direct foreign investments as a base to compute the rate of return on these investments is discussed in Chapter 4.

²Smith, p. 11.

TABLE I-1

PREFERENCE AND PRACTICE AS TO OWNERSHIP OF FOREIGN COMPANIES
 REPORTED BY 72 UNITED STATES CORPORATIONS, 1959

<u>Type of Relation</u>	<u>Preference</u>	<u>Practice</u>
100% Ownership	47	28
Over 50% Ownership	14	23
50:50 Ownership	1	1
Less than 50% Ownership	3	3
No Preference or Dominant Pattern	7	7
	<u>72</u>	<u>72</u>

Source: Foreign Investment Questionnaire (mimeograph), Ford Foundation Project, University of Oregon, 1959, Table IV.

The practices of ownership of United States and British investors often are contrasted. United States firms prefer control of their foreign investments. For example, of 72 United States corporations questioned in 1959, approximately 85 percent of these firms both preferred and practiced better than 50 percent ownership. (Table I-1). As a further example, of 200 firms established in the United Kingdom between 1940 and 1953, and in which United States residents held shares, for 178 firms the percentage of United States shareholding was greater than 60 percent. 146 firms exercised 100 percent ownership, and there were only 3 firms in which the United States' share was 40 percent or less.¹ United States majority ownership in Great Britain is not uncommonly high; in many other countries and in many other types of United States investments there has been even less joint participation for most of the postwar period.² It has been

¹John H. Dunning, American Investment in British Manufacturing (London: George Allen & Unwin Ltd., 1958), p. 95.

²Ibid., p. 102.

estimated that on the average United States investors hold 85 percent and the British 40 percent of the shares of Australian subsidiaries.¹

Statistics such as these often are cited to illustrate the failure of United States foreign investors to share profits with local investors. The experience in Australia also points out one rather common result of the insistence on majority control. Whereas much attention and controversy has been directed at United States investments, earnings, and remittances during the past five years, British investments have attracted little unfavorable attention. The basic reason for this difference in attitude stems from the fact that with 100 percent or near 100 percent ownership, there is little sharing of profits with residents. Thus, while there is undoubtedly an element of economic nationalism associated with the controversies, there is also an economic side to the arguments, for these remittances put pressures on the balance of payments.² The earnings on British investments, on the other hand, have been considered more favorably by Australians because they do not have the same relative impact on the balance of payments; a greater proportion of earnings is paid to Australian residents.

The Flexibility of Income Payments

Arguments which emphasize the costs of United States direct foreign

¹Penrose, p. 227.

²In 1953-54, the dividend declared to the parent company by General Motors-Holden, Ltd., a subsidiary of General Motors Corporation, was approximately 8 percent of Australia's dollar exports in 1954-55. ibid., p. 221.

Investments are concerned not only with the volume of income payments, but also with their distribution over time. Traditionally, discussions about investment service have emphasized that loan capital with its fixed interest and repayment schedule introduces a rigid element into the balance of payments and presents more of a problem for service than direct investments. In the case of direct investments, it has been felt that income payments are positively related to economic activity, exports, and other indicators of a country's ability to service foreign investments. In other words, generally it has been assumed that should foreign exchange receipts decline or should there be a decline in general economic activity, profits and dividends of foreign companies would decline, also. The more flexible nature of dividends and profits remittances offers this advantage, but it has been argued frequently that the differences between the service of loan capital and direct investments may not be great under certain circumstances.

Generally, the depression years of the 1930's are cited as examples of the decline in dividend payments as compared to interest payments. In any period of greatly reduced economic activity, such as a world wide depression, similar results are likely to occur, but the postwar experience has shown that when severe fluctuations in income and employment are avoided there is less difference in the regularity of interest and dividend payments. The returns on direct foreign investments in manufacturing industries, especially those manufacturing investments which produce primarily for the local market, often are not responsive to changes in foreign exchange receipts unless changes in external receipts coincide with fluctuations in the general level of economic activity in the host

country. It is argued that there is little difference between the flexibility of dividend payments from manufacturing investments producing for the local market and the relatively fixed payments of interest and principal which accompany loan capital. While dividend payments undoubtedly are the more flexible of the two, it is argued that the differences may be slight.¹

Production for the Local Market

It is frequently argued that foreign investments in the export sectors of the host countries have many disadvantages for these countries. Foreign companies producing for export markets are regarded as contributing to a dualistic economic structure for the host country and as increasing instability because of its greater dependence on foreign trade and markets.² However, in discussions which consider the problems of servicing direct foreign investments, greater emphasis is put on the fact that many United States companies abroad are not foreign exchange earners for the host economy but rather produce primarily for the local market. This argument is presented.

Even though a foreign investment may be productive, there is no necessary relationship between this contribution to increased real income and the capacity to transfer earnings. The capacity to transfer investment income abroad requires not only the allocation of domestic income and

¹Dragoslav Avramovic, Debt Servicing Capacity and Postwar Growth in International Indebtedness (Baltimore: The Johns Hopkins Press, 1958), p.102.

²H. W. Singer, "The Distribution of Gains Between Investing and Borrowing Countries," The American Economic Review, XL (May 1960), pp. 473-485.

savings for this purpose, but a country must be able to convert these savings into foreign exchange.¹ If a direct investment does not result in a net addition to foreign exchange earnings, some other means must be utilized to acquire this net surplus. Thus while foreign investments may lead to an increase in income and savings, a debtor country may at the same time face a balance of payments problem. For this reason some argue that criteria for foreign investments should require not only that it be productive in the sense that this criterion is applied to domestic investment. It is maintained that, in addition, foreign investment must have a sufficient bias toward export production or import substitution that it insures an improvement in the balance of payments which enables the host country to finance the transfer of dividends and profits which are made to foreign investors.²

In discussions of investment service, it is maintained that foreign investment directed into export or import-competing sectors of the economy mitigates many of the problems of servicing this investment. Thus, it is emphasized that when earnings and remittances are tied closely to foreign exchange receipts, or to the reduction of foreign exchange payments, the transfer will be effected more easily. In this respect, overall statistics on the ratio of investment service payments to current international receipts must be used cautiously. A lower ratio of these payments related

¹For a discussion, see Avramovic, p. 57, and Gerald M. Alter, "The Servicing of Foreign Capital Inflows by Underdeveloped Countries," Mimeograph Paper, Roundtable of the International Economic Association, Rio de Janeiro, August 19-28, 1957, p. 3.

²Arndt, p. 256.

to investments which are not directly connected with export earnings or import substitution may constitute more of a problem to a country than a higher ratio when the volume of income payments is closely tied to exports. In the latter case, a deterioration in a country's ability to service investments likely will be accompanied by a decline in earnings and the dividends paid on the earnings.

Countries which during the postwar period have experienced the highest ratio of aggregate service payments to current external earnings are those where foreign investment has been directed into the export sector.¹ Iraq, Iran, Venezuela, and the federation of Rhodesia are countries whose ratio has approximated 25 percent; oil investments are the most prominent examples of a close relationship between export earnings and investment income payments. In general, when direct investments are primarily in the extractive export industries, mining, and plantation agriculture, it is felt that the export bias needed for easing the transfer problem is provided.² In Canada, with about 70 percent of United States investment going into petroleum, mining, and pulp and paper, it is estimated that one-third of the total Canadian exports to the United States in 1955 was attributable to United States direct investment companies.³ However, when foreign

¹Avramovic, p. 97.

²Arndt, p. 257, and August Maffray, "Direct Versus Portfolio Investment in the Balance of Payments," Papers and Proceedings, American Economic Association, XLIV (May 1954), pp. 614-623.

³Irving Brecher and S. S. Reisman, Canada-United States Economic Relations (Ottawa: Royal Commission on Canada's Economic Prospects, July 1957), p. 95. See also The American Economic Impact on Canada, The Duke University Commonwealth-Studies Center (Durham, N.C.: Duke University Press, 1959), Chapter I, for examples of the experience in this respect in Canada.

investment is concentrated in industries having less direct influence on the balance of payments, earnings and export receipts are not so closely related. For example more than half of the direct foreign investment in Australia has been in manufacturing establishments producing primarily for the domestic market, and this is a matter of concern to some Australians.

There can be very little doubt that the inflow of overseas capital has been a factor, perhaps a major factor, in the disproportionately rapid growth of Australia's secondary industries, relatively to her traditional export industries. This establishes a strong prima facie case for the view that post-war direct investment, far from having had the necessary bias towards export production, has helped to give post-war Australian economic development a bias against export production. If this is true, it would imply that overseas investment would have contributed to a long-term balance of payments problem even if it had taken the form of free gifts.¹

Dr. Arndt recognized that this is a viewpoint having relevance within a limited framework only, and he acknowledges that it does not take into account the longer run possibilities of these industries eventually producing for overseas markets, or the import-competing aspect of the investments. Nevertheless, he stresses that the immediate problems of transferring earnings is made more difficult by the domestic orientation of foreign investments.

The Growth of United States Companies Abroad Through Retained Earnings

Another argument which stresses the costs of United States direct foreign investments stems from the fact that United States firms abroad rely heavily on retained earnings as the source of investment funds for

¹Arndt, p. 257.

their growth. In the economic literature there has been much emphasis on the problems for the host country which are brought about because of the expansion through ploughed-back earnings. Some argue that retained earnings do not represent a new addition of foreign exchange to the host country and that because they lead to income payments in foreign exchange in the future without being a source of foreign exchange themselves, they eventually worsen the balance of payments position of the host country. Second, it is argued that retained earnings allow United States concerns abroad to become fairly independent of the parent firm and some of the benefits which accompany direct foreign investments are lessened because of this independence.

The expansion of United States firms abroad by retained earnings has been offered as one reason why these firms cause balance of payments problems for the host country. The argument is as follows: The reliance on retained earnings alters the transfer problem from what it would be if further investment occurred through a net outflow of dollars from the United States. Retained earnings per se are not regarded as a source of foreign exchange to the host country. As investments by undistributed profits expand and the income payments on these investments increase correspondingly, the foreign exchange burden of the investment is increased. Dunning has related this argument to the British experience. He emphasizes that because two-thirds of the postwar growth of United States investments in the United Kingdom have been financed by reinvested earnings dollar claims have been created out of proportion to the dollar inflow.¹

¹Dunning, American Investment in British Manufacturing Industry, p. 289.

It is maintained that even though the ratio of income remittances to the value of the investment and the annual investment earnings may remain fairly constant, growth through retained earnings may cause foreign exchange payments on the investment to increase in proportion to the foreign exchange supplied to the host country through capital movements.

The other argument which was mentioned and which focuses on the problems to the host country arising from the reliance on retained earnings for expansion is based on the fact that some United States firms abroad become highly independent of the parent concern, and this autonomy is regarded as contributing to a decrease in the benefits which are derived from the operations of these subsidiaries. It is felt that once a foreign subsidiary is established, it is likely to gain a greater degree of independence than a domestic subsidiary. The reasons for this position are:

(1) The directors of foreign subsidiaries are often much more familiar with local cost and marketing conditions, as well as local tastes, customs, and other factors which bear on investment decisions;

(2) The expansion of the firm does not require decisions or additional capital from the parent company; as was stated before, retained earnings are the primary source of funds for this expansion;

(3) Distances and language differences may reinforce any tendency toward independence.

Some argue that the granting of a high degree of autonomy to foreign subsidiaries by the parent firms decreases the benefits from United States direct foreign investments. First, it is maintained that if a firm achieves a high degree of independence from its United States parent, after a period of years it has characteristics which apply less to a foreign investment

than to a local investment. This argument stresses that the more a subsidiary makes its investment decisions independent of the parent company, and the less it relies on the latter for funds, technology, research, and personnel, the less are the benefits to be derived from the "foreign" aspect of the investment. Direct foreign investments to the host country are a package of capital, skilled managerial and other personnel, marketing techniques, research facilities, and all the other properties of going concerns which are in short supply in the less-developed countries. After a number of years, when a foreign subsidiary is well-established, when almost all its personnel are indigenous, when no new capital is supplied from abroad but retained earnings are the source of funds for expansion, and when many of the practices of the firm have been diffused to the local economy and local firms are capable of using the same techniques, the contribution to the host economy by the foreign subsidiary may be very similar to that of many local concerns. The experience of General Motors-Holden, Ltd. in Australia has been cited in this regard. The argument stresses that unless domestic equity participation is allowed, the investment continues to give rise to income payments in foreign exchange long after the "foreign" benefits have ceased. Some feel as a result that the problems of servicing the foreign investment may be out of proportion to the benefits received from abroad. This is felt to be true especially for a foreign subsidiary which has been allowed to produce behind tariffs and other import restriction and, through constant expansion by reinvesting earnings, which grows disproportionately large. There may be little local competition and profits may remain high because of its privileged position.

The Increased Vulnerability of the Host Country's Economy

A high volume of income payments and capital imports are viewed with alarm by many representatives of capital-importing countries because, in their opinion, foreign investors gain control over too large a proportion of particular sectors of the economy and because the domestic economy of the capital-importing country becomes too vulnerable to international developments. For example, in Canada there has been increasing disquiet in both official and unofficial circles over the extent of American control over business and industry in Canada and the effects of this control on the ability of Canada to promote the country's economic well-being. In the 1959 Annual Report of the Governor of the Bank of Canada, J. E. Coyne stated that "Canada was leaning too heavily on foreign investment, particularly from the United States."¹ Furthermore, it was stated in regard to the overall deficit in the balance of payments that "the cumulative effect must be to weaken the ability of the Canadian economy to meet the difficulties of the next recession to come upon us from abroad, and to make more likely the development of a domestic recession arising from the excesses and structural strains within our own economy," and it was felt that "there is no reason in principle why Canada would not make great progress without drawing on the savings of foreigners."²

A high volume of capital imports and growing income payments also causes concern to some because it is felt that the capital-importing countries, in their need to earn foreign exchange to make service payments,

¹New York Times, July 16, 1960, p. 51.

²Ibid., pp. 51 and 56.

will have to increase exports and will become dependent on foreign markets. It is argued that their greater dependence on exports will lead to internal instability because of uncertain foreign markets and changes in commercial and other policies by foreign countries. Some feel it is better to reduce capital imports and thus diminish their reliance on foreign markets.

The Legislation of the Capital-Importing Countries

The arguments and attitudes toward direct foreign investments in general and United States direct foreign investments in particular which have been presented give a one-sided viewpoint of the attitudes toward these investments. Many countries and spokesmen for the less-developed areas have expressed attitudes and viewpoints which indicate they are favorably disposed toward importing capital in this form. Even when countries favor private direct foreign investments, however, their legislation towards foreign investments often reflects the attitudes and arguments which have been summarized in this chapter. This section reviews the legislation of capital-importing countries with the purpose of gaining further indications of the attitudes towards foreign investments.

The legislation toward direct foreign investments may be categorized as follows:

- (1) Controls over income remittances.
- (2) Controls over capital repatriation.
- (3) The screening of investments to improve the balance of payments.
- (4) Regulations concerning the employment of nationals.
- (5) The screening of investments to ensure their compatibility with

social and economic policies.

(6) Regulations concerning ownership and control of foreign investments.

Controls Over Income Remittances

Extensive regulations have been applied to income remittances by many capital-importing countries. For example, in the Philippines, profits may be remitted in amounts ranging from 25 percent to 100 percent of the foreign investors' share of net profits, the exact ratio being dependent upon the company's "social productivity rating." Remittances may not exceed 20 percent to 40 percent of the value of the foreign investment.¹ Indonesia levies a special tax on the transfer of dividends.²

On the other hand, some countries have attempted to encourage foreign investments by guaranteeing that foreign investors may remit their annual income payments in foreign exchange. India's Investment Guaranty Agreement of September 1957 with the United States provides convertibility guarantees for conversion of earnings into dollars.³ In Cambodia, since January 1960 "old" investments, those made prior to May 31, 1960, may not have profits transferred unless permission is granted; 20 percent of the profits on "new" investments, those made after May 31, 1960, may be transferred

¹Wolfgang G. Friedmann (ed.), Legal Aspects of Foreign Investments (Boston: Little, Brown and Company, 1959), p. 440.

²Ibid., p. 295

³Foreign Commerce Weekly, LXI, (March 23, 1959), p. 8.

annually.¹

Controls Over Capital Repatriation

Practically all less-developed countries exercise controls over the repatriation of capital in efforts to ensure that investments are made on a permanent basis rather than as "quick profits" ventures and that repatriation does not occur too quickly and thereby cause balance of payments problems. For example, repatriation of capital from Australia is not guaranteed although special consideration is given if it is demonstrated that there is real need for repatriation or if it is no longer possible to continue operations.² Burma prohibits the withdrawal of foreign capital and funds altogether.³ Japan guarantees repatriation if after notice that the capital is to be repatriated the withdrawal of funds is deferred for two years and the payments are made over a period of five years.⁴

The Screening of Investments to Improve the Balance of Payments

The attitudes and arguments that direct foreign investments should contribute to the foreign exchange earning capabilities of the host country or in some way improve its balance of payments position has received much recognition in the legislation of capital-importing countries. For example,

¹International Monetary Fund, International Financial News Survey, XII (May 6, 1960), p. 345.

²Friedmann, p. 32.

³Ibid., p. 114.

⁴Nobutane Kluchi, "Capital Importation in Postwar Japan," Asahi Evening News (June 23, 1959), p. 6.

in Argentina, special consideration is given to enterprises which are "economically desirable enterprises, including those that will manufacture products which can be sold abroad to obtain needed foreign exchange or those that will produce substitutes for items now being imported."¹ The Philippines grant concessions to an enterprise "where the value of the imported raw material used in making its product does not exceed 60 percent of the manufactured cost plus reasonable selling and administrative expenses."² American firms which desired to establish branches or subsidiaries in the United Kingdom had to undergo scrutiny during most of the postwar period to determine whether their operations would reduce the demand for imports, or stimulate United Kingdom exports to desirable markets.³

Regulations Concerning the Employment of Nationals

One of the ways by which capital-importing countries attempt to share in the benefits from the operations of foreign concerns is by extensive regulations which apply to the employment of nationals. This may be encouraged through discriminatory legislation or it may be stipulated more directly. Chile's employment code requires that 85 percent of the employees of any foreign-owned firm must be nationals of Chile, although exemptions are made for the employment of a greater proportion

¹Friedmann, p. 9.

²ibid., p. 419.

³Dunning, American Investment in British Manufacturing Industry, p. 49.

of foreigners if they are especially qualified for their positions.¹ Colombia has similar regulations; foreign employees can be only 10 percent of the total workers, or 20 percent if they have special training. In both countries, administrative, some technical, and managerial personnel are exempt from these laws. In Brazil it is not only required that the directors of a Brazilian corporation and the head of a local branch of a foreign corporation be residents of Brazil, but two-thirds of the employees of most enterprises must be Brazilian nationals, and two-thirds of the total payroll must be paid to such employees.²

The Screening of Investments to Ensure Their Compatibility with Social and Economic Policies.

Countries which are making active efforts to accelerate economic growth screen foreign investments to ensure that they make the greatest possible contribution to social product and that they do not interfere with plans for economic development. Foreign firms may be excluded from certain sectors of the economy because these sectors are to be developed only by the government. Some countries reserve the development of minerals and other raw materials industries either to the government or to domestic firms. Perhaps the most prevalent reason for the screening of foreign investments is the attempt to direct foreign investors into those sectors

¹United Nations, Department of Economic and Social Affairs, Processes and Problems of Industrialization in Under-Developed Countries (New York: United Nations, 1955), p. 79.

²Friedmann, p. 81

of the economy which are most desirable from the viewpoint of promoting economic growth. For example, the Philippines grant special concessions to investments if they will contribute to a stable and balanced national economy. In addition, foreign firms are given "social productivity ratings" which are based on the firm's ability to contribute to "(1) the national income and employment; (2) the strengthening of the country's balance of payments position; and (3) the supply of basic needs of the economy."¹ Japan's foreign currency law of May 1950 permits capital which contributes to a self-supporting Japanese economy and which protects it both from a heavy burden of unsound debt and an adverse balance of payments. Applications by foreign investors are examined by the Foreign Capital Deliberation Council, which is composed of representatives of both Government and business.² Turkey has regulations which more generally stipulate that for foreign investments to be authorized "such investments must tend to promote the economic development of the country"³

Regulations Concerning the Ownership and Control of Foreign Investments

Regulation of the foreign ownership of companies and industries usually is based on (1) concern that large remittances of income are too costly in terms of resources and foreign exchange, and (2) concern that the control of particular industries and sectors of the economy by foreigners is detrimental from the viewpoint of national defense and the

¹ibid., p. 440.

²Kluchi, p. 6.

³Friedmann, p. 559.

promotion of domestic economic activity. In this latter case, it often is maintained that foreign enterprises should not be allowed to achieve a position which would enable them either to exert appreciable influence and perhaps contradict a nation's efforts to maintain full employment, for example, or to control a large enough segment of an industry to interfere with a nation's political independence or its national defense effort.

In respect for this concern, the Philippine Constitution "reserves the exploitation of natural resources to Filipino citizens and corporations or associations, at least 60 percent of whose capital is owned by Filipinos."¹ India attempts to ensure that to the greatest extent possible majority control must be in Indian hands, although consideration is given to arrangements whereby ownership is predominantly foreign but Indian participants exercise much influence on the operations of the foreign enterprises. Japanese legislation is liberal, "but no application calling for foreign controlling interest has been approved in several years...."² Only in the oil industry is there extensive foreign controlling interest in Japan; oil companies have been insistent on maintaining control of their investments. Neither federal nor provincial laws of Canada regulate the extent of foreign control of business enterprises nor are foreigners prohibited from engaging in any commercial undertaking. However, encouragement is given to foreign investors to permit some Canadian equity participation in their investments. For example,

¹ Ibid., p. 414.

² Business International, Investing and Licensing Conditions in 30 Leading Markets (New York: Business International, 1957), p. 29.

"In the involved negotiations which led to the financing and construction, with governmental assistance, of the gas pipeline system of Trans-Canada Pipe Lines Limited, pressure was exerted with a view to ensuring that a substantial number of shares in the undertaking would be available to Canadians for investment."¹

The attitudes, arguments, and legislation which are concerned with the practices of United States investors in maintaining majority and often 100 percent control of their foreign investments have been based on the experience with United States foreign firms over most of the post-war period. However, in recent years there have been two developments which, although not receiving much recognition in the formal legislation of capital-importing countries, have altered somewhat the character and impact of many United States investments abroad. The first is that countries increasingly are encouraging joint ventures and other forms of local equity participation in firms established by foreign investors. Canada's interest in encouraging local equity participation was mentioned earlier. In Mexico there is increasing emphasis on arrangements whereby foreign and domestic firms participate jointly in the establishment and operations of enterprises.² In the Philippines, as well as many other countries, there are numerous examples of joint ventures in manufacturing, mining, agriculture, and commerce.³ Some capital-

¹Friedmann, p. 121.

²Flores, p. 15.

³Columbia University, Joint International Business Ventures in the Philippines. (Unpublished research project of Columbia University, 1958), pp. 64-71.

Importing countries make low interest loans or restrict their loans to joint ventures.

The second development has been the wider acceptance and use by capital-importing countries of licensing agreements, management contracts, and other arrangements whereby United States companies can provide products, skills, and ideas without making an equity investment overseas. Licensing programs are used as a means of getting products overseas without a drain on capital funds and with less risks than are involved at times in the establishment of a subsidiary.¹ The Japanese have sought licensing agreements without equity participation; royalties from these agreements were \$39 million in 1957, compared with dividends on direct investments of only \$5.8 million for the same year.² In Japan, as well as in many other countries, there is increasing emphasis on limiting foreign equity investments and promoting licensing agreements.

The Economic Issues

These arguments, attitudes, and legislation are a conglomerate of political, economic, and social considerations. The political and social policies of capital-importing countries form a backdrop and impose limits on an economic analysis of the problems of servicing United States direct foreign investments. This study tries to make the economic analysis meaningful by recognizing these limits. One of the

¹Jack N. Behrman, "Promoting Free World Economic Development through Direct Investment," Papers and Proceedings, American Economic Review (May 1960), p. 277.

²Kiuchi, p. 6.

purposes of this study, however, is to distinguish between the political and social attitudes which are disguised in economic headdress and arguments which have a more fundamental basis in economic considerations.

There is need, first of all, to define more adequately the costs of servicing direct foreign investments. The arguments and attitudes sometimes refer to those of an individual investment and at other times to the flows of foreign investments. Often the costs of servicing foreign investments have not been related to the benefits from these investments, and yet the former are not meaningful unless the benefits are taken into consideration. In addition, the attitudes and arguments have focused on the capital flows and income payments of United States foreign investments, and this is a restricted viewpoint of the effects of these investments on the ability of a country to service them. By investigating and defining these costs and benefits more rigorously, the arguments and attitudes can be brought into perspective and can be better analyzed and evaluated.

In the problems raised by the arguments presented in this chapter, a differentiation must be made between the low-income, capital-importing countries and countries such as Australia and Canada. The debate for the less-developed countries primarily concerns a determination of the forms in which foreign capital is best suited for meeting their needs and desires; the principal alternatives are loan capital and private direct foreign investments. For Australia and Canada, as a few of the quotations indicated, there seems to be greater concern over the volume of foreign investments. Limitations on the volume of foreign capital which should be permitted entry is a primary concern.

The analysis of the costs and benefits of direct foreign investments must be broadened to consider the alternative means of achieving accelerated economic growth. The less-developed countries, having accepted economic growth as the primary goal of economic policy, must make decisions on the relative contribution of direct foreign investments, foreign loans, and domestic investment, both private and public. Conceivably a country could reject all forms of foreign capital, but none in the free world have accepted this alternative. Once the decision is made to welcome foreign capital in some form and in some volume, the relative costs of servicing different forms of foreign investment becomes important to the host country, and the relative benefits from these investments are equally as important because they make the costs and problems of servicing foreign investments meaningful. A rigorous economic and statistical analysis of these costs and benefits makes possible an evaluation of the arguments and attitudes expressed in this chapter.

CHAPTER TWO

THE COSTS OF UNITED STATES DIRECT FOREIGN INVESTMENT: THE AMOUNT OF RESOURCES WHICH ARE TRANSFERRED TO NON-RESIDENTS

There are two principal elements which comprise the costs to the capital-importing country of servicing United States direct foreign investments. The first is the amount of resources which must be transferred out of the host country to pay for the obligations which arise from these investments. The second element is the problems of adjustments in the domestic economy and the balance of payments which are required to make these transfers possible. This dichotomy of the costs is artificial in that each is dependent upon and intimately related to the other, but for analytical purposes it is helpful to consider each separately in order to understand more adequately the costs of United States direct foreign investments. The problems for a country of adjusting to changes in its international investment position will be discussed in Chapter Three. This chapter analyzes the costs in terms of the resources which accrue to non-residents as a result of the investments.

Foreign investments impose costs and confer benefits on the host country. The net costs of these investments may be either positive or negative; the net costs are negative if the benefits from foreign investments are greater than the costs. It is stressed that costs are meaningful only in relation to the benefits from the operations of foreign enterprises. For example, the costs of income payments in terms

of foreign exchange payments have no relevance until all other foreign exchange payments and receipts accompanying the investments have been studied.

The Costs of Particular Investments

The present cost to the host country of a direct foreign investment in terms of the resources which must be moved out of the country to pay for this investment is equal to the discounted values of (1) future income payments arising from the original investment (P), (2) future income payments arising from reinvested earnings (PR), and (3) future capital repatriation (CR). The present benefit to the host country of a foreign investment, on the other hand, is equal to the discounted value of the net domestic product (O_d) from this investment; this is determined by subtracting from the total product (O) first, that portion of total product which is an import component (M), and, second, the opportunity costs of the local resources (C), including labor, capital, and natural resources, which entered into the production of total output. In addition, the present value of the discounted benefits from a foreign investment includes the indirect impact (α) of a foreign investment on the local economy; this impact includes external economies, the encouragement of local investment, and the training of supervisory personnel and the labor force. Thus,

$$\text{Costs} = P + PR + CR \quad \sum_{T=1}^{T=n} \left(\frac{P_T}{(1+i)^T} \right) \quad (I)$$

$$\text{Benefits} = O + \alpha - M - C \quad \sum_{T=1}^{T=n} \left(\frac{O_d T + \alpha_T}{(1+i)^T} \right) \quad (II)$$

If from (I) and (II), the discounted value of benefits exceeds the discounted value of the costs of a foreign investment, the investment has

made a net contribution to the resources of a host country. In this case there has been a net addition to a country's total resources and output as a result of the foreign investment.

The variables in (I) and (II) are not independent of each other, and it is important to understand their relationships to each other.

The value of income payments for any one year are dependent upon the level of earnings and the proportion of earnings which are paid out. Reinvested earnings have a twofold effect on the volume of income payments. For a specified year reinvested earnings decrease the value of income payments which must be paid to foreign investors; at the same time, however, the reinvestment of earnings in the past has increased the value of the investment, and if the added investment is productive and profitable a portion of present earnings and income payments are attributable to past reinvested earnings. One effect of reinvested earnings, then, is to alter the volume of income payments over time. A lower volume of income payments in the first few years is compensated for by higher payments in the future. The extent to which the volume of income payments changes because of reinvested earnings differs with changes in the rate of undistributed profits and the profitability of new investment from ploughed-back earnings.

Thus, the relationship between P , PR , and CR is one of the distribution of payments to the foreign investor over time. For example, if all earnings were paid out, then PR would be zero. On the other hand, if all income was reinvested and then capital was repatriated at some date in the future, P and PR would be zero, and the discounted value of CR would be the measure of the costs of the investment. The higher

the discount rate, of course, the more advantageous it is to the host country for P and PR to be zero, -- that is, for all earnings to be reinvested. For any given discount rate, costs are minimized by postponing payments to the foreign investor.

The choice of an appropriate discount rate is difficult. Essentially, the discount rate should represent the return from alternative uses of the invested funds, or the marginal efficiency of investment. For the less-developed countries, one of their characteristics is a shortage of savings and capital, and the discount rate should be quite high, possibly 7 to 10 percent. The government of India has rather arbitrarily used a rate of 8 percent to discount future returns on capital. For countries like Australia and Canada, where capital is more plentiful, the discount rate may be closer to 6 percent. The high discount rate for less-developed countries is indication of the advantages to these countries of reinvested earnings, for the longer the payment of income to investors is delayed the lower is the discounted value of all future costs.

Income payments are closely related to output. Earnings reflect the productivity of an investment, and when United States companies abroad remit income from current profits to the United States it is likely that the contribution to the resources available to the host country is greater than the amount of resources which must be expended to pay for the income payments. In this respect direct investments do not pose the same problem as does loan capital when consideration is given to whether or not the funds are being used productively. Loan capital represents a fixed obligation regardless of whether or not the

funds are used in a productive manner; if direct investments are not productive and efficient in relation to competitors, profits will be diminished, or there will be no profits, and income remittances are likely to be reduced correspondingly.

Reinvested earnings both decrease the value of income payments in the present and increase the value of future output; they play a strategic role in determining the relative costs and benefits of a foreign investment. While future income payments are likely to increase if reinvested earnings are used productively and profitably, these income payments only reflect increased output. By postponing the payments of income to investors and by increasing output in the present and future, reinvested earnings increase the benefits of foreign investments relative to the costs.

Capital repatriation has varying effects on the benefits from increases in the discounted value of the net domestic outputs. If an investment is liquidated in the process of repatriation, the loss of output to the host country represents a cost which must be added to the cost of CR. In this case, capital repatriation not only increases the volume of resources which must be transferred abroad, but it decreases the volume of output provided to the host country. Where capital repatriation occurs by selling out to local investors, there is a cost in terms of the alternative uses of local funds. Thus, it must be emphasized that not only are P , PR , and CR related to each other but also to θ_d . (I) and (II) are a convenient means of summarizing the costs and benefits from foreign investments, but it must be remembered that the variables are not independent of each other and the relationships be-

tween the variables must be recognized at all times.

Net domestic product is derived by subtracting from total output, first, that portion of total product which is an import component, and, second, the opportunity costs of local resources which enter into the production of total output.

To the extent that the production of foreign branches and subsidiaries is dependent upon imports there is a reduction in the contribution to net domestic output by these firms. Resources obtained from abroad by imports must be paid for by resources available to the host country. If a great proportion of the output from the operations of a foreign investment consists of imported raw materials and other import components, the value added to output by a foreign company is considerably less than the value of total output. The relative importance of imports in the production of United States companies abroad varies between countries and the types of investments. Imports of fuels and capital equipment may be substantial in the extractive and raw materials industries; the operations of many foreign manufacturing branches and subsidiaries are dependent upon imports of raw materials, capital equipment, and semi-finished materials. This will be discussed in greater detail in a later section.

The opportunity costs of local resources used by foreign concerns vary widely among countries, industries, and other conditions of particular concern to individual countries. By concentrating on the less-developed countries, it is possible to make a few generalizations about these costs. First, the opportunity costs of an unexploited resource or raw material, such as minerals in the ground, which have not been

developed because of insufficient capital, equipment or skilled personnel will be quite low or zero for a less-developed country. Similarly, if there is widespread unemployment or underemployment labor may be directed into use by foreign concerns with little loss in output from the rest of the economy. The opportunity costs of unskilled laborers which are trained by a foreign firm to do more technical work is likewise quite low. On the other hand, if foreign concerns were to divert skilled workers from domestic firms the opportunity costs of using these workers will be considerably higher.

United States foreign companies often acquire capital in the host country, primarily through borrowing but also through the sharing of equity investment with local investors. The opportunity costs of using local capital depends partly on whether these funds would have been invested in the absence of foreign investment and partly on the relative efficiency of these funds which are utilized by the foreign investors or by the local entrepreneurs. These will be considered in detail in Chapters III and IV. Also important for assessing the contribution of foreign investments is a determination of whether these investments represent an addition to investment in the local economy or whether they displace local investment. It is likely that in most less-developed countries United States firms, because of their technical superiority, access to research facilities, and advanced positions in general over local firms clearly represent a net addition to investment. In a country such as Canada and Australia, they may replace some investment by local firms, but it is just as likely that they stimulate local investment. The opportunity costs of any displaced local capital depends on

its efficiency relative to that of the foreign capital, and, unless it remains idle, how it eventually is put to work. These considerations also will be examined carefully in Chapters III and IV.

The final element in assessing the factors which make up the benefits of foreign investment is that of the indirect benefits (∞) from these investments. An appraisal of (∞) must be very general because it varies significantly with different types of investments and with different conditions in the host countries. It is not possible, of course, to reduce it to quantitative terms. (∞) signifies the contribution of foreign investments to external economies, the training of the labor force, the introduction of new techniques to the host country, the stimulation of local investment, and even the attitudes of natives of the host country toward work and material possessions. By the introduction of a variety of new goods and services consumption patterns change, and the provision of durable consumer goods affect the attitudes of individuals toward saving. The training of workers improves the efficiency of the labor force, and by introducing new organizational techniques more efficient production is likely to be stimulated.

It is not possible to specify a fixed relationship between the size of (∞) and the stage of development for a country. A country in a low stage of development, such as India or Pakistan, may profit greatly from foreign capital accumulation in its economy or from the training of local workers. The circumstances at any given time in a country may give a particular investment a strategic role in triggering additional investment and output. On the other hand, the

indirect benefits from a foreign investment, perhaps in an export sector, may provide little indirect benefits to the local economy. A more developed economy, such as Canada or Australia, may have a trained labor force lacking only the newest foreign capital equipment to ensure its most efficient use. Again, local investment may be stimulated considerably if access to foreign research facilities is granted. However, no generalization relating the stage of development of an economy to the indirect benefits of foreign investments is justified.

It seems likely, however, that (∞) is likely to be greatest in the early years of an investment; as a foreign company's techniques are diffused to the local economy, and as workers become trained, (∞) becomes less significant. The discounted value of (∞) is greater because the indirect benefits are distributed over time in this manner than if they were distributed evenly over time.

Private and Social Product

Thus far, in discussing the benefits and costs of direct foreign investments, there has been no differentiation between private and social product. It has been assumed that \$1000 in coca-cola output is as worthwhile to capital-importing countries as \$1000 in electrical equipment output. Similarly, private profit has been assumed as a measure of the contribution of a foreign firm to national product. These assumptions are not warranted, of course, because less-developed countries value an investment by how it contributes to the fulfillment of national economic and social objectives. The social value of an investment is judged by such criteria as its contribution to stimulating other investment and

other production, to producing goods which are in particularly short supply or which meet daily living requirements, to training skilled workers, or to easing a bottleneck in a particular industry or sector of the economy. The private value of an investment, on the other hand, is in almost all cases its profitability.

The evaluation of the costs and benefits of a direct foreign investment must include an assessment of its contribution to socially desirable domestic product over costs, not just its contribution to domestic product over cost. It is on this basis that foreign companies often are refused permission to establish subsidiaries for the production of luxury goods, for example. The screening of foreign investments by host countries to ensure that the increase of production which accompanies these investments is socially desirable is generally based on criteria which have roots in the desire to promote self-sustaining economic growth, to improve the levels of living of as great a proportion of the population as possible, and to minimize unemployment. The economist must accept the goals, but he can examine the appropriateness of the criteria for promoting these goals. It is in this context that the costs and benefits of foreign investments are examined in this study.

The Costs of Annual Flows of Investments

The previous discussion attempts to define and analyze the costs and benefits of particular investments. For any given investment the discounted value of future income payments and capital repatriation are compared with the discounted value of future additions to net domestic product. This is a static analysis which tries to assess the

costs and benefits of an investment at a point in time; it is a basis for evaluating whether an investment will make a greater contribution in resources than it will cost in terms of resources. Its limitations in practice are obvious. There is no way of estimating future income payments and output, and any values assigned to opportunity costs of local resources, the indirect benefits, and the discount rate would be arbitrary. Statistics are not available even to evaluate the past performance of an individual investment.

An alternative approach for assessing the relative costs and benefits of foreign investments is to measure the value added to net domestic product by all foreign investments for each year and to compare it with the annual income payments on these investments plus capital repatriation. These would represent the benefits and costs, respectively, for all foreign investments on an annual basis. In this manner, a determination could be made of the net gain or loss in resources from foreign investments as a whole over time. However, this approach also is incapable of being used statistically for many of the same reasons which were stated for the discounted costs and benefits of particular investments. Although yearly income payments are available, statistics on the annual output of foreign companies for individual countries are not available except in one or two instances, and the problems of determining opportunity costs, the indirect benefits, and the import content of output are still unresolved.

Any statistical analysis of the costs and benefits of foreign investments is severely limited by the lack of adequate statistics. Annual statistics are available on income payments, on net capital in-

flow or outflow to the capital-importing countries, and on retained earnings of foreign subsidiaries. From the previous discussion it is evident that even on a flow basis these represent an improper measurement of the costs and benefits of United States direct foreign investments. It gives an insight only to the annual net increases in U. S. investment in the host countries and the costs of these investments in terms of income payments. It is a measurement of the amount of new foreign resources which are made available to the host country for any given year, compared to the amount of resources which must be paid to foreigners during the same year as a result of income payments on existing investments. In Chapter Four, where the available statistics on United States direct investments abroad are presented, this approach is used. It is supplemented by other data which is available and which helps to explain the impact of United States companies abroad on the servicing of United States investments by the host countries. The limitations of this approach are recognized.

CHAPTER THREE

THE TRANSFER OF RESOURCES AND PROBLEMS OF ADJUSTMENT

Introduction

Chapter Two considered the benefits and costs of United States direct foreign investments in terms of the increase in net domestic product compared to the amount of resources which accrue to foreign investors as a result of these investments. In Chapter One, one of the arguments which was cited emphasized that the payment of these obligations to foreign investors requires adjustments in the host country which are antithetical to national objectives for accelerating economic growth and minimizing unemployment. This chapter analyzes the problems of adjustment which accompany the transfer of resources to non-residents.

From the viewpoint of the host countries, adjustments to income payments on foreign investments are regarded as problems under the following conditions. Efforts are made by the capital-importing countries to stimulate economic growth and increase the levels of living of their peoples. This stimulation occurs under varying degrees of governmental control of the economy in the non-Communist world, ranging from the use of monetary and fiscal controls to the direct control by government of production in specified sectors of the economy. Formal growth targets may be specified, or targets may merely represent aspirations of the population which are reasonable with regard for the domestic and foreign resources which are available. Foreign capital

is imported to augment the supply of resources and to make possible a higher rate of growth in total output than if domestic resources alone were utilized. Chapter Two indicated that in the case of direct foreign investments a substantial increase in net domestic output is achieved relative to the costs of these investments. The problems of adjustment center about the distribution of this output, for there are competing claims to it. The local population expects its level of consumption to rise. Domestic investment is expected to expand in order to provide for future additions to output. Finally, foreign investors expect a return on their investments, and this return requires a payment in resources to non-residents from the host country. The economy of the host country must adjust to release the resources and to acquire the foreign exchange which is required to make this payment.

It is the purpose of this chapter to review the process whereby resources are transferred to non-residents, to relate it to the servicing of United States direct foreign investments, and to analyze the problems which are associated with the adjustments accompanying the transfer of resources.

Capital Imports, Income Payments, and the National Accounts

Before proceeding into a discussion of the problems of transferring resources to non-residents, a formal presentation of the relationships between income payments, the current account of the balance of payments, and the national accounts will help to explain the adjustment mechanism and the role of foreign investments in this mechanism.¹ Assuming that there

¹The following approach and symbols are adapted from Gottfried Haberler, A Survey of International Trade Theory (Princeton University, 1955), Chapter 5.

are no foreign assistance or reparations payments or receipts, national income (Y) is equal to consumption (C) plus domestic investment (I_d) plus exports of goods and services (X) minus imports of goods and services (M) plus income receipts or minus income payments on foreign investments (D):

$$Y = C + I_d + X - M + D. \quad (I)$$

If a country is a net capital importer, M exceeds X ; if it is a net capital exporter, X exceeds M .

It is helpful to distinguish between the effects of direct investments and the income payments accompanying these investments on the national income, on the one hand, and on the production (P) and the domestic consumption of consumer and investment goods (V) of the capital-importing countries, on the other. In an isolated economy, Y , P , and V are equal; in an open economy they are not.

For a country which is a net capital importer and which makes investment income payments, the relationship between Y and P is dependent upon the relative size of income payments and net capital imports. First, assuming there are no net capital imports or exports,

$$P = Y - (-D) \quad (X > M) \quad (II)$$

National production is greater than the flow of goods and services in the domestic economy by the amount of investment income payments. The real payment of investment income represents that portion of national production

¹For this equation, "consumption (C) and domestic investment (I_d) are defined so as to include imported consumption and investment goods. In the theoretical literature, on the other hand, C and I_d are frequently defined as home produced consumption and investment goods. It is difficult, however, to sustain such a distinction statistically." *Ibid.*, p. 33. In addition, X and M exclude income payments.

which is not available for domestic consumption or investment.

Capital imports, on the other hand, increase the flow of goods and services in the economy relative to domestic production. Assuming there are no net payments or receipts of investment income,

$$P = Y + X - M \quad (M > X) \quad (III)$$

This, of course, is the precise function of borrowing abroad.

Thus, if net capital imports exceed net investment income payments, Y exceeds P ; if net income payments are greater than net capital imports, P exceeds Y .

An important relationship is that between V and Y . V , the domestic consumption of consumer and investment goods, sometimes expressed as absorption, is defined as,

$$V = C + I_d - (X - M) \quad (IV)$$

If income payments exceed net capital imports ($X > M$), then Y is greater than V . The converse is true if net capital imports are the greater. The real payment of income remittances, by increasing exports relative to imports, reduces the absorption of a country relative to its national income.

Adjustments to Rising Income Payments

The service of direct foreign investments requires adjustments in the domestic economy and the balance of payments of the host country in order to release the resources and to obtain the foreign exchange for making these payments. In order to analyze the transfer problem for countries experiencing rising income payments, it is helpful to distinguish between the transfer of resources and the problems of balance of payments adjustments. This distinction is made only for purposes of analysis and exposition, be-

cause the transfer of resources is managed through balance of payments adjustments and the two are elements of the same overall process. Any problems of transferring resources to foreigners is automatically a foreign exchange problem, because the net transfer of resources occurs through the balance of payments.

The Transfer of Resources

We are interested in the problems of a capital-importing country which is faced with income payments which are rising relative to net capital imports. The country is also attempting to achieve economic growth and to maintain rising levels of domestic consumption and investment. The problem confronting the host country is to increase investment and output sufficiently to meet its foreign obligations and at the same time to provide for rising levels of domestic per capita consumption.

Assume first the problems of a country for which income payments are rising relative to net capital imports, but net capital imports are still greater than income payments. In this case, absorption is greater than domestic production because of the utilization of resources from abroad. However, as income payments rise relative to capital imports, domestic consumption must decrease relative to domestic production. Thus the problem of maintaining absolute increases in consumption depends on the ability of the capital-importing country to increase domestic production at a rate faster than the rise in income payments relative to capital imports.

The growth of domestic production is a function of the quantity and direction of investment, efficiency in the utilization of resources,

technology, the quality and quantity of labor and management, and all the other factors which enter into the processes of production. For our purposes it is sufficient to concentrate on the role of investment, for sustained economic growth over a period of time is highly dependent upon increased investment, and increased investment is the principal contributory factor to the growth of output and income.

With income payments rising relative to capital imports, the increase of domestic income and consumption depends on increased domestic output. Increases in investment are necessary to bring about this growth in domestic production, and, in order to finance this investment, savings as a percentage of national income must increase. That is, the marginal rate of saving must be greater than the average rate.

We are studying the problems for a country which is attempting to increase its level of living and which sets a target rate of growth in output or consumption, generally on a per capita basis, as an economic policy objective. Given this target rate of growth in output or consumption per capita, a country which is faced with rising income payments relative to capital imports must increase the rate of domestic savings and investment sufficiently to expand output at a rate which will fulfill the demands on output. The primary determinants of the rate of increase in the rate of domestic savings and investment which is necessary for achieving the target rate of increase in per capita output and for meeting increased obligations to foreign investors are the capital-output ratio and the rate of increase of income payments relative to capital-imports. Of course, the higher a country sets its target rate of growth in output per capita, and the higher the rate of population growth, the higher must be the rate of

increase in domestic savings and investment to provide for this expansion of per capita output.

The ratio of net annual capital formation to the annual increment of real output is often designated as the incremental capital-output ratio (ICOR). If it is remembered that the ICOR includes all the factors in the economy which affect the growth of output, it is a useful tool for estimating the amount of investment which is required to bring about a given increase in output. For example, in a simplified model, if the ICOR is 2.5, and the target rate of growth in output for that year is 2 percent, investment must be 5 percent of national income to sustain the target growth in output.¹ As the ICOR increases, investment as a proportion of income must increase to sustain a given target rate of growth in output. As the ICOR decreases, investment requirements also decrease.

The rate of increase of income payments relative to capital imports also helps to determine the rate of increase in investment which is necessary for achieving the desired rate of increase in output per capita. For example, if capital imports should decline abruptly from one year to the next and income payments should continue to rise, an extremely high and perhaps impossible increase in the rate of domestic investment might be required to maintain an increasing level of domestic consumption. Thus, the gradualness of the increase in income payments relative to capital imports is a

¹ $0 = I / ICOR$, where 0 equals target rate of growth in total output, I equals the annual rate of investment as a percentage of income, and ICOR is defined as in the text above. See Organization of American States, Financing of Economic Development in Latin America (Washington D.C.: Pan American Union, 1958), pp. 28-38 for a discussion of the use of the ICOR.

determining factor of the types of adjustments which the host country's economy must undergo. A sudden drop in the level of capital imports imposes an especially heavy burden on the host country, as this decline represents a direct decrease in total investment for the host country. On the other hand, if income payments rise abruptly and capital imports remain relatively stable, domestic investment must increase correspondingly. Because investments from abroad have remained at the same level, however, the pressure on domestic investment is eased somewhat.

These are the principal factors which determine the increases in the rate of domestic savings and investment which must accompany a rise in income payments relative to capital imports if domestic consumption or output per capita is to continue to rise. They also determine the limits to increases in domestic consumption and output under these conditions, and they deserve consideration by the developing country when target rates of growth are contemplated. All other things being equal, the lower the rate of population growth, the lower the capital-output ratio, and the more gradual the increase in income payments relative to capital imports, the lower will be the increase in the rate of domestic savings and investment which is necessary to achieve the target rate of growth.

As long as the volume of net capital imports is greater than the volume of income payments, domestic absorption is greater than net domestic production. The process which has been described above is one whereby domestic absorption exceeds domestic production, but the difference between the two is narrowing. The transition to a position where income payments for the host country exceed net capital imports raises no fundamental differences in the adjustment process. Increases in income, con-

sumption and domestic output remain dependent upon increases in investment. When the host country reaches a position where its domestic absorption is less than domestic production, the process of adjustment and the relative burden of increasing investment depend on the same factors which were discussed above. The target rate of increase in output can be achieved if marginal savings and the rate of investment increase sufficiently.

The preceding discussion illustrates the function of capital imports in the development process. Less-developed countries lack the resources and the level of investment to achieve the level and rate of increase in national output to sustain desired rates of economic growth. Capital imports, by buttressing domestic investment both qualitatively and quantitatively, may assist in eventually raising output to a level that the rate of domestic savings are sufficient for financing the investment which is needed to sustain target rates of increase in real per capital income. If the volume of capital imports and domestic investment has been sufficient to achieve this goal, and if the transition is smooth enough, the developing country should be able to gradually reduce its dependence on capital imports for future economic growth and make service payments at the same time. The relevant consideration is: Is investment being increased at a rate sufficient to provide for the target rate of growth of per capital output and, at the same time, to meet the obligations to foreign investors? The contribution of capital imports to increasing net domestic output is one basic criterion by which the relative benefits from foreign investments should be judged.

Adjustments In the Balance of Payments

We have been concerned in the previous section with the adjustments in the economy of the host country to increases in income payments relative to capital imports. The focus has been on the problems of maintaining increases in the target rate of growth of output and at the same time making higher income payments to foreign investors. This payment of income to foreign investors is a foreign exchange payment. Therefore, the balance of payments of the host country must adjust to provide the foreign exchange for making these payments.

The adjustments in the balance of payments to rising income payments are, however, only one element in the balance of payments adjustments accompanying economic growth. For the less-developed countries, increases in output generally require imports of raw materials, capital goods, and fuels which are essential to investment and production. For example, over three-fourths of Latin American commodity imports consist of capital goods, raw materials and intermediate products, and petroleum.¹ These imports are vital to the growth of investment and output in these countries. Thus, increases in output and investments put pressures on the balance of payments by first, raising the volume of imports, and, second, by the rising income payments to foreign investors when foreign investments have been utilized.

The increased foreign exchange payments for income remittances and imports can be offset in the long run by an increase in exports or by

¹U. S., Congress, Senate, Committee on Foreign Relations, United States-Latin American Relations: Problems of Latin American Economic Development, 85th Congress, 2d session, 1960, p. 82.

import substitution. The experience during the past decade has demonstrated that the less-developed countries have not been successful in limiting imports or expanding exports relative to imports. The agricultural export policies of some countries, primarily the United States, and the protection of agriculture by most of the industrialized countries have been instrumental in limiting the exports of the less-developed countries. Exports of these countries have increased, but at a relatively slow rate. More formidable, however, are the severe limitations to the ability of the less-developed countries to reduce imports by import substitution. The persistent increase in demand for both consumer and capital goods and fuels during a period of economic growth makes it impossible for the developing countries to maintain levels of investment and production which could meet this increased demand by domestic production alone. The experience during the past decade has shown how imports have increased relative to exports for the less-developed countries. For example, exports of the Latin American countries increased only 23 percent between 1950 and 1957, while imports increased 55 percent.¹ For the Philippines, exports increased 49 percent and imports increased 64 percent from 1950 to 1958; India, for the same period, experienced an increase in exports of only 6 percent while imports increased 56 percent.²

The excess of imports over exports by most of the less-developed countries during the 1950's has been financed by private foreign capital,

¹Ibid., p. 81.

²International Monetary Fund, International Financial Statistics, XII (December 1959), pp. 148-149 and 210-211.

by loans from international lending agencies such as the International Bank for Reconstruction and Development, and government loans and grants. As income and interest payments rise relative to capital imports, however, the balance of payments must adjust and countries must increase foreign exchange receipts relative to foreign exchange payments. The manner in which the balance of payments adjusts to achieve this relative increase in foreign exchange receipts is the subject of this section.

In the short run an increase in foreign exchange payments relative to foreign exchange receipts generally is met by drawing down foreign exchange reserves or by short term borrowing from the International Monetary Fund or other foreign sources of short term funds. The consequences of exchange rate changes or deflationary policies are regarded as too severe by these countries to use these tools of adjustment to correct short run disequilibrium. Over the long run, however, a country must pay its own way, and more permanent adjustments must be made to increase foreign exchange receipts relative to foreign exchange payments.

The manner in which the balance of payments and the domestic economy adjust over the long run to a persistent deficit or surplus in a country's international transactions varies for each individual country and with the basic causes of disequilibrium. However, for purposes of analysis, it is helpful to distinguish between those adjustments which occur more or less automatically, those which rely on changes in the exchange rates, and those which result from conscious efforts by governments to reallocate resources in order to restore equilibrium. The restoration of equilibrium in the balance of payments is likely to depend on all these types of adjustments.

Automatic Adjustment Forces

As an explanation of the restoration of balance of payments equilibrium, the classical adjustment mechanism relied on prices to bring about balance of payments adjustments and to restore equilibrium. With flexible prices and mobility of resources, an excess of foreign exchange payments over receipts was expected to bring about a contraction of credit caused by the outflow of gold. As a result of the decrease in the quantity of money the general price level would decline in the deficit country. This decline in prices would make its exports more competitive on world markets, and imports would become relatively expensive. It was thought that resources would be directed into the export sector, imports would be discouraged, and the resulting increase in exports and decrease in imports would restore equilibrium in the balance of payments.

More modern theory which emphasizes automatic adjustments places greater attention on the role of income changes in balance of payments adjustment. It is expected that in the surplus country income should rise through the excess of exports relative to imports. Increased expenditures stimulate domestic investment and, via the multiplier, incomes increase as a multiple of the original expenditure. Some of this increase in income will be spent on imports, the proportion depending on the marginal propensity to import, and to the extent that imports decrease, balance of payments adjustment occurs directly. The remainder of the increased expenditures are expected to result in price changes which have the effects which were described in the discussion of the classical adjustment mechanism.

In the deficit country incomes decrease as a multiple of the original deficit in the balance of payments, and as a result it is expected that

Imports will decline, the rate of decline depending again on the marginal propensity to import. Thus, while price changes are not ignored in this explanation of the automatic adjustments to deficits and surpluses, they are subordinated to the effects of changes in income.

Changes in Exchange Rates

Changes in exchange rates are another means of adjustment to restore balance of payments equilibrium. Exchange rate changes may be fairly automatic, as when a country adopts a fluctuating exchange rate, or they may require official government action, such as devaluation of a fixed exchange rate.

Most countries, with the exception of Canada and more recently some of the countries of Latin America, have not had fluctuating exchange rates in the postwar period. A country which has a flexible exchange rate achieves equilibrium in the balance of payments by allowing the price of its currency in terms of foreign exchange to vary with the effective supply and demand for its currency. If the exchange rate is free to fluctuate with no interference from government authorities, essentially it is an automatic adjustment mechanism. However, government authorities generally apply monetary and fiscal policies and other tools at their disposal to stabilize the exchange rate. The extent to which a fluctuating exchange rate is a means of automatic adjustment depends on the degree of government interference in the foreign exchange market and the actions which a government takes domestically to counteract rises and declines in the exchange rate.

During the postwar period most countries have employed fixed exchange

rates with their currencies tied to gold or to another currency which is tied to gold. Some countries have maintained their fixed exchange rates by balancing the supply and demand for foreign exchange through extensive controls over foreign exchange transactions and the movements of goods, services and long term capital, but the use of these controls has declined progressively in the last decade. With fixed exchange rates, the adjustment to persistent deficits or surpluses in the balance of payments has generally been through exchange rate devaluation. By devaluation and the proper use of monetary and fiscal policies, governments make efforts to eliminate excess demand, to stimulate exports, and to promote the reallocation of resources in order that equilibrium may be restored in the balance of payments. The relative effectiveness of devaluation in promoting adjustments in the balance of payments and in the domestic economy varies with the appropriateness of government policies with regard to the causes of disequilibrium, the elasticities of supply and demand for imports and exports of the devaluing country, and other individual characteristics of the economies of the countries undertaking devaluation.

The Policies of Governments toward Adjustments

In the managed economies of the postwar world, governments have been an active and usually the dominant influence in the adjustment process. Monetary and fiscal policies are used to counteract tendencies toward deficits or surpluses in the balance of payments. With government expenditures and revenues assuming large proportions in total output and income in most countries, the direction of government investment, subsidies, selective controls, and taxation are among the means which a government

has at its disposal to promote adjustments to disequilibrium in the balance of payments, or, for that matter, to a deficiency or surplus in demand or investment in any sector of the domestic economy. Governments in the less-developed countries use these tools to promote economic growth and to attempt to maintain balance of payments equilibrium. Some governments put greatest reliance on monetary and fiscal policies, and others emphasize direct controls and more government participation in production and distribution. Governments may program investment priorities or apply extensive developmental planning to stimulate investments or to maintain equilibrium in the balance of payments.

Adjustments to Rising Income Payments by Capital-Importing Countries

No country relies exclusively on any one of the types of adjustment mechanisms to achieve equilibrium in the balance of payments. In fact, these categories of adjustment are artificial, for all operate simultaneously. The relative influence of automatic adjustments, exchange rate changes, and direct government intervention in bringing about adjustments to a deficit in the balance of payments will differ between countries and vary in importance at different times for the same country.

For less-developed countries which are experiencing an increase in income payments and attempting to maintain target rates of growth in per capita output, the appropriate types of adjustments for maintaining balance of payments equilibrium will be different for each individual country. However, because many of these countries are confronted with similar problems of adjustment, some general observations can be made about the nature and types of adjustments which are likely to be employed and to be

appropriate.

First, because the governments of these countries are often exerting direct influences on the direction and volume of investment, it is likely that their present and anticipated balance of payments positions are among the criteria which help determine investment priorities and the direction of government expenditures. Potential deficits in the balance of payments of these countries should bring about efforts by them to direct investments into export and import-competing sectors of the economy. The means used to stimulate the supply of exports and import substitutes will vary with individual circumstances. Export subsidies or government investments in transportation facilities utilized by export industries suggest the wide range of policies which countries may use to increase foreign exchange earnings.

Increasing levels of imports and income payments may require other adjustments, however. Developing countries often have trouble restricting price rises, and their exchange rates may be overvalued. Whether or not devaluation is a proper solution depends on many factors. If the country exports only one or two primary products which have relatively low supply elasticities, devaluation may not have much effect in increasing total export receipts. Attempts to diversify the economy and more vigorous attempts to control inflation may be the most appropriate policies. On the other hand, if the elasticities of supply and demand for the types of goods which these countries export and import are more elastic, and the deficits in the balance of payments are the result of overvalued exchange rates and an excess of domestic absorption over domestic production, devaluation may be an effective approach toward adjustment. Of course, the success of devaluation depends on the effective application of other

policies, also. If a country devalues its currency but does not adopt monetary and fiscal policies which restrict credit and minimize internal price increases, devaluation may only result in an inflationary spiral. Similarly, if resources are relatively immobile the expansion of exports may be quite limited. Governments may train workers in skills required in export industries or in other ways directly promote a reallocation of resources into the export sector to increase the possibilities for increasing export receipts by devaluation.

Automatic adjustments to balance of payments disequilibrium often play an important role, also. In the long run countries must adapt to changing demand and supply conditions in world markets, and they must live within their capacity to produce and to borrow from abroad. A rise in the prices of goods which are imported may be the most effective way of encouraging resources into the production of import substitutes. If deficits in the balance of payments are accompanied by deflationary policies, and if prices are flexible and resources are relatively mobile, price changes may be the most efficient means of restoring equilibrium.

Summary

The long run growth in output, domestic savings, and investment and an increase in the capacity to transfer resources to foreign investors are integral elements of the growth process. Unless a country is able to adjust, consciously or otherwise, to a changing balance of payments position, the opportunities for achieving a sustained growth in income are diminished and perhaps jeopardized. Growth in income, savings, and investment and growth in the capacity to service foreign investments are interdependent

in the long run.¹

Capital imports make a contribution to the host country both in terms of resources and in terms of foreign exchange. By utilizing resources from abroad, net capital-importing countries can increase production and consumption at higher rates than if they rely only on domestic resources. In addition, capital imports give these countries access to foreign resources without increasing their foreign exchange requirements.

As income payments rise relative to net capital imports, however, the host country must increase foreign exchange receipts relative to other foreign exchange payments; it also must increase investment and output sufficiently if its level of living is not to decline as resources are transferred to non-residents. The extent to which rising income payments in foreign exchange and the real transfer of resources cause problems for the host country depends basically on the rate of increase in output and the ability of a country to increase foreign exchange receipts relative to foreign exchange payments. The rate of increase and the direction of investment are the determining factors in this process of adjustment. Investment, both foreign and domestic, must be directed into sectors of the economy where it is most efficient and makes the greatest contribution to output.

The relative importance of price changes, government monetary and fiscal policies, and other means of adjustment to changing demand and supply and balance of payments conditions will vary from country to country and will vary from one period to the next. The types of adjustments which

¹Avramovic, pp. 57-58.

are most beneficial for a country, with consideration for its efforts to increase the rate of per capital output, are those which promote the most efficient utilization of available foreign and domestic resources and at the same time maintain balance of payments equilibrium over the long run.

CHAPTER FOUR

THE MEASUREMENT OF THE COSTS AND BENEFITS OF UNITED STATES DIRECT FOREIGN INVESTMENTS

Statistics are not available for measuring accurately the costs and benefits of United States direct foreign investments. A quantitative assessment of the value of the indirect benefits and of the opportunity costs of local resources is, of course, not possible. A measurement on an annual basis of the net contribution of United States direct foreign investments to the resources of capital-importing countries compared with the resources which must be paid out as a result of these investments would be an approximate assessment of the costs and benefits on a flow basis. However, the annual output of United States companies abroad is not separated from that of all companies in statistics of practically all capital-importing countries. The United States Department of Commerce does have breakdowns by area, country, and industry of net capital flows, income payments, and reinvested earnings of United States companies abroad, and one study of the sources and uses of funds by United States companies abroad is useful for estimating the relative importance of capital flows and income payments to the total sources and uses of funds. In addition, a study was made by the United States Department of Commerce of the operations of United States companies in Latin America in 1955, and it includes some statistics on the production and sales in Latin America for that year.

The previous discussions of the costs and benefits of United States

direct foreign investments and the problems of transferring income payments pointed out the considerations which are most important in determining the ability of countries to maintain rising levels of consumption and investment and at the same time to pay for rising investment service obligations. The performance of United States companies abroad in promoting exports, in reducing or increasing imports, and in promoting local savings and investment will be evaluated where statistics are available.

The limitations on the data which are used are many. They will be discussed as the material is presented. Data are given for Canada, Argentina, Chile, Colombia, Cuba, Mexico, Peru, Venezuela, Australia, India, Indonesia, Japan, New Zealand, and the Philippine Republic. The countries selected are some where United States direct foreign investment has been appreciable and where statistics are available. Manufacturing investments have been singled out for special attention in order to have some basis for evaluating the arguments in Chapter One which indicated that manufacturing investments pose particular problems for the balance of payments of the capital-importing countries when these investments are primarily oriented toward production for the domestic market.

Definitions

In most cases data of the United States Department of Commerce are used, and its definition of direct investment, earnings, income, net capital outflow, and undistributed earnings are important for understanding the relevance of sets of statistics and evaluating the influence of United States direct foreign investments on the servicing of these investments.

For Department of Commerce purposes, direct investments are those

where there is a holding of 25 percent or more of the voting stock of the foreign corporation by one person or one company; this may be a direct holding or through domestic affiliated corporations. This statistical measurement does not encompass all the aspects of control but it is helpful for statistical purposes and it is not ambiguous.¹ Some adjustments are made for companies in which it is known that control is exercised even though ownership is less than 25 percent, or if the converse is true.

The value of direct foreign investments is equal to the sums of net capital outflow, undistributed subsidiary earnings, and relatively minor accounting adjustments.² The values used are book values, and they understate values which more closely approximate market or replacement value. For example, book values do not include depreciation or depletion allowances; neither do they account for expenditures on plant and equipment financed by funds obtained in the foreign capital market. "A review of the limited number of enterprises for which both a market and a book value can be established indicates that the market value of direct investments could well be more than double their book value."³ It is also estimated that nearly 40 percent of the total funds available to direct investment firms are derived from foreign financing and depreciation charges.⁴

¹U.S., Department of Commerce, Balance of Payments of the United States, 1949-1951 (Washington: U.S. Government Printing Office, 1952), p. 93.

²U.S., Department of Commerce, Survey of Current Business, XXXVII (August 1957), p. 22.

³Department of Commerce, Survey of Current Business, XXXVI (August 1956), pp. 14-15.

⁴Department of Commerce, Survey of Current Business, XXXIX (January 1959), p. 21.

Department of Commerce estimates of the value of United States direct foreign investments represent a somewhat limited approach to assessing the volume of these investments, and they reflect only capital outflows as they appear in the United States balance of payments plus undistributed subsidiary earnings. However, they are useful for estimating the outflow of dollars and dollar goods by United States investors to capital-importing countries.

Net Capital Outflow and Undistributed Earnings

Net capital outflow and undistributed subsidiary earnings are not statistically distinct from each other. Net capital outflow basically is a balance of payments concept. Since most direct investment capital movements take place between intercompany or home office accounts, net capital inflows or outflows are the balance of all gross movements in these accounts.¹ There is ambiguity in the term, net capital outflow, as used by the Department of Commerce; it may be traced to the differentiation between branches and subsidiaries and the different statistical treatment given to the earnings of each. In Department of Commerce statistics, "branches" refer predominantly to United States incorporated foreign subsidiaries of United States petroleum and mining corporations. Such subsidiaries are often incorporated in the United States for tax purposes; by doing so, depletion allowances may be used in computing taxable income.² This definitional distinction between subsidiaries and branches is not important in assessing

¹Balance of Payments of the United States, 1949-1951, p. 94.

²Because Canada also offers such allowances, mining and petroleum companies generally incorporate their subsidiaries in Canada, and in these cases are treated as "subsidiaries" by the Department of Commerce.

the flow of resources to other countries from United States investments, but it does result in an understatement of the volume of reinvested earnings as a source of United States investment funds. Branches are assumed to remit all profits to the parent company, and any earnings which are retained appear in the balance of payments as net capital outflows.

Earnings, Income, and Retained Earnings

The statistics for earnings show the sums of income plus undistributed subsidiary earnings. For the Department of Commerce, income refers to dividends, interest, and branch profits, and it is a measure of foreign earnings which are remitted, or assumed to be remitted, to the United States. They represent the cost in foreign exchange of servicing direct investment. Undistributed subsidiary earnings measure retained earnings of foreign incorporated subsidiaries. Retained earnings encompass a great many uses of funds and do not necessarily signify an increase in productive capacity. Undistributed profits may be used to expand plant and equipment, but they also may be used for inter-company loans or advances to parent companies, or they may remain as idle funds when neither permanent investment nor remittances to the parent company is feasible or possible.¹ For example, foreign government restrictions on remittances may result in the compulsory retention of funds, or tax considerations of the parent company may bring about retention of earnings for other than investment purposes. Of course, some investment may occur when the funds become available originally for other reasons; investment is likely to be a superior alternative to

¹Department of Commerce, Survey of Current Business, XXXIII (December 1953), p. 11.

allowing the funds to remain idle.

With these definitions of direct investments, net capital outflow, earnings, income payments, and retained earnings established, it is possible now to examine in a limited way the inflow to the host country of goods and dollars accompanying United States net capital outflows and retained earnings. These may be compared with the volume of income payments, which is a limited measurement of the cost in resources of servicing these investments.

The Net Contribution of Resources

The Value of Direct Foreign Investments

It is important to examine both the overall magnitudes of United States direct foreign investments and annual variations in these investments. While the value of direct investments does not measure their contribution of resources to capital-importing countries, it does indicate whether these investments are increasing or decreasing, and also the rates of change are indicated. The annual increments to foreign investment not only influence long-run adjustments in the balance of payments but may cause short-run disturbances which impair the ability of a country to service investments.

The 1950-1958 period has witnessed a fairly steady growth of United States direct investments in foreign countries; they rose from \$11.8 billion in 1950 to \$27.1 billion in 1958. (Appendix Table 1). For most years the annual increase has been between \$1.3 billion and \$1.8 billion, with the exception of 1956 and 1957 when increases of approximately \$3 billion each year was registered. In 1958, Canada and the Latin American

republics represented 65 percent of this total, and both areas have experienced yearly increases in the value of direct investments over the 9-year period. Of the 15 countries for which data are given, only six countries (Chile, Colombia, Peru, Venezuela, Indonesia, and New Zealand) had any one annual decline in the value of direct investments, with Colombia and Indonesia experiencing two such declines. There is some cyclical pattern to the United States investment outflows, with relatively smaller increases from 1953 to 1954, and from 1957 to 1958, the latter following the abnormally high volume of 1956 and 1957 which primarily represented increased foreign oil investments.

The experience of direct investments in manufacturing has been similar to investments in all sectors. (Appendix Table II). Manufacturing investments rose from \$3.8 billion in 1950 to \$8.5 billion in 1958, an increase of about 221 percent, compared to an increase of approximately 229 percent for all direct investments. Most countries experienced annual increases in the value of United States direct investments in manufacturing, but this growth was less steady for particular countries. For example, in Cuba the value of direct investments in manufacturing in 1956 was less than the total in 1950. On the other hand, while total investments in Brazil were 209 percent higher compared with 1950, manufacturing investments were 260 percent of the 1950 figure. The annual increases in the value of investments in manufacturing for all areas averaged 10.5 percent over the period 1950-1958, these annual increases ranging from 6.2 percent in 1953 to 13.6 percent in 1951. Most countries experienced better than a doubling of the value of direct investments in manufacturing over the period.

It is difficult to assess the relative contribution of net capital

outflow and undistributed earnings to the growth in investments. As indicated earlier, net capital outflow includes retained earnings of branches. For example, the greatest proportion of the increase in net capital outflow during 1956 and 1957 was in petroleum, where investments in branch organizations is a large proportion of total petroleum investments; a large proportion of this net capital outflow represented reinvested earnings. Thus, while undistributed earnings are underestimated in Department of Commerce data, the relative magnitudes and patterns of these two sources of investment funds may be compared.

From 1950 to 1958, undistributed earnings accounted for 47 percent of the \$15.3 billion increase in the value of direct investments. (Appendix Tables IX and X). Net capital outflow was 60.1 percent of this increase, the two not adding to 100 percent because of minor adjustments and statistical discrepancies. (Appendix Tables III and IV). The comparable figures for manufacturing investments were 72 percent and 34 percent, respectively. Net capital outflow would be a smaller percentage of the contribution to total investment if branch reinvested earnings were not included. For most years, annual increases in net capital outflows are accompanied by increases in undistributed earnings, and each contributed to approximately half of the rise in the value of direct investments, although the large petroleum investments in 1956 and 1957 resulted in net capital outflows approximately twice as large as reinvested earnings.

Undistributed earnings are a proportionally greater source of funds in manufacturing investment. Net capital outflow was only 48 percent of the contribution by reinvested earnings over the 1950-1958 period. For each year undistributed earnings in manufacturing were larger than United

States net capital outflow to manufacturing firms. Many capital-importing countries experienced annual increases in the value of investments in manufacturing at the same time that there was a net repatriation of capital to the United States; in these cases reinvested earnings were greater in volume than the withdrawal of capital by United States investors. For example, in Mexico from 1953 to 1954 undistributed earnings were \$10 million and \$9 million of capital, net, returned to the United States. Thus, even while the value of investments was increasing there was a net repatriation of capital on capital account for Mexico during 1953. The general experience, however, has been for both net capital outflow and retained earnings to contribute to the annual increases in the value of manufacturing investments. Only in 1953 was there a net capital inflow to the United States in the manufacturing sector, and the increase in the value of manufacturing investments in 1953 is attributable only to retained earnings.

Undistributed earnings in the manufacturing sector are a more stable source of investment funds than United States net capital outflow and are less sensitive to United States economic fluctuations. Over the 1953-1954 period, net capital outflow in manufacturing was \$58 million, which was only 28 percent of the 1952 figure; the comparable figure for 1958 was less than half that of 1957. The net capital inflow to the United States in 1953 was greater than the total net outflow over the next three years. In contrast, during 1953-1954 undistributed earnings in manufacturing were equal to the volume for the previous two years, and the comparable figure for 1958 was greater than that for 1957, increasing from \$391 million to \$402 million. Therefore, the increase in foreign manufacturing investments during periods of recession in the United States is attributable primarily

to retained earnings; the proportion of the increase in the value of the investments represented by a new outflow of dollars or goods is reduced. Foreign subsidiaries in their investment decisions are less affected by economic conditions which influence investment decisions of the United States parent companies than are firms contemplating either a new foreign investment or additional dollar flows to established subsidiaries.

Earnings, Income, and Undistributed Profits

By studying the earnings, income payments, and retained earnings of United States foreign companies, we can learn what has been the rate of return on United States direct foreign investments and we may observe the annual flows of income payments on these investments. In this way the arguments which stress the high rate of return on direct investments and the inflexibility of income payments also may be evaluated.

During the 1950-1958 period, total annual earnings of United States companies abroad increased by approximately two-thirds, from \$1769 million in 1950 to \$2954 million in 1958.¹ (Appendix Table V). The two years of recession in the United States and throughout the world generally, 1953 and 1958, were the only years in which earnings were lower than those for the previous year. For both these years earnings in manufacturing increased and the overall declines primarily resulted from decreased earnings in export industries, particularly petroleum. Not all countries had the same

¹Earnings are net of foreign taxes but before payments of the United States corporation income tax. While they do not represent net returns to the United States investors, they do show the return paid by the foreign countries and the earnings of the United States from its foreign investments.

experience, however. While earnings for such countries as Argentina, Brazil, Chile, Colombia, Cuba, Mexico, and Peru declined in 1953, Canada, Australia and Venezuela experienced increases. The value of earnings of direct investments in Australia, for example, increased from \$33 million in 1952 to \$51 million in 1953, an increase of approximately 55 percent, the largest annual percentage increase for Australia during the 1950-1958 period.

Earnings for manufacturing investments have not shown the same cyclical pattern as earnings for all investments. (Appendix Table VI). Except for 1952, the value of earnings for all areas increased each year, although again individual countries had varied experiences. The level of manufacturing earnings for Brazil declined steadily from \$89 million in 1951 to \$21 million in 1958, even though the book value of investments climbed from \$270 million in 1950 to \$701 million in 1958.

For the 1950-1958 period earnings as a percentage of the book value of direct investments for all areas has averaged annual 14 percent. (Table IV-1). This average would be considerably less if earnings on petroleum investments were excluded; the annual average for petroleum investments has been over 20 percent. The annual average of earnings as a percentage of the book value of direct investments in manufacturing was 13 percent. (Table IV-2). However, for those countries where petroleum investments are not a significant proportion of total foreign investments, the rate of return on investments in manufacturing was higher for almost all years than the rate of return on all investments when book values are used. Returns on investments in agriculture, service industries, and public utilities has been substantially lower than in manufacturing. The rate of return both on all investments and on investments in manufacturing has

TABLE IV-1

EARNINGS AS A PERCENTAGE OF THE BOOK VALUE OF DIRECT INVESTMENTS
FOR ALL AREAS AND SELECTED COUNTRIES, 1950-1958

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
All Areas	15	16	16	13	13	15	14	13	11
Canada	12	10	9	9	8	9	10	8	6
Argentina	5	8	8	5	7	6	5	6	3
Brazil	15	18	15	11	8	6	6	6	4
Mexico	11	14	12	9	9	11	12	10	9
Venezuela	23	30	28	26	25	30	30	25	16
Australia	13	14	11	16	15	13	11	14	14
Philippine Republic	26	22	19	15	16	17	16	15	16

Source: Appendix Tables I and V.

TABLE IV-2

EARNINGS AS A PERCENTAGE OF THE BOOK VALUE OF DIRECT INVESTMENTS IN MANUFACTURING
FOR ALL AREAS AND SELECTED COUNTRIES, 1950-1958

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
All Areas	17	16	13	13	12	13	12	11	10
Canada	16	13	12	11	10	12	12	10	9
Argentina	9		9	4	10	6	6	6	3
Brazil	17		17	13	9	6	6	5	4
Mexico	14		11	10	10	11	12	11	10
Venezuela	21		21	19	15	17	19	8	8
Australia	23		23	19	19	20	15	18	19
Philippine Republic				20	24	26	29	24	24

Source: Appendix Tables II and VI

declined over the 1950-1958 period, although since 1951 the rate of return has ranged between 11 percent and 13 percent except for 1958 when it dropped to 10 percent. For most countries represented in the sample, 1953 and 1958 were years of decline in the rate of return over those prevailing in previous years; this has been true not only for all investments but also for investments in manufacturing. Australia and the Philippine Republic are the principal exceptions. In neither country has there been any appreciable decline either over the entire period or for any individual year, and for both of these countries the rate of return on manufacturing investments has been higher on the average than for other countries. For the 1953-1958 period, the annual average rate of return on foreign investments in Australia was 19.0 percent, while for the Philippine Republic it was 24.5 percent. The average annual rate of return for these investments in Canada was 11.6 percent, for Brazil 9.8 percent, and for Mexico 11.0 percent. For all the countries listed other than Australia and the Philippine Republic the return on manufacturing investments declined in 1953 and 1958.

The use of book values of investments as the base for computing the rate of return has certain limitation for purposes of comparison with rates on alternative forms of investment, primarily interest rates on loan capital. As was stated earlier, the United States Department of Commerce estimated that book values of United States investments abroad understate market values by approximately one-half. If this is true, the rate of return on manufacturing investments as a percentage of the market value of the investments would range around 7 percent. The importance of the choice of a proper base on which to compute the rate of return may be illustrated by some figures which apply to the profits of General Motors-Holden, Ltd. in

Australia. For 1953-1954, profits for this company were 560 percent on the original dollar investment, 39 percent on net worth, 24 percent on the funds employed, and 14 percent on sales; similarly, the dividend to the parent company was 260 percent on the original dollar investment, 18 percent on net worth, and 11 percent on the funds employed.¹ All of these figures have been cited at one time or another in Australia as evidence of the high rates of return on United States direct investments. Thus, while book values are the only basis we have for calculating the rate of return, we should remember that these overstate considerably the rate of return based on market values of the investments.

The rate of return and fluctuations in this rate help determine the amount of income paid out to foreign investors; variations in the proportion of earnings which are distributed as dividends rather than being retained also change the volume of income payments accompanying a given volume of earnings. If a decline in earnings is offset by a relative decrease in retained earnings and a higher percentage of earnings is paid out as income, income payments could rise even though earnings are decreasing. The percentage of direct investment earnings distributed as income is an important factor in determining the level of investment income payments and must be studied along with the level of earnings.

The value of income payments has tended to follow the volume of earnings, but changes in the percentage of direct investment earnings paid out as dividends, interest, and branch profits have resulted in some excep-

¹Penrose, p. 221

tions. In only two cases have total income payments declined from the previous year; although earnings increased from \$2244 million in 1951 to \$2295 million in 1952, income payments declined by \$115 million despite an increase in the percentage of earnings distributed. (Appendix Tables VII and VIII). This decrease in income payments was a result of the decreased earnings in petroleum and restrictions on income remittances by some countries. The experience with variations in the value of earnings and income payments for manufacturing investments has been similar to that for all investments. Since 1952 income payments have risen steadily from \$287 million to \$471 million in 1958. Retained earnings of manufacturing firms have averaged about 51 percent of earnings.

The percentage of direct investment earnings distributed as income for all areas averaged 69 percent, compared to 49 percent for manufacturing investments. (Tables IV-3 and IV-4). Because the percentage for all investments includes branch profits of petroleum firms, a large proportion of which was reinvested, Department of Commerce statistics understate reinvested earnings for all investments. It is likely that the proportion of branch earnings that are reinvested is higher than in the case of subsidiary earnings.¹ For Canada, where most petroleum companies are foreign incorporated subsidiaries, the percentage of income paid out on all investments and on manufacturing investments averaged 55 percent for each over the 1950-1958 period.

The figures on income payments and remittances of branch profits give

¹Raymond F. Mikesell, Promoting United States Private Investment Abroad, (Washington D.C.: National Planning Association, 1957) p. 20.

TABLE IV-3

THE PERCENTAGE OF DIRECT INVESTMENT EARNINGS DISTRIBUTED AS INCOME
FOR ALL AREAS AND SELECTED COUNTRIES, 1950-1958

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
All Areas	73	67	62	66	73	68	68	70	74
Canada	67	57	53	44	50	50	49	57	65
Argentina	33	38	40	55	29	33	54	32	50
Brazil	63	53	43	66	52	46	36	53	66
Mexico	66	48	52	64	109	48	40	53	61
Venezuela	102	94	78	90	92	93	92	91	90
Australia	41	31	24	26	42	38	42	43	42
Philippine Republic	72	74	82	83	77	26	50	49	45

Source: Appendix Tables V and VII

TABLE IV-4

THE PERCENTAGE OF EARNINGS OF DIRECT INVESTMENT IN MANUFACTURING DISTRIBUTED AS INCOME
FOR ALL AREAS AND SELECTED COUNTRIES, 1950-1958

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
All Areas	56	48	45	46	49	48	45	54	54
Canada	70	61	54	48	55	52	40	57	61
Argentina	28	26	22	38	14	29	43	33	57
Brazil	47	44	36	54	44	33	29	47	50
Mexico	47	28	30	52	52	37	35	50	51
Venezuela	80	83	71	43	43	60	73	38	44
Australia	27	14	17	25	53	40	49	47	49
Philippine Republic				80	71	75	60	50	42

Source: Appendix Tables VI and VIII

a fairly accurate estimate of the volume of resources which must be transferred out of the country to meet payments to United States investors. The 1950-1958 period has been one of steady increase in the volume of income payments for the sample of countries which has been considered. Income payments, especially in manufacturing, have shown little tendency to fluctuate with the levels of general economic activity. United States investors apparently attempt to stabilize income receipts from the operations of their foreign branches and subsidiaries. At the same time, however, the value of direct investments has increased rather steadily, and income payments have not increased as a proportion of the value of direct investments. Only in 1954 and 1958 has net capital outflow plus undistributed subsidiary earnings for all areas been considerably less than income payments. (Appendix Tables III, VII, and IX). In 1954 the value of net capital outflow plus undistributed earnings was \$1308 million and income payments were \$1725 million; the comparable figures for 1958 were \$1849 million and \$2198 million. On the other hand, in 1952, 1953, and 1957 income payments were less than the increase in the book values of all United States foreign investments for all areas.

The experience in manufacturing investments has shown that for all areas net capital outflow plus undistributed earnings has been greater than income payments in every year for the 1950-1958 period except 1953, when the increase in the value of direct investments and income payments practically offset each other. (Appendix Tables IV, VIII, X). In many of these years the increase in the value of direct investments was almost double that of income payments.

Thus, the United States contribution in resources to the host countries

in terms of net capital outflows and undistributed earnings has been considerably greater in manufacturing than the value of resources required to make income payments. For all United States investments the experience has varied from year to year. For the 1950-1958 period as a whole, income payments on all investments totalled \$15,915 million, while the value of United States direct investments increased from \$11,788 million to \$27,075 million, an increase of \$15,287 million. Because United States Department of Commerce figures seriously understate the true value of these investments, they do not measure the real impact of these investments in providing resources to the capital-importing countries, and all United States investments undoubtedly make a much greater contribution in resources than they have taken out of these countries.

Additional Estimates of the Contribution of Resources

The contribution of United States direct foreign investments to the national products and national incomes of the host countries is much greater than is indicated by the book values of United States investments in these countries. The contribution to resources is not revealed in statistics which measure United States direct foreign investments by net capital outflow and reinvested earnings. Studies of the uses of funds by United States companies abroad show more completely the effects of the operations of these companies on the capital markets, on investments, and on expenditures in the economies of the host countries. In addition, accompanying United States direct foreign investments are skilled managerial and technical personnel which not only play a role in educating and training domestic employees but introduce new techniques which, if efficient and profitable, influence the operations

of local concerns. Access to patents and United States research facilities offers otherwise unattainable opportunities for providing new and better quality products and services which increase the real incomes of the population of the host country.

The concentration of United States direct foreign investments in productive sectors such as mining, petroleum, manufacturing, and agriculture brings about a close relationship between these investments and increases in output in the host country. Moreover, the advantages of technology, patents, and skilled personnel which United States companies often possess over their foreign competitors means that United States firms often make, in relation to the value of these investments, a proportionately greater contribution to national product than indigenous companies.

The uses of funds by United States firms abroad in 1957 and 1958 indicate the impact of these investments on the production of the host countries. (Table IV-5). While United States net capital outflow and undistributed subsidiary earnings were \$2.1 billion for all areas in 1957, the uses of funds by United States companies abroad for the same year were more than twice that amount, or \$6.3 billion; the corresponding figures for 1958 were \$1.8 billion and \$5.2 billion, respectively. A heavy proportion of the funds used by United States foreign enterprises were directed into expenditures for property, plant, and equipment. For all areas in 1957 these expenditures amounted to 55 percent of the total uses of funds, and in 1958 it was 58 percent. Income paid out amounted to 26 percent and 33 percent for 1957 and 1958, respectively; however, if petroleum investments are excluded, income payments as a proportion of the total uses of funds were only 23 percent and 25 percent for these two years. The greater use of

TABLE IV-5

USES OF FUNDS OF UNITED STATES DIRECT FOREIGN INVESTMENTS
(millions of dollars)

	Total		Property Plant and Equipment		Inventories		Receivables		Other Assets		Income Paid Out	
	1957	1958	1957	1958	1957	1958	1957	1958	1957	1958	1957	1958
<u>All Areas Total</u>	6290	5151	3468	2993	593	-109	402	195	209	347	1618	1725
Mining & Smelting	446	445	300	348	33	-29	3	-6	-29	7	139	125
Petroleum	3886	2966	2059	1693	347	-88	276	109	144	99	1060	1153
Manufacturing	1371	1232	805	626	148	-10	58	64	55	235	305	317
Trade	310	290	134	132	53	26	53	20	17	34	53	78
Agriculture & Public Utilities	277	219	170	195	11	-7	12	7	23	-27	61	51
<u>Canada, Total</u>	1506	1248	1115	914	115	-87	-16	44	2	105	290	272
Mining & Smelting	172	132	110	119	19	-5	3	-13	-28	-15	68	46
Petroleum	705	578	564	480	52	-20	10	30	10	23	69	65
Manufacturing	550	463	345	272	33	-64	-29	24	11	38	140	143
Trade	51	42	32	19	9	2	(1)	2	5	4	5	15
Agriculture & Public Utilities	27	32	15	25	2	-1	-1	1	3	5	8	2

TABLE IV-5 continued

	Total		Property Plant and Equipment		Inventories		Receivables		Other Assets		Income Paid Out	
	1957	1958	1957	1958	1957	1958	1957	1958	1957	1958	1957	1958
<u>Latin American Republics, Total</u>	2239	1395	1218	869	201	-37	149	33	112	36	559	494
Mining & Smelting	241	234	171	193	14	-19	2	5	3	23	51	42
Petroleum	1478	738	822	425	138	-40	50	-5	49	1	419	357
Manufacturing	183	179	64	83	18	21	40	22	31	26	30	27
Trade	102	78	13	22	22	5	45	5	11	20	11	26
Agriculture & Public Utilities	234	166	147	156	8	-5	12	6	19	-34	48	43

(1) Less than \$500,000

Source: Department of Commerce, Survey of Current Business, XXXIX (October 1959), Table 1, p. 19.

funds for investment expenditures illustrates these companies' contribution to productive investment.

The Experience of United States Companies in Latin America, 1955

Although there are not comprehensive statistics on the total production and sales of United States companies, a study of the operations of United States companies in Latin America during 1955 was made by the United States Department of Commerce.¹ From the experiences in Latin America for that year it is possible to gain some understanding of the impact of these companies on the host economies, and the total sales and production of these companies may be compared with the book value of investments and the net capital outflow and income payments in 1955.

The value of United States direct investments in the Latin American republics in 1955 was \$6.6 billion, and the increase in the value of investments from the end of 1954 to the end of 1955 was less than \$400 million. Income payments by United States companies in Latin America were \$678 million. For 1955 sales by the reporting countries in this survey, accounting for approximately 91 percent of the total assets owned by United States companies in Latin America, were over \$4.9 billion. Approximately three-fourths of the gross revenues of these companies were spent on local taxes, wages, and materials costs. Expenditures of manufacturing companies on local materials and components accounted for over 40 percent of the value of their sales revenues. In addition, United States companies paid out \$1.5 billion in income and taxes to local governments, and this amount represented approxi-

¹This section is based on U.S., Department of Commerce, U. S. Investments in the Latin American Economy (Washington: United States Government Printing Office, 1957).

mately 15 percent of all government revenues in Latin America. The greatest proportion of the taxes on income were paid by oil companies, and Venezuela accounted for approximately 40 percent of all tax revenues. Manufacturing companies in Latin America in 1955 paid approximately \$148 million in taxes on income and indirect taxes.

The United States companies which were covered in this survey employed approximately 625,000 persons in Latin America in 1955; less than 9,000, most of whom were in the petroleum industry, were from the United States. Salaries, wages, and other payments to employees were \$1 billion.

The experience in Brazil during 1955 is illustrative of the relative importance of net capital inflow, reinvested earnings, and income payments in the total expenditures and operations of the United States firms operating there. The book value of United States direct foreign investments in Brazil increased \$66 million in 1955. Net capital inflow accounted for \$30 million, the remainder of the increase resulting from ploughed-back profits. Total income remittances were \$33 million. On the other hand, United States-owned manufacturing companies which accounted for approximately three-fourths of United States manufacturing companies in Brazil had sales of \$355 million in 1955, and they spent about 81 percent of their total sales proceeds in Brazil. Approximately half of the value of goods sold by United States manufacturing companies in Brazil was represented by expenditures for local materials, supplies, and utilities.

This section has not been a detailed assessment of the impact of United States companies abroad on the local economy. Its principal purpose has been to illustrate how increases in the book values of direct investments and income payments on these investments do not give an accurate picture

and greatly underestimate the effects of these companies' operations on the economy of the host country.

Summary

The inadequacy of the statistics for measuring the costs and benefits of foreign investments in terms of the contribution to net domestic product and the costs in terms of resources which must be transferred out of the host country to service these investments is evident. The total output of United States firms abroad, and the import content of that output, is not known. There is no way of attributing values to the indirect benefits of these investments, nor of estimating the opportunity costs of local resources which are utilized. The costs and benefits of individual investments cannot be calculated, for statistics relate only to aggregate annual capital flows. The statistics are probably most accurate in estimating the value of income payments to United States investors. Since these constitute the principal costs to the host country, it is the benefits from United States investments which are most likely to be underestimated.

The benefits from United States direct foreign investments are extensive. United States companies abroad supply resources and skills which are in short supply in less-developed countries. By their concentration in manufacturing and the extractive industries they promote industrialization, a policy goal of most of these countries. Through their contribution of specialized products and skills they can be especially helpful in relieving bottlenecks in the economy or certain sectors of the economy. By producing more varied and better quality products United States companies abroad increase the real income of residents of the host countries.

While the experience has varied for particular countries, the growth of United States direct investments in the countries which have been considered has been relatively steady. Net capital outflow is more responsive to business conditions in the United States, and reinvested earnings are a more steady source of investment funds. United States foreign manufacturing companies rely heavily on reinvested earnings for expansion, and their growth is generally more even than foreign investments in export-oriented industries such as petroleum and mining.

United States companies attempt to stabilize income payments from their branches and subsidiaries abroad. A lower rate of earnings may be counteracted by a higher proportion of income paid out in order to maintain income remittances at the same level. Total income payments from United States companies abroad have increased steadily, but income payments have not increased as a proportion of the book value of direct foreign investments over the 1950-1958 period. Over these nine years, total net capital outflow plus undistributed subsidiary earnings have been approximately equal to total income payments.

The Balance of Payments

In order to relate the experience of United States companies abroad to the problems of transferring income payments it is helpful to consider some of their more direct effects on the balance of payments of their host countries. United States companies operating abroad exert appreciable influence on foreign exchange receipts and payments of their host countries. By their sales of goods to other countries, and by producing goods for domestic consumption which ordinarily would be imported, they achieve a net

gain in foreign exchange. By imports of capital goods, raw materials, and other component parts which are made necessary by these investments, and, more indirectly, by stimulating imports via the demonstration effect and the contribution to increases in income, foreign exchange payments are incurred. Statistics are not available for measuring the magnitude of these effects, but the relative impact on foreign exchange payments and receipts may be estimated. Investment in different sectors of the economy have varying effects on the merchandise account in the balance of payments, and an examination of these may point out the problems confronting particular countries.

Exports

The value of exports from the sales of United States foreign companies is not always an accurate measurement of the worth in foreign exchange of these exports. Imports of raw materials or any other semi-processed goods may contribute foreign exchange costs to the goods being exported, and to the extent that exports have such a cost the value of sales to foreign countries overstates net foreign exchange earnings. Because data are not available to assess accurately the cost in foreign exchange attributable to imports which enter into the exported merchandise, in this study the value of exports is assumed to be a measure of the foreign exchange earnings of a country. In the discussion of the effects of the operations of United States subsidiaries on imports, when available the data showing the values of these imports necessary for the production or manufacture of exports will be presented.

The contribution of United States-owned companies to the exports of

capital-importing countries has been extensive. It is estimated that during the 1946-1950 period almost 25 percent of the goods imported by the United States was supplied by United States companies abroad.¹ These imports accounted for approximately \$8.9 billion of the \$35.5 billion in imports during these years. In 1953 one-sixth of all raw materials imported into the United States was from United States foreign subsidiaries, and in 1955 \$2.6 billion, or 23 percent of the \$11.5 billion non-military merchandise imports by the United States, resulted from the sales of United States foreign companies.² Similarly, \$1.2 billion of the \$6.4 billion increase in United States imports from 1946 to 1955 was from the operations of United States companies abroad.³ Such imports were a higher percentage of total imports from the Latin American republics and Canada; they accounted for approximately one-third of the total imports from these countries.

These imports are largely primary products. Almost 90 percent of the imports from United States-owned companies abroad are crude oil, newsprint, sugar, copper, refined oil products, paper base stocks, nickel, iron ore, bananas, and aluminum. Crude oil and refined oil products accounted for 30 percent of this total. Individual countries accounted for substantial proportions of the imports in particular commodity groups. Canada accounted for 100 percent of the imports of paper base stocks and newsprint, 84 percent of nickel imports, 64 percent of aluminum imports, and 24 percent of

¹U.S., Department of Commerce, Foreign Investments of the United States (Washington: United States Government Printing Office, 1953), p. 2.

²Department of Commerce, Survey of Current Business, XXXVI, (August 1956), p. 22.

³Ibid.

iron ore imports. In all, Canada accounted for \$940 million or 36 percent of United States foreign companies exports to the United States. If crude oil and refined oil products are excluded, the sources of which are concentrated in Venezuela and the oil producing countries of the Middle East, over 50 percent of the imports originating from United States foreign subsidiaries was from Canada. This percentage reflects the concentration of United States capital flows to Canada in the primary sectors of the economy.

The United States is a relatively important market in the foreign sales of United States companies abroad. The foreign sales in 1955 of approximately 300 United States companies in Latin America, these companies representing approximately 91 percent of the assets of United States-owned firms in the area, amounted to over \$2 billion. (Tables IV-6 and IV-7). "While confined to one major area of the world, the results are typical of the general economic benefits which accrue to the economies of foreign countries from such investments in productive enterprises."¹ Sales to the United States predominate in every sector except manufacturing, but sales to foreign markets other than the United States account for almost 40 percent of total foreign sales. Petroleum and mining sales predominate in other markets, too, accounting for \$655 million of the \$831 million sales volume. These countries which sell a large proportion of exports in a particular industry sector to the United States also dominate in sales to other foreign markets. United States manufacturing firms operating abroad exported 61 percent of foreign sales to markets other than the United States. Of the \$89 million in manufacturing exports, 81 percent represented sales by meat packing plants,

¹Department of Commerce, U.S. Investments in the Latin American Economy p. 3.

TABLE IV-6

EXPORTS OF UNITED STATES COMPANIES IN LATIN AMERICA, 1955
(millions of dollars)

	Total	Agriculture	Mining & Smelting	Petroleum	Manufacturing	Public Utilities
Exports to the United States	1261	220	396	608	35	2
Other Exports	831	122	252	403	54	-
Total	2092	342	648	1011	89	2

Source: Department of Commerce, U. S. Investments in the Latin American Economy, Table IV, p. 113

TABLE IV-7

FOREIGN SALES OF UNITED STATES COMPANIES OPERATING IN LATIN AMERICA, 1955
(millions of dollars)

	Petroleum		Mining and Smelting		Agriculture		Manufacturing	
	U.S.	Other	U.S.	Other	U.S.	Other	U.S.	Other
Argentina	-	(1)	-	-	-	-	23	43
Brazil	-	-	-	-	-	-	2	2
Chile	-	-	149	191	-	-	(1)	1
Colombia	23	8	-	-	-	-	-	-
Cuba	(1)	-	-	-	102	55	1	4
Mexico	-	-	133	33	3	-	2	2
Peru	-	20	56	22	-	-	(1)	1
Venezuela	583	374	-	-	-	-	-	(1)
Central America, Dominican Republic and Haiti	-	(1)	0	0	0	0	1	(1)
Others	<u>1</u>	<u>(1)</u>	<u>59</u>	<u>5</u>	<u>118</u>	<u>67</u>	<u>-</u>	<u>-</u>
Total	608	403	396	251	220	122	35	54

(1) Less than \$500,000.

Source: Department of Commerce, U. S. Investments in the Latin American Economy, Table 21, p. 127; Table 40, p. 141; Table 61, p. 153; Table 67, p. 157; Table 75, p. 162; Table 82, p. 166; Table 88, p. 170; Table 96, p. 175; Table 103, p. 180; Table 110, p. 185; Table 117, p. 190.

almost entirely from Argentina.¹ Less than 6 percent of all manufacturing sales by United States companies in Latin America were export sales.

That a very large proportion of manufacturing sales are in the domestic market reflects in part the circumstances under which the foreign investments are made and the stage of development of the economies of Latin America. Most United States manufacturing firms in Latin America operate behind tariff walls and foreign exchange and quota systems which insulate these firms from effective foreign competition. Many investments were made because these restrictions made it impossible to export manufactured goods to these countries. The lack of large domestic markets, the lower efficiency of factors in these countries, and other impediments to efficient operations which appear in a less-developed country raise costs, and these together with trade restrictions imposed by other countries limit the export potential of the manufacturing firms. The experience of Great Britain indicates that under different circumstances United States foreign manufacturing investments can be excellent foreign exchange earners. In 1954 United States manufacturing firms in Great Britain "exported £275 million worth of commodities, an amount equal to nearly 12 percent of the total United Kingdom manufacturing exports for that year.... If one considers the newer industrial products only then U.S.-financed firms were responsible for about one-third of all U.K. exports, or--if we are to include motor-cars within this category--two-fifths."² More recently, in 1959 United States subsidiaries and

¹U.S., Congress, Senate, Committee on Foreign Relations, United States-Latin American Relations: United States Business and Labor in Latin America, 85th Congress, 2d Session, 1960, p. 28.

²Dunning, American Investment in British Manufacturing Industry, p. 293.

Anglo-American firms were...."supplying between 10 and 12 percent of all United Kingdom manufacturing exports."¹

In summary, United States direct foreign investments have been important foreign exchange earners. However, because 40 percent of these investments has been in petroleum, and investments in other primary sectors have been extensive, overall statistics of the foreign exchange earning capacity of United States companies abroad do not adequately present the balance of payments problems facing countries in which United States investments are producing primarily for the domestic economy. Those countries which are not endowed with oil resources or raw materials in demand on world markets and which are in an early stage of economic development can rely less on foreign investments to be exporters, especially those investments in the manufacturing sector.

Imports

Imports and income payments by United States companies abroad are the two principal ways by which these companies are directly responsible for foreign exchange payments by their host country. Statistics are not available to measure the value of imports by all United States companies abroad, but the United States Department of Commerce has published figures for United States companies in Latin America for 1955 which it feels are indicative of the experience of United States companies in most areas.² For

¹The (London) Times, April 22, 1959, p. 19.

²Department of Commerce, U. S. Investments in the Latin American Economy, and Survey of Current Business, XXXVII (January 1957).

Latin American republics in 1955, imports by United States companies exceeded income payments. (Table IV-8). Based on a sample of United States companies which accounted for 91 percent of the total assets employed by United States firms in Latin America and for four-fifths of the total United States direct investment earnings in Latin America for 1955, total imports for these United States companies were \$667 million, compared to \$610 million in income payments. Imports from the United States were 77 percent of total imports by these companies. All industries did not share the higher proportion of imports compared with income remittances in foreign exchange payments. For the mining and smelting and petroleum industries, income payments in each were greater than the value of imports. In petroleum, there were income payments of \$424 million, while imports from all areas totalled \$258 million. In marked contrast was the experience of United States manufacturing companies; imports were \$282 million, compared with income remittances of only \$53 million. As an example, United States manufacturing companies operating in Mexico had imports of \$106 million, while income remittances were only \$13 million. Thus, United States companies abroad not only contribute a smaller share to exports compared with United States companies in other industries, as was shown in an earlier section, but they also account for a larger proportion of imports by United States foreign enterprises.

Raw materials, component parts, and other materials are the principal imports by United States companies in Latin America. Capital equipment accounted for approximately 21 percent of total imports, and in manufacturing, of \$282 million expended on imports in 1955, these United States companies in Latin America imported only \$18 million, or approximately 6 percent, in capital equipment. A greater proportion of the imports of United States

TABLE IV-8

FOREIGN EXCHANGE PAYMENTS BY UNITED STATES COMPANIES IN LATIN AMERICA, 1955
(millions of dollars)

	Total	Agriculture	Mining & Smelting	Petroleum	Manufacturing
Income Remittances	610	40	93	424	53
Imports from U.S.	515	38	76	164	237
Imports from other Countries	152	12	1	94	45

Source: Department of Commerce, Survey of Current Business, XXXVII (January 1957), Table 2, p. 7.

companies in mining and petroleum consists of capital equipment. Thus, United States manufacturing enterprises in Latin America are dependent to a greater extent than other industries on imported raw materials and component parts in their operations. Imports by United States companies in Latin America accounted for approximately 9 percent of the imports by all Latin American countries during 1955.

Import Substitution

The effects of the sales in local markets by United States companies abroad on the balance of payments of the host countries is difficult to evaluate. It is doubtful that all local sales by United States companies abroad should be considered as substitutes for products which would have been imported in the absence of foreign investments. The relationships between these sales in the local markets and such factors as trade restrictions, advertising, the demonstration effect, differences in costs of production, and increases in income in the host country which are attributable to foreign firms vary among countries and can be evaluated only in imprecise terms.

Ignoring at this point the dynamics of growth and the significance of import substitution for a developing country, there are several reasons for believing that local sales are considerably greater than if the same products had to be imported. This is especially true for most of the less-developed countries. United States foreign branches and subsidiaries, by their proximity to markets in the countries where they are located, are more likely and better able to adjust to changing conditions in local markets and to adapt their products to local tastes and other special requirements of these

markets.¹ Companies located in the United States are less acquainted in most cases with peculiarities of individual markets than are their foreign branches and subsidiaries, and when a product is exported to many countries and areas modifications of the product to conform to specific requirements may be either too costly or not feasible for other reasons. Similarly, with sales highly dependent upon adequate servicing facilities and the needs for specialized marketing outlets, in many countries United States firms must establish such facilities themselves because of the lack, in these countries, of independently trained maintenance, sales and other personnel who are thoroughly acquainted with the United States product. In addition, United States firms in foreign countries are more likely to use and be successful with informative advertising and other selling techniques than would enterprises with all their operations centered in the United States.

If the price elasticity of the demand for products which are produced either in the local economy or imported from the United States is greater than unity, the value of sales by United States firms abroad in the same country where they are located will be greater than the value of import sales of the same products if these goods can be produced and sold at a lower price by the foreign branches and subsidiaries. There are three primary reasons for believing that lower prices will result from local production than from importing the same products. These are (1) transport costs, (2) tariffs, and (3) lower costs of production.

The effect of transportation costs is to raise the price of the product

¹For a discussion of this and some of the following points see Dunning, American Investment in British Manufacturing Industry, pp. 232 ff.

from what it would be in their absence, and in international trade transportation costs can be an important proportion of total costs for many types of products. Of particular importance for many of the less-developed countries is the lack of an adequate domestic transportation system, and some markets may be feasible only if production takes place very close to the market.

Tariffs imposed for revenue and protective purposes increase the price of imported goods for domestic consumers, and if the products which are imported can be produced as cheaply in the local economy as abroad, firms located behind the tariffs are in a favorable competitive position. By raising prices of imported goods, tariffs decrease the value of imports and local sales are correspondingly greater.

Another reason why prices of goods produced locally may be less than those of similar imported products is that production costs may be lower in the local economy. Production close to the source of raw materials, lower labor costs, or other characteristics of the foreign economy which contributes to lower costs of production may make it possible to sell at lower prices in the host country compared with producing in the United States. With the ability of United States companies to bring with them to foreign countries the capital equipment, advanced technology, access to United States research facilities, and organizational skill which are such important factors in the efficiency of United States production, the lower costs of foreign labor and some raw materials enable United States firms to produce more cheaply abroad in many instances.

The influence of price on sales revenue depends on the elasticity of demand for the products under consideration. For the economy as a whole, especially for less-developed countries, the price elasticity of the demand

for imports of fuels, raw materials, and capital goods, when these are essential to the production of many industries, is quite low, often less than one. Imports of products which may be put into a consumers goods classification are more likely to have a price elasticity of greater than one. Thus, in assessing whether local sales are an accurate measurement of import substitution when tariffs are used to bring about a price differential, local sales by foreign branches and subsidiaries of goods with a low price elasticity are more likely to be substituting for imports than are those with a high price elasticity.

Direct controls over imports are more likely than tariffs to be used by most of the countries under consideration to limit imports and to promote domestic production. At one extreme, import controls could be regulated in a way that certain products either are produced locally or they are not consumed at all in the local economy. More likely restrictions will severely limit the consumption of certain imports. Luxury and other consumer goods which are not of high priority in the plans of countries making an active effort to promote and to channel economic development may receive this treatment. In this case the only motivation for establishing a foreign subsidiary may have been to obtain access to a market otherwise inaccessible because of import controls. In effect, the host country may be providing a monopoly for foreign firms if imports are excluded and for reasons of technology, patents, or other factors domestic firms are unable to compete successfully against foreign investors. Local sales in the host country by foreign firms located there are, in this case, not import substitutes but sales for which there is no alternative supply. As was shown in Chapter One, many United States firms invest abroad in order to circumvent foreign import restrictions,

and their import substitution effect is very slight in these circumstances.

The analysis of the import substitution effect of local sales has been applicable thus far only on a partial equilibrium basis. The discussion has neglected the alternative means of increasing income and output and how these would affect imports and import substitutes. It is true, of course, that if output and income are not increasing imports likely would be lower. With a given level of income and output it is also true that local sales are likely to be greater than sales if the goods had to be imported. However, the impact of United States foreign companies on the balance of payments of the host country may be evaluated in a more meaningful manner if it is related to the growth in income and output and to alternative means of achieving growth.

Assume first that output and incomes are rising in a developing country without utilization of any capital imports. It has been shown earlier that as less-developed countries expand their incomes and output and diversify their production, their imports increase. The growth of incomes with the resulting increase in demand for a greater variety of consumer goods and the needs for raw materials, capital equipment, and fuels increases imports for these countries. The increases in imports are a result of economic growth. If income and output increase, imports will likely increase whether or not foreign investments have played a part in increasing output and incomes.

Within this framework it is pertinent to consider how the money spent on local sales by foreign firms when they are located in the host countries is spent in the absence of these sales. If goods of similar kind and quality are not available from domestic producers, these expenditures will lead directly to greater imports. Many of the goods produced by United States

firms abroad cannot be as efficiently produced or produced at all by local concerns, because there would be little likelihood that United States firms would invest abroad if their products were capable of being produced by local firms in these countries. Even if the expenditures were diverted partly into goods which are produced by local concerns the relative impact on the balance of payments will depend on the import content of the goods produced by these firms.

For these reasons, in a period of rising incomes and output, local sales by United States foreign enterprises represent substantial foreign exchange savings for the less-developed countries. Foreign exchange which would have been used to purchase goods ordinarily imported is now available for other purposes. In addition, by producing goods and services for which there is a demand in the host countries, foreign concerns increase the real incomes of the local population. This is probably the most significant contribution to the host country by local sales of United States companies.

CHAPTER FIVE

EVALUATION AND CONCLUSIONS

Introduction

It is the purpose of this chapter to examine and to evaluate the attitudes and legislation which are concerned with the problems of servicing direct foreign investments. The analyses of Chapters Two and Three and the data which have been presented have enabled us to establish criteria for evaluating the costs and benefits of direct foreign investments as they relate to the efforts of capital-importing countries to increase per capita output and consumption.

The statistics which were presented in Chapter Four indicated that on an annual flow basis direct foreign investments make a net contribution in resources to the host countries. Through the inflow of capital, reinvested earnings, sales, and expenditures in the host countries' economies, substantial annual contributions are made to the domestic output of these countries. Income payments reflect and are less than the contribution of direct foreign investments to the net domestic products of the capital-importing countries.

In addition, while the indirect benefits from direct foreign investments are not capable of being measured, they represent a strong stimulus to economic growth. The training of workers and supervisory personnel, the introduction of new organizational techniques, and the stimulation of local investment are but a few of these benefits. The less-developed countries profit greatly from access to the research facilities of United States corporations. Informative advertising and the introduction of new products

influences attitudes toward work and saving. Many feel these indirect benefits of direct foreign investments are more important for the host country than investment in the form of equipment, raw materials, and money capital.

Undoubtedly direct foreign investments impose costs on the host country by adding to the foreign exchange payments of these countries and by making necessary adjustments in their economies and balance of payments in order to pay for rising income remittances. However, income remittances have been a small proportion of the increase in total foreign exchange payments which accompany any efforts to accelerate economic growth. Also, the increase in income remittances must be compared with the increase in foreign exchange payments from alternative means of utilizing capital from abroad.

Evaluation of Attitudes toward Direct Investments

The Rate of Return on Direct Foreign Investments

The rate of return on direct foreign investments as a percentage of the book value of these investments often has been compared with the lower rate of return on loan capital. The rate of return computed on book values of petroleum investments and manufacturing investments have been at least two or three times that of loan capital during the 1950-1958 period; loan capital has been available at rates ranging from 4 to 7 percent from international lending institutions and governments.

There are two primary reasons for doubting the relevance of these comparisons. First, the use of book value as a base on which to compute the rate of return of direct foreign investments is not appropriate. Book values underestimate market values of direct investments, probably by almost one-half in many cases, and book values are not an adequate measurement of

the contribution to output by a foreign concern. Second, the comparison in this manner of the rate of return on a direct foreign investment and a foreign loan assumes that the benefits from each are approximately the same. The rate of return on equity capital represents the profitability and productivity of the concern, and it also includes a risk element. Direct investments provide substantial indirect benefits to the host country which do not accompany loan capital. The research facilities, skilled personnel, and the organizational experience of a going concern which have been described in earlier chapters represent substantial benefits to the capital-importing country. Only by a careful examination of the benefits from each individual investment is it possible to give meaning to relative rates of return between loan and equity capital.

100 Percent Ownership

It was argued by some that 100 percent ownership of their foreign subsidiaries by United States investors increased the volume of dividend payments to foreign investors relative to what they would be if ownership were shared with local investors and that the result was a greater pressure on the balance of payments from income remittances. This is true. However, it neglects the relative foreign contribution to investment and production when 100 percent ownership is exercised compared to when equity is shared with the host country. A United States corporation makes a greater capital contribution to the host country when it has 100 percent control than if it has less than complete ownership. If it shares equity with local investors, the net foreign contribution to investment in the host country has been decreased. In addition, 100 percent ownership may increase the rate of

reinvested profits, because often when there is local equity participation there are greater pressures to pay out a larger proportion of earnings. The higher volume of income payments which accompany 100 percent ownership by United States investors only reflects the larger capital contribution of these investors.

If the benefits from direct foreign investments will not be appreciably decreased by permitting local equity participation and the decline in the discounted value of income remittances will be greater than the decline in the discounted value of the benefits, the host country can increase its net gain by encouraging local equity participation in the foreign investment. For example, if the principal benefits for the host country from a foreign investment result from access to a foreign corporation's research facilities or patents, and if the foreign investor will make these facilities or patents available when it has only a minority interest in its foreign investment, then it may be to the advantage of the capital-importing country to have local investors share equity with the foreign investor. The opportunity costs of local capital would have to be quite low for this to be an advantageous policy, however.

The use of licensing agreements and management services reflects considerations such as these. Those countries where local capital has become less scarce may find it to their advantage to limit their obligations to foreigners by being selective in the types of resources and services they obtain from foreign investors. For the lower income countries, however, the sharing of equity and the greater use of licensing agreements may have a substantial opportunity cost in terms of the smaller capital contribution of foreign investors.

The Direction of Investment

It has been stated by some that if the production of direct foreign investments is oriented toward the local market, the real transfer of income remittances to foreign investors will require adjustments in the balance of payments and the economy of the host country which will be disruptive to efforts being made to accelerate economic growth. For this reason it is argued that foreign investments should be required by the host country to produce exports or import substitutes in order that they provide the foreign exchange needed to make dividend remittances.

The discussion in Chapter Three of the process by which a capital-importing country adjusts to a rise in income payments relative to net capital imports demonstrated the close relationship between increased output and the ability of a country to adjust to its rising foreign obligations and at the same time to increase its per capita real income. It also illustrated the need of the economy as a whole to increase foreign exchange receipts relative to foreign exchange payments. There is no reason why it should be expected that because foreign investments give rise to income payments to foreign investors that these investments should therefore be foreign exchange earners. Such an argument implies that it is more beneficial from the host country's viewpoint to encourage a foreign investment which is less efficient and which makes less of a contribution to domestic production as long as it earns foreign exchange rather than another foreign investment which is more efficient but which produces for the local market and does not improve directly the balance of payments position of the host country.

Such a criterion overlooks the relationship between output and the relative burden of adjusting to a changing balance of payments position. It

also neglects the effects foreign investments may have on other sectors of the economy. For example, a direct foreign investment in a public utility which increases the supply of electricity may enable other firms to increase production, reduce costs, or improve their efficiency and thus assist them in becoming foreign exchange earners. A foreign company which produces capital equipment may stimulate domestic investment and output to such an extent that the adjustment to increased income payments may be easier than sustaining the same level of income payments if output did not increase as much.

It has been shown that income payments are only a small proportion of the foreign exchange payments accompanying increased investment and output in a developing country. A growth in domestic investment and output usually can be sustained only by increased imports and developing countries must direct resources into industries which earn foreign exchange to meet the rising level of imports. Otherwise, the new levels of investment and output may not be sustained. There is no reason, however, for there to be a criterion that any one type of investment, either domestic or foreign, be required to earn foreign exchange. The adjustment to rising foreign exchange payments must be made by the economy as a whole, and it is most easily accomplished when resources have been allocated efficiently and output has risen to the greatest extent possible.

Retained Earnings

Some have argued that the problems of servicing United States direct foreign investment are magnified because of the reliance of United States companies abroad on retained earnings as a source of funds for expansion.

These arguments are based on a differentiation between new capital inflow from abroad, which is viewed as a contribution in foreign exchange to the host country, and retained earnings, which is seen as contributing no foreign exchange to the host country. Is this differentiation valid?

New capital inflow from the United States in the form of direct investments generally consists, first, of capital equipment, personnel, raw materials, and other equipment from the parent company to the subsidiary or branch. Second, it also may take the form of investment expenditures in the host country. In the first case resources from abroad are made available to the host country without requiring a foreign exchange payment. The effect of investment expenditures in the host country on its foreign exchange position varies greatly. Expenditures may be financed by local borrowing, or perhaps they may be financed by a merger with a local concern which provides the funds for investment expenditures in exchange for patent rights or access to research facilities of the parent company. Only when the United States parent corporation converts dollars or other foreign exchange into local currency in order to make expenditures has the inflow of new capital increased the foreign exchange holdings of the host country.

Reinvested earnings also provide resources which are owned by foreigners to the host country without requiring payments in foreign exchange. In addition, because the alternative to retained earnings is to distribute profits to investors, retained earnings represent a saving in foreign exchange payments to the host country. There seems to be no basic differentiation between capital inflow and retained earnings on the balance of payments of the host country.

However, the argument which emphasizes retained earnings as contri-

buting to the problems of servicing direct foreign investments is concerned with the build-up by expenditures in local currency of an equity on which future income remittances in foreign exchange will be required. An approach such as this neglects the role of reinvested earnings as a source of resources, investment, and productive capacity to the host country.

It is true, of course, that if all income is paid out immediately, future income payments will decline relative to what they will be if profits are reinvested for a time. A viewpoint which stresses that the volume of income payments is a cost to be minimized neglects the relationships between income payments and the benefits of foreign investments which were explained in Chapter Two. Income payments are minimized when no foreign capital is admitted at all. A reduction in the discounted value of future income payments also reduces the discounted value of future additions to net domestic product. A country which is attempting to increase its rate of growth of output has its primary interest in obtaining the greatest possible increase in net benefits from foreign investments, not in minimizing income payments.

Lower income countries which are attempting to accelerate economic growth profit considerably from the retention of earnings by United States firms abroad. By postponing the payment of income for a period of time, a greater opportunity is allowed for output to have increased sufficiently that the domestic rate of savings is increased. Countries with a low rate of savings and experiencing pressures on the balance of payments are able to make a higher volume of income remittances in the future with fewer adverse repercussions on sustaining an increased rate of growth if output, domestic investment, and domestic savings have increased correspondingly. The postponement of investment service of direct foreign investments is

one of the principal advantages of this form of investment over the servicing of loan capital.

The Vulnerability of the Economy

The attitudes which stress the higher degree of instability which the host country experiences when capital imports, income payments, and the investments and sales of foreign companies attain significant proportions in total output and balance of payments transactions generally advocate that the volume of foreign investments be limited. In the literature on Canada and Australia there are many admonitions from officials of these countries that they should rely less on foreign investment in any form and make greater efforts to promote domestic savings and investment in order to reduce the level of borrowing from abroad.

Each capital-importing country may make its choice on the extent to which it is willing to welcome foreign capital. Any country is free to make a decision to reduce its rate of growth and output in order to reduce the volume of foreign investment. It is understandable also, for example; that a country does not desire to have its defense establishment dependent on foreign business interests. However, often arguments over the degree of influence on the economy by foreign investors neglect the effects on domestic investment and output if foreign investments were reduced. In addition, there has been little evidence presented that foreign dominance in a particular sector of the economy has resulted in decisions which were detrimental to national interests of the host country. The Manufacturing Industries Advisory Council of Australia recently reported that there had been no evidence that any decisions taken by overseas parent companies

of Australia subsidiaries have been inimical to the national interest.¹

It is true that the more a country depends on foreign capital the more it will depend on exports. The increase in output which accompanies capital imports and the need to make income payments in foreign exchange will result in greater exports for the host country. The capital-importing country must weigh the stimulus to growth against any disadvantages which, in its opinion, accompany a greater dependence on exports. The host country also should consider that the acceleration of economic growth by any means is likely to increase exports, because generally imports increase as per capita output increases, and these imports must be paid for in the long run by exports of goods and services.

Evaluation of Legislation

From our analysis in earlier chapters and the evaluation of the principal attitudes toward direct foreign investments it is possible to evaluate the legislation of capital-importing countries towards foreign investments. We continue to assume that they are countries making an active effort to achieve higher levels of living, and that the legislation should recognize the obligations incurred when capital is borrowed from abroad. It is preferable that the terms on which foreign investments are offered and received be understood both by the investors and by capital-importing countries. Policies written into law, well-defined, and closely adhered to are preferable to arbitrary decisions and uncertainty.

¹International Monetary Fund, International Financial News Survey, XII (August 5, 1960), p. 451.

Controls over the Volume of Remittances

There is little justification for controls over the volume of remittances when these represent part or all of the return from current operations. The principal effect of controls on income payments is to discourage new foreign investments. Restrictions on remittances are cited by United States companies as one of the principal reasons for a reluctance to invest abroad. The experience with United States companies abroad has shown that their preferred pattern in disposing of income is to establish, after the first few years when the greater proportion of earnings are reinvested, a comparatively fixed pattern of income remittances. Any efforts to thwart these payments can result in a greater effort to repatriate earnings at as high a rate as possible when restrictions are removed. It seems preferable for capital-importing countries to allow any balance of payments adjustments which accompany income payments to occur more gradually with the growth in these payments.

Controls over Capital Repatriation

The relatively steady growth in the value of investments for almost all the countries represented in this study's sample indicates that net capital repatriation has not been a serious problem to these countries over the 1950-1958 period. Many of the same reasons for opposing the control of income remittances also apply to the control of the repatriation of capital. However, there is some merit to capital-importing countries in reserving the right to control the repatriation of capital in order to prevent investments which are speculative and more interested in "quick profits" rather than in the establishment of firms which are expected to remain in the host country for as long as operations are profitable. In addition,

some controls over capital repatriation in times of severe pressure on the balance of payments may be justifiable if they are not abused by "planning" balance of payments crises.

The Screening of the Direction of Foreign Investments

Every country has the right to determine the general direction of growth, to establish priorities in investments, and to influence the distribution of increased output. It should formulate these goals with consideration for their effects on its ability to increase the rate of socially desirable output per capita. If a country has made a decision to postpone investments in luxury items for equity purposes, for example, this is its prerogative. However, some criteria used for screening foreign investments go further than assuring that they contribute to socially desirable output. Many regulations governing the direction of foreign investments impose criteria which are not applied to domestic investments.

The most common regulation of this kind is that requiring that foreign firms make a direct contribution to foreign exchange receipts or save foreign exchange payments by producing goods which may be exported, or import substitutes. As was mentioned earlier, such regulations imply that a less efficient investment which increases foreign exchange receipts is more beneficial than one which is more efficient and produces for the local market. It also neglects the indirect effects of foreign investments on the ability of other firms to export.

A country cannot neglect its balance of payments position or its prospects for sustaining increases in output may be lessened. If a foreign investment is efficient and contributes to an increase in the rate of output and it also has prospects of being an exporter, it is likely to

be highly advantageous for the host country. On the other hand, if a foreign firm can produce goods efficiently which are in short supply in the domestic economy, there should not be grounds for rejecting it simply because it is not a net foreign exchange earner. The relevant criterion is: Can the economy as a whole adjust to rising imports and foreign obligations without jeopardizing absolute increases in the rate of per capita output or consumption? A country should borrow from abroad only within its capacity to pay for any obligations which are incurred. The ability to adjust to rising income payments should be judged by an assessment of the overall direction of investment and production and not that of each individual investment.

Regulations Concerning Ownership

Many less-developed countries have regulations which encourage joint ventures and other ways by which foreign investors share ownership of their firms with local investors. Generally, the intent of these regulations is to limit the volume of future income remittances to foreign investors, to stimulate domestic investment and local experience with entrepreneurship, or to build up local capital outlets.

Restrictions which specify that foreign ownership may not exceed 50 percent, for example, are in effect limiting capital imports. The foreign contribution in the establishment of any individual concern is limited compared to what it would be if 100 percent ownership and control were exercised. Such an arrangement may be advantageous to the host country if particular talents or facilities can be utilized and when capital per se is not the scarce factor. Skills, research facilities, and organizational experience may be provided without 100 percent ownership.

In such circumstances, however, it is doubtful that strict limitations on foreign ownership is the proper way to encourage local equity participation. Its principal effect may be to limit capital imports. Tax concessions to joint ventures may be a proper means to encourage the joint participation of local and foreign capital. Also, many countries have successfully encouraged joint ventures through national development banks, through low interest loans, and through cooperation with international institutions like the International Finance Corporation, which is affiliated with the IBRD. However, if local capital is available, private interests themselves often will negotiate without government prodding for the patents, skills, personnel, and techniques which they lack. The relative increase in recent years of joint ventures has resulted both from private initiative and governmental actions.

WARRANT BOND

SUBSTITUTION OF

U.S.A.

APPENDIX

The source for Appendix Tables I-X is:

U.S., Department of Commerce, Survey of Current Business, 1950-1960.

The source for Appendix Table XI is:

International Monetary Fund, International Financial Statistics, XII (September 1959), pp. 16-17, and XIII (June 1960), pp. 36-38.

The source for Appendix Table XII is:

United Nations, Direction of International Trade, V (August 1954), VI (October 1955), IX (October 1958), X (August 1959), and XI (March 1960).

TABLE I
 VALUE OF DIRECT INVESTMENTS
 (millions of \$)

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
All Areas	11788	13089	14819	16286	17626	19313	22177	25238	27075
Canada	3579	3972	4593	5242	5871	6494	7460	8332	8929
Latin American Republics	4735	5176	5758	6034	6244	6608	7059	8325	8730
Argentina	356	365	393	406	424	447	466	501	517
Brazil	644	803	1013	1017	1049	1115	1218	1301	1345
Chile	540	583	623	657	633	639	676	702	736
Colombia	193	205	232	233	260	274	298	297	289
Cuba	642	672	686	686	713	736	777	840	861
Mexico	414	471	490	514	524	607	690	765	781
Peru	145	203	242	287	283	305	343	400	429
Venezuela	993	992	1174	1291	1366	1428	1829	2683	2863

Table 1 continued

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
Australia	201	256	310	326	393	498	552	601	673
India	38	49	63	68	92	95	108	110	116
Indonesia	58	72	74	88	65	86	118	150	149
Japan	19	45	69	92	106	128	145	181	182
New Zealand	25	31	37	34	40	42	47	51	54
Philippine Republic	149	163	178	188	217	229	267	307	343

TABLE II
 VALUE OF DIRECT INVESTMENTS IN MANUFACTURING
 (millions of \$)

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
All Areas	3831	4352	4920	5226	5711	6349	7152	7898	8485
Canada	1897	2000	2241	2418	2592	2841	3196	3512	3696
Latin American Republics	774	992	1166	1149	1240	1372	1543	1673	1740
Argentina	146		198	200	218	230	249	256	256
Brazil	270		513	483	533	565	614	659	701
Chile	29		33	34	35	37	39	39	40
Colombia	25		37	41	51	58	67	62	66
Cuba	72		63	58	55	55	66	80	82
Mexico	118		210	214	217	274	321	363	364
Peru	16		17	17	19	24	26	33	30
Venezuela	24		34	37	46	60	78	97	114

Table II continued

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
Australia	95			172	201	240	266	302	354
India	16			23	27	29	33	36	39
Indonesia	10			17	19	21	24	25	27
Japan				8	10	13	21	36	43
New Zealand	9			12	15	18	19	19	19
Philippine Republic	23			25	29	31	35	42	49

TABLE III
TOTAL NET CAPITAL OUTFLOW
(millions of \$)

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
All Areas	621	528	850	721	664	779	1859	2058	1094
Canada	287	240	420	387	385	300	542	584	398
Latin American Republics	40	166	277	117	88	193	592	1086	288
Argentina	15	-9	8	4	-5	9	(1)	15	8
Brazil	20	92	125	-35	-6	30	55	48	26
Chile	22	40	37	26	-28	1	33	24	25
Colombia	-7	11	20	1	33	16	24	9	-2
Cuba	7	13	5	-5	27	15	28	51	17
Mexico	25	24	-10	7	-1	51	33	39	-12
Peru	-9	17	28	39	-13	7	27	47	29
Venezuela	-39	-16	115	93	46	31	350	796	132

Table III continued

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
Australia	24	29	29	-22	32	65	17	2	17
India	10	7	9	3	18	-2	7	-4	-2
Indonesia	-13	4	-23	14	-5	7	28	-13	-33
Japan	7	21	23	20	8	14	14	19	-7
New Zealand					4	(1)	2	2	1
Philippine Republic	6	5	9	5	19	-3	16	16	6

(1) Less than \$500,000

TABLE IV
NET CAPITAL OUTFLOW IN MANUFACTURING
(millions of \$)

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
All Areas	192	190	211	-53	111	160	268	370	175
Canada	88	30	121	27	51	54	101	160	52
Latin American Republics	64	116	80	-73	24	60	76	91	20
Argentina	1	-5	12	-4	(1)	3	4	-3	-4
Brazil	17	61	65	-59	25	6	20	28	29
Chile	(1)	3	-2	1	1	1	2	-1	(1)
Colombia	7	2	8	2	7	4	9	-4	3
Cuba	4	5	1	-6	-3	-1	9	11	1
Mexico	23	42	-3	-7	-9	33	15	43	-16
Peru	3	3	-6	-1	1	4	1	8	-3
Venezuela	4	3	4	(1)	5	8	13	13	12

Table IV continued

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
Australia	6	7	4	-6	27	6	4	8	18
India	3	(1)	-3	-1	17	1	2	-1	1
Indonesia	-1	2	(1)		-5		1	-1	1
Japan	(1)	1	1	(1)	9	(1)	(1)	6	2
New Zealand					3	(1)	1	(1)	-1
Philippine Republic	-1	1	(1)	(1)	17	(1)	1	1	1

(1) Less than \$500,000

TABLE V
TOTAL EARNINGS
(millions of \$)

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
All Areas	1769	2244	2295	2174	2369	2811	3120	3300	2954
Canada	440	417	421	467	470	591	720	641	568
Latin American Republics	631	901	902	722	715	870	1041	1101	763
Argentina	18	29	30	20	31	27	22	31	14
Brazil	97	142	150	112	83	71	75	75	53
Chile	41	57	54	34	41	74	93	50	44
Colombia	16	15	20	13	15	23	23	17	2
Cuba	59	64	53	30	35	42	51	66	48
Mexico	44	64	61	47	45	66	82	77	69
Peru	21	36	31	21	29	40	34	37	18
Venezuela	232	297	329	334	346	434	550	675	468

Table V continued

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
Australia	27	36	33	51	60	64	62	83	94
India	13	14	15	12	18	16	12	15	19
Indonesia	36	38	29	32	26	37	35	52	52
Japan	2	8	4	8	15	21	21	27	12
New Zealand						7	7	8	8
Philippine Republic	39	35	33	29	34	38	44	47	55

TABLE VI
EARNINGS IN MANUFACTURING
(millions of \$)

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
All Areas	637	696	643	667	698	821	858	852	873
Canada	301	268	257	274	249	330	393	348	337
Latin American Republics	106	170	156	122	123	119	125	124	97
Argentina	14	19	18	8	21	14	14	15	7
Brazil	47	89	88	61	50	36	38	34	26
Chile				4	3	4	3	2	3
Colombia	4	4	4	5	8	8	5	7	2
Cuba	7	6	5	4	5	6	5	7	5
Mexico	17	29	23	21	21	30	37	40	35
Peru				3	4	4	4	4	2
Venezuela	5	6	7	7	7	10	15	8	9

Table VI continued

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
Australia	22	28	24	40	38	48	41	53	67
India	6	7	10	5	6	3	4	3	4
Indonesia	6	4	3				2	2	2
Japan				1	4	5	10	10	7
New Zealand	2	2	2				4	4	4
Philippine Republic				5	7	8	10	10	12

TABLE VII
TOTAL INCOME
(millions of \$)

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
All Areas	1294	1492	1419	1442	1725	1912	2120	2313	2198
Canada	294	236	222	208	237	293	353	367	368
Latin American Republics	522	652	599	570	589	678	800	912	627
Argentina	6	11	12	11	9	9	12	10	7
Brazil	61	75	65	74	43	33	27	40	35
Chile	41	54	51	26	37	67	90	48	35
Colombia	10	12	13	12	18	21	22	26	8
Cuba	43	49	44	28	33	34	40	56	45
Mexico	29	31	32	30	49	32	33	41	42
Peru	15	33	25	22	20	25	23	27	19
Venezuela	236	278	256	300	318	402	505	617	419

Table VII continued

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
Australia	11	11	8	13	25	24	26	36	39
India	12	10	10	9	12	11	6	9	10
Indonesia	27	34	4	32	43	23	31	7	20
Japan	2	3	3	4	10	12	8	11	3
New Zealand						4	4	6	6
Philippine Republic	28	26	27	24	26	10	22	23	25

TABLE VIII
INCOME IN MANUFACTURING
(millions of \$)

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
All Areas	357	331	287	309	345	398	390	461	471
Canada	211	164	139	132	138	172	156	197	206
Latin American Republics	55	72	64	68	56	52	53	64	51
Argentina	4	5	4	3	3	4	6	5	4
Brazil	22	39	32	33	22	12	11	16	13
Chile				4	3	3	2	1	1
Colombia	2	3	3	3	4	4	2	8	2
Cuba	5	4	5	4	5	5	3	5	4
Mexico	8	8	7	11	11	11	13	20	18
Peru				2	3	3	3	4	2
Venezuela	4	5	5	3	3	6	11	3	4

Table VIII continued

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
Australia	6	4	4	10	20	19	20	25	33
India	4	3	4	2	2	1	1	1	1
Indonesia	1	1	1			1	(1)	1	(1)
Japan				(1)	2	2	2	1	1
New Zealand	1	1	1				3	4	3
Philippine Republic				4	5	6	6	5	5

(1) Less than \$500,000

TABLE IX
TOTAL UNDISTRIBUTED EARNINGS
(millions of \$)

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
All Areas	475	752	876	776	644	898	1000	1017	755
Canada	146	181	199	259	232	298	367	274	200
Latin American Republics	109	249	303	152	125	192	241	189	135
Argentina	12	18	18	9	22	18	10	21	7
Brazil	36	67	85	38	40	38	48	35	18
Chile	(1)	3	3	8	4	7	3	2	9
Colombia	6	3	7	1	-3	2	1	-9	-7
Cuba	16	15	9	3	1	8	11	10	3
Mexico	15	33	29	17	-4	34	49	36	27
Peru	6	3	6	-1	8	15	11	10	-1
Venezuela	-4	19	73	34	29	32	45	58	49

Table IX continued

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
Australia	16	25	25	38	35	40	36	47	55
India	1	4	5	3	6	5	6	6	9
Indonesia	9	4	25	(1)	-17	14	4	44	32
Japan			1	3	5	9	13	17	9
New Zealand					2	3	3	2	2
Philippine Republic	11	9	6	5	8	15	22	24	30

(1) Less than \$500,000

TABLE X
UNDISTRIBUTED EARNINGS IN MANUFACTURING
(millions of \$)

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
All Areas	266	359	357	361	353	423	468	391	402
Canada	85	101	122	153	111	158	237	151	132
Latin American Republics	49	96	94	54	67	67	72	60	46
Argentina				6	18	10	8	10	3
Brazil				26	28	25	27	17	13
Chile				(1)	(1)	1	1	1	1
Colombia				2	4	4	3	(1)	(1)
Cuba				1	1	1	2	2	1
Mexico				10	10	19	24	20	17
Peru				1	1	(1)	1	(1)	(1)
Venezuela				4	4	5	4	5	6

Table X continued

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
Australia				26	18	29	20	28	34
India				2	4	2	3	3	3
Indonesia							2	1	2
Japan				1	2	3	7	9	6
New Zealand						2	1	(1)	(1)
Philippine Republic				1	2	2	4	6	7

(1) Less than \$500,000

TABLE XI
EXPORTS OF SELECTED COUNTRIES, 1950-1958
(millions of \$)

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
Canada	3095	4038	4760	4593	4433	4784	5288	5456	5422
Argentina	1361	1169	688	1125	1027	929	944	975	994
Brazil	1347	1757	1409	1539	1562	1423	1482	1392	1243
Chile	281	370	453	408	398	472	542	455	386
Colombia	396	463	473	596	657	580	599	511	461
Cuba	668	806	694	675	563	611	695	845	734
Mexico	521	629	656	585	656	807	880	727	731
Peru	189	248	234	219	245	268	308	320	281
Venezuela	1161	1353	1450	1445	1690	1873	2116	2366	2321
Australia	1668	2038	1689	1977	1656	1747	1887	2203	1660
India	1146	1611	1295	1116	1182	1276	1300	1379	1216
Indonesia	800	1292	934	840	867	946	882	969	755
Japan	820	1355	1273	1275	1629	2011	2501	2858	2877
New Zealand	511	692	671	659	683	725	776	774	700
Philippine Republic	331	427	346	398	401	401	453	432	493

TABLE XII
 EXPORTS OF SELECTED COUNTRIES TO THE UNITED STATES, 1950-1958
 (millions of \$)

	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>
Canada	1877	2198	2374	2474	2441	2662	2946	3090	3021
Argentina	206	220	159	181	103	126	133	129	133
Brazil	734	861	726	745	579	602	735	660	534
Chile	160	204	286	242	197	200	236	196	156
Colombia	313	362	384	466	506	442	410	384	333
Cuba	456	540	516	427	429	451	519	618	546
Mexico	315	326	410	355	328	397	401	430	458
Peru	49	61	62	87	96	110	135	138	124
Venezuela	324	324	396	400	504	583	705	900	892
Australia	143	341	158	128	114	126	136	131	97
India	219	300	253	202	185	195	184	277	196
Indonesia	133	206	233	169	149	167	141	148	130
Japan	183	190	234	234	283	457	552	606	693
New Zealand	52	81	77	51	39	42	55	61	102
Philippine Republic	246	258	338	264	246	240	242	225	275

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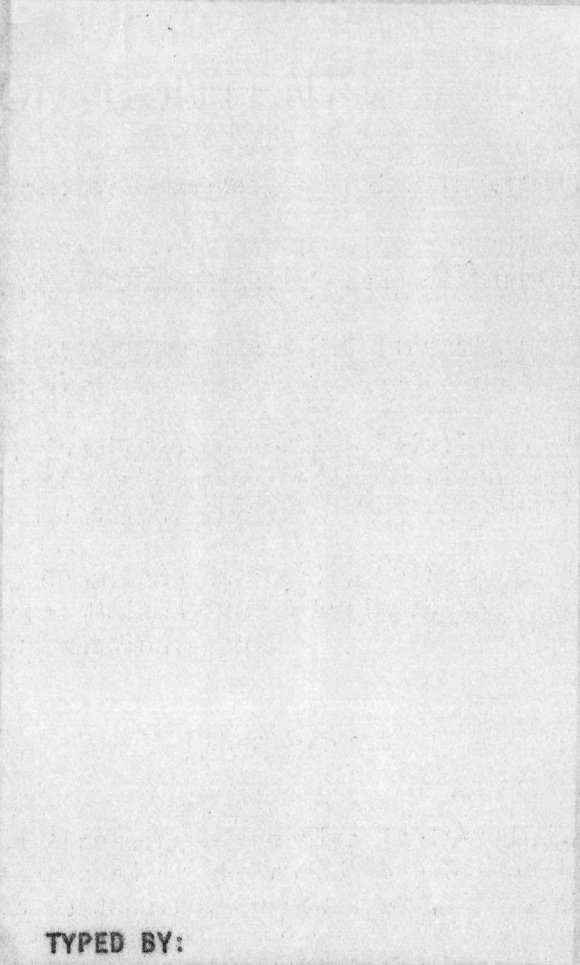
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