CONDITIONS OF ECONOMIC DEVELOPMENT IN LATIN AMERICA

——With Special Reference to Capital Formation——

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1. Determinants of Economic Development

The economic development of a nation depends, as is generally known, upon its population, the level of its techniques, natural resources, political and social environment, the amount of capital so far accumulated (together with the rate of accumulation), and many other economic and non-economic conditions. Of these, the most important factor is the accumulation of capital, and the rate and amount available can influence greatly the development of a nation's economy. However, both the rate and magnitude of capital accumulation depend in turn on the interplay of other factors, and because conditions vary widely between countries and because of the diverse nature of the factors themselves, no generalization of the correlation of these factors can apply equally to all areas. In an analysis of a nation's capital formation and its economic development, therefore, it is also very important to study in what particular way these factors work in that particular country.

The Latin American countries are marked by an abundance of natural resources, large inflows of capital from the United States and Europe, a peculiar social structure combining a native population with an influx from other continents, a system of agricultural production which has been characterized, ever since the Spanish and Portuguese dominion, by unequal land holdings, the ownership of which is concentrated in the hands of a small minority, and also the absence of large and vigorous markets, a consequence of the relatively low concentration of population and low standard of living. These conditions do not apply to all countries of this huge continent, as has been previously stated, but it can be said that an abundance of natural resources has greatly helped the development of the economies of these countries.

Countries lacking natural resources must rely on imported raw materials for their development, and frequently they must buy these at high prices. These needs must be paid for by exports, and it is necessary, therefore, for a stable exchange rate to be maintained. They must also aim at stabilizing domestic price levels. And since the stabilization of both the exchange rate and the price level is in most cases more important than a very high rate of economic growth, the latter is often sacrificed at the expense of the former.

During the years 1957–61, Brazil enjoyed an annual economic growth in real terms of seven per cent, although prices increased 30 per cent per annum during the same period. If Japanese price levels had soared at this rate, its economy would no doubt have been completely destroyed.

Brazil's comparatively high rate of real economic growth in this period, in spite of a persistent inflation, was also attributable to a huge inflow of foreign capital. One of the reasons for the constant inflow of foreign capital into a country plagued by inflation was that foreign investors did not always expect to gain a large profit in a short time for remittance back home, but, instead, hoped to gain profits over a longer period of time. And not only were they prepared to invest money in Brazilian enterprises, but they were also ready to undertake the risk of establishing their own enterprises in this promising but inflationary country.

The Willys Motors Inc. of the United States of America is a case in point. In 1961 they sold 64,691 vehicles for $ 153.64 million. In the same year, their subsidiary company, Willys-Overland do Brasil, sold about forty-two thousand units for $ 92 million. Another subsidiary in the Argentine, Industrias Kaiser Argentina S.A. sold as many cars as its sister company in Brazil, but its proceeds amounted to approximately $ 136 million. Thus the main efforts of the Willys group seem to be devoted to the Latin American Continent.[1]

These long-term capital investments by foreigners imply a confidence in the future of the Brazilian economy. And the comparatively high real rate of economic growth and the country's promising future, in spite of its severe inflation, are supported directly or indirectly by the existence of untapped rich natural resources.

Most of the Latin American countries, as has been said before, have been richly endowed by nature. But in spite of this, ever since the old colonial days, capital has not, in general, accumulated in a satisfactory manner. The economic and social backwardness of these countries may be attributed to this shortcoming, which in turn is a consequence of the small propensity to save on the part of the people and also of their extremely low income levels. Inevitably these countries depend heavily upon the introduction of foreign capital for their industrialization which is needed to raise their living standards. Recently, however, many governments have become aware of the dangers of this dependence on foreign countries, and they are looking for means to finance their industrial development from sources within their own countries.

In analysing the economic development of Latin America, it is necessary to know, first of all, the characteristics of capital formation there. This will help in understanding what factor or factors retard their economic growth. In the following pages an attempt will be made to delineate some problems concerning their economic development, by comparing the capital formation on this continent with that of the early development of modern Japan.

1 Willys-Overland do Brasil S.A., *Relatório da Diretoria,* exercício encerrado em 30 de junho de 1962, São Paulo, 1962, p. 1; John Moody, *Moody's Industrial Manual 1962,* New York, Moody's Investor's Service Inc., 1963, p. 950. Willys Motors Inc. acquired the assets of Willys-Overland Motors in Brazil by the amalgamation of April 28, 1953. Now they hold 38 per cent of Willys-Overland do Brasil. In 1956 they bought 29 per cent of the stock of Industrias Kaiser Argentina S.A.

2. Capital Accumulation in the Postwar Years

The formation of capital on this continent had lagged from the beginning of the nineteenth century, when many of the Latin American countries became independent, until the outbreak of the Second World War. During the war, however, the private sector of the economy accumulated a large amount of capital, owing to the windfall increase in the exports of primary products, both physically and in terms of money. An interesting feature of the wartime and postwar economy was that a major part of the private capital thus accumulated was speculatively spent on purchases of tangible properties like land and other immovables, thus bringing about an inflationary tendency. At the same time, the foreign exchange reserves increased remarkably in these countries. Although it intensified the inflationary tendency of the economy, the huge foreign exchange reserves made possible the rapid industrialization of the economy of postwar Brazil, the Argentine, Mexico, Chile, etc.

The gross product of Latin America in 1956 was 69 per cent larger than that of 1945 in real terms. The total output of the manufacturing and mining industries doubled during the years between 1948 and 1960. The total capital in 1955 was, according to an estimate of the Economic Commission for Latin America, $ 106.7 billion at the 1950 prices, or 66 per cent higher than the level of 1945. This means an average of about $ 600 per head of population.[1]

This figure of $ 600 is a considerable one if it is compared with similar figures for most of the Asian and African countries, but it is low when compared with figures for the highly developed Western nations. In fact, the per capita stock of capital for these advanced countries is several times more than that of the Latin American countries. As for the figures of Japan, the total of the fixed capital of the private sector of the economy and the assets of the transportation facilities only was $ 45 billion in 1955 and $ 77.4 billion in 1962. The per capita stock of only these types of capital was $ 504 and $ 817 in the respective years.[2] We may safely conclude, therefore, that in spite of their efforts, capital formation in Latin America has not progressed satisfactorily.

The amount of investment in this part of the Latin American continent was $ 9.1 billion (adjusted to the 1950 index) in 1956, of which about 30 per cent was effected governmentally.[3] Since these countries do not produce capital assets themselves, they must import a large part of the machinery and plant they need for industrial development. So their power to invest is limited to the availability of foreign currency. How much they can afford to invest depends upon how much of their primary products foreign countries are willing to buy, and in turn, upon their balance of international payments situation.

1 U.N., ECLA, *Economic Survey of Latin America, 1955,* New York, 1956, p. 9.

2 Economic Planning Agency, *Keizai Haku-sho, 1963* (Economic White Paper, 1963), Tokyo, 1963, Appendix Table 39.

3 F. Benham and H.A. Holley, *A Short Introduction to the Economy of Latin America,* London, Oxford Univ. Press, 1960, p. 71.

The annual gross investment in Latin America amounts to about 17 per cent of the gross product. This gross investment naturally includes depreciation and allowances for replacement of obsolescent machinery and other equipment already existing. It is difficult to estimate accurately what the necessary depreciation allowances should be. However, if the existing capital assets are to be amortized reasonably, about one-fourth would have to be deducted from the gross investment in order to compute the amount of net investment. A major part of the remaining three-fourths, the net investment, will be needed to provide the increasing population with food, housing, education, services and facilities, employment, security, etc. Therefore, their gross investment, amounting to only 17 per cent of the gross product, is hardly enough to raise the per capita production and elevate the general standard of living. In Japan, for example, the private investment for equipment was 20.6 per cent of the gross product in 1962. In order to achieve a higher rate of development, the Latin American countries must urgently find sources from which to finance capital formation, whether from domestic savings or borrowings of capital from abroad.

Table 1. THE GROSS PRODUCT AND INVESTMENT IN LATIN AMERICA

(In million dollars, in the 1950 price)

Years	Gross Product (A)	Balance of Trade	Commodities and Services	Consumption	Investment (B)	(B)/(A) (%)
1950	39,808	−1,411	38,397	31,795	6,602	16.6
1951	42,139	104	42,243	34,865	7,338	17.4
1952	43,044	19	43,063	35,504	7,559	17.6
1953	44,635	−1,222	43,413	35,808	7,605	16.8
1954	47,216	−213	47,003	38,779	8,224	17.4
1955	49,989	−692	49,297	40,646	8,651	17.4
1956	51,388	−1,237	50,151	41,051	9,100	17.7
1957(1)	53,808	250	54,058	43,764	10,294	19.1

Source: U.N., ECLA, *Economic Survey of Latin America, 1957,* New York, 1959, p. 83.
Note: (1) Provisional

3. Savings as a Source of Capital Formation

Some of the domestic sources that could provide the needed capital formation are the private savings of individuals and firms, credit, creation of banks, and governmental expenditures. Of these three, the most fundamental one is the voluntary savings made by private individuals and firms.

Before analysing the merits and demerits of these sources, we must first remind ourselves of the fact that, in most of these countries, there is a wide gap between the high-income and low-income groups. In addition, a great majority of the people here are living in poverty. Their tendency to consume, both average and marginal, is very strong, and the fact that the amount of their voluntary savings is small is due no doubt to their extremely low income levels and to their indifference to saving. As has been frequently pointed out by many economists, the small number of people with large incomes are inclined to waste their income on expensive consumption and foreign travel, which does not contribute to the accumulation of capital of the nation.[1]

It must of course be admitted that each country has its own peculiar circumstances and, therefore, that a generalization about consumption and savings in a single country is sometimes misleading. In fact, some economists claim that a not inconsiderable amount of savings has been made by a minority of people who enjoy the greater part of the national income.[2]

It cannot be denied, however, that an eagerness of the people to save is lacking in a country like Brazil which suffers from a serious inflation and a continuing fall in the purchasing power of its currency. In addition to this low propensity to save on the part of the public, another handicap is the tradition among the wealthier Latin Americans of holding their assets in foreign countries. They are naturally eager to protect their wealth against the damages which may result from political and social unrest and the likely decrease in the value of the currency. This tendency must, no doubt, have been intensified by the persistent and malign effects of inflation in these countries. And the consequent result of this outflow of capital is a low rate of capital formation, which otherwise might have been much higher.

Private savings in Latin America, therefore, consist largely of the undis-

Table 2. PROFITABILITY OF UNITED STATES INDUSTRIAL INVESTMENTS IN BRAZIL (1946–1960)

Years	Total Net Earnings as % of Book Value	Earnings Remitted to U.S. as % of Book Value	Earnings Retained in Brazil as % of Book Value
1946	14.3	6.4	7.9
1947	21.6	9.3	12.3
1948	22.3	6.2	16.1
1949	18.8	5.3	13.5
1950	16.2	6.0	10.2
1951	28.0	9.7	18.3
1952	25.6	6.8	18.8
1953	17.7	8.4	9.3
1954	14.2	4.9	9.3
1955	9.9	2.0	7.9
1956	10.2	2.2	8.0
1957	11.4	4.5	6.9
1958	8.3	2.8	5.5
1959	8.9	2.0	6.9
1960	11.1	5.1	6.0

Source: Lincoln Gordon and Engelbert L. Grommers, *United States Manufacturing Investment in Brazil,* Boston, Harvard Univ. Press, 1962, p. 88.

1 Alberto Baltra C., *Crecimiento Econômico de América Latina,* Santiago, Editorial del Pacífico S.A., 1960, p. 179.

2 Simon G. Hanson, *Economic Development in Latin America,* Washington, Inter American Affairs Press, 1951, p. 189.

tributed profits of corporate bodies and only a small part of the savings of individual citizens.[1] The amount of corporate profits reserved naturally depends upon how high the rates of profit are, and fortunately such rates are usually high here, as is shown in Table 2. It may be noted that, in this continent where inflation is rampant, corporate profits are generally held in the form of raw materials and real estate.

Table 2 shows the profit rate of U.S. private enterprises in Brazil from 1946 to 1960. In the 1950's both the cash value and the unit volume of their sales increased. However, owing to inflation which pushed up the cost of production steeply, and also because these companies could not increase the prices of their products to the same degree, the net profit rate showed a constant decline with the exception of the years 1955, 1958, and 1959. And it is seen that the profit rate in Brazil is still higher than those of the more developed countries. In the case of Japan the ratio of profit to the total capital in manufacturing industries averaged about twelve per cent in 1936 and about five per cent in 1954.[2] A large part of the private voluntary savings in Latin America accrue as a result of this high rate of return to investment. Although the savings made by individuals are small, those savings made by firms, together with the savings of the Government, constitute a major part of their rather large voluntary savings, which are almost comparable with those of the developed countries.

The Abbink Mission Report assumes that the savings in Brazil are more than ten per cent of the national income.[3] According to H.W. Spiegel, the investment made in Brazil in 1944 was between 24 and 29 per cent of the income payments made to all individuals. (The ratio of the investment to the national income was, therefore, a little smaller than this.) He says that the ratio of investment is fairly high even if compared with recent figures for developed countries.[4] Instituto Brasileiro de Economia reports that more than ten per cent of the gross national product has been saved every year since 1958, and also admits that the savings rate has been fairly high, if account is to be taken of the persistent and malignant inflation affecting this country.[5] Mexico is said to have been saving a large portion of its national product[6] and its rate of investment is high, too.

To sum up, the amount of savings in general is considerable in some of the Latin American countries, but in most of these cases the proportion representing personal savings is often quite small. This situation can be explained

1 F. Benham and H.A. Holley, *op. cit.*, p. 71.

2 Ichirō Nakayama ed., *Shihon Chikuseki no Kenkyū* (Study of Capital Accumulation), Tokyo, Tōyō Keizai Shimpō-sha, 1956, p. 20.

3 Simon G. Hanson, *op. cit.*, p. 189.

4 Henry W. Spiegel, *The Brazilian Economy*, Philadelphia, The Blakiston Co., 1949, p. 40.

5 Instituto Brasileiro de Economia, Fundação Getulio Vargas, *Background Information in Inflation in Brazil*, Rio de Janeiro, 1962, Table 37.

6 Sanford A. Mosk, "Financing Industrial Development in Mexico," *Inter-American Economic Affairs*, edited by Simon G. Hanson, June, 1947, p. 8.

by the absence of suitable monetary institutions that would absorb in enough of that part of the income of the people which is not spent in current consumption. It is also explained in part by the low propensity of the people to save, which is a consequence of the fact that they place little confidence in the monetary policies of their governments, and reflects their uncertainty about the future value of their currency.

Table 3. SAVINGS AND INVESTMENT IN BRAZIL IN 1955

(in billions of cruzeiros)

Savings		Investment	
Undistributed corporate profits (Includes depreciation allowance)	65	Fixed capital assets in the private sector	67
Private savings[1]	7	Fixed capital assets in the public sector	20
Âgio minus bonus	10	Inventory[4]	7
Surplus of the Government's current account[2]	8		
Deficit of the current account for commodities and services	2		
Errors and omissions[3]	2		
Total	94	Total	94

Source: U.N., ECLA, *Economic Survey of Latin America, 1957,* New York, 1959, p. 135.

Notes: (1) Savings deposited with monetary institutions.

(2) Includes all the balances of the Central and State Governments of the Social Security Fund, but excludes all the capital expenditures.

(3) Includes all the private savings other than those included in the item of "Private savings."

(4) Excludes changes in retailers' inventories and some others.

This situation in Latin America contrasts sharply with that of Japan where, in spite of the low standard of living, the people's urge to save has been very high since economic development started in the latter part of the nineteenth century. The Japanese working classes were diligent by nature and were content with a rather humble way of life. Even rich people preferred to invest their surplus income rather than to waste it on what was regarded as luxuries. The Government also encouraged this thrift and had fostered a sound monetary system. Various monetary institutions were established, especially banks, which assured the people of a safe and profitable return on their savings. In Japan, the people's rate of saving was 20.3 per cent in 1962, for instance, a rate much higher than that of Latin America, and still higher when compared with the West European countries and the United States.

4. *Capital Formation by the Government*

Governmental revenue in excess of current expenditures can also be a source of national savings. The Government can invest this excess of income where it chooses, so that any particular field of the economy can be encouraged to develop at the highest rate possible. In order to secure sufficient revenue, which in most cases consists largely of the proceeds of taxation, the Government must enforce maximum collection, for example, by checking tax evasion, or at least by obtaining the co-operation of the taxpayers.

The people of the Latin American countries are very reluctant to pay heavy taxes. The amount of taxes imposed by the central government is usually not much more than ten per cent of the national income. Only in Venezuela and Chile is the ratio of tax revenues to national income higher than in the other countries. This ratio amounts to about 18 per cent in Venezuela and about 14 per cent in Chile. This high ratio is, however, due to the fact that the governments of these two exceptional countries impose heavy taxes on the foreign companies in their territories.[1] Generally speaking, the tax burden in Latin America is comparatively light, for in 1959 the ratio of taxes to the national income was about 32.1 per cent in England, 32.6 per cent in West Germany, 27.6 per cent in the United States, 26.7 per cent in Italy, and 22.2 per cent in Japan.

Many governments in Latin America formerly used to resort to issuing new paper money in order to defray necessary expenditures. Quite naturally, this method of governmental finance was bitterly criticized by the public since it almost inevitably resulted in runaway inflation. The governments then began to establish new banks and forced these to buy national bonds. It became the custom for these banks to issue as many notes as were necessary to finance the national debt. This method of finance also necessarily involved inflation if the national bonds which were originally bought by the banks were not soon taken up by the voluntary savings of the public.

A glance at the balance sheet of a central bank in Latin America will show that its loans to the Government are by far the largest of all the loans made. Consequently, its working funds would not permit sufficient loans and discount for city banks. These loans to the Government may cause inflation if not spent properly. However, as long as they are spent on productive investment of one kind or another, the inflation involved may even do some good to the economy by transferring the purchasing power of the public to a certain sector of the economy and, at the same time, by decreasing the purchasing power of the public will have the effect of compulsory savings. The economic development so far attained by Brazil is typical of this manner of financing.

The importance of the role of the Government in the formation of capital has been increasing continually in most of the underdeveloped countries ever since the end of the Second World War. The part played by the Government was very important to the Japanese economy, too, during its early stages of development at the turn of the century. In spite of the willingness to save, the voluntary savings of the people were small due to their meagre incomes and were insufficient to supply the capital needed for development. The Japanese economy was receiving at that time a negligible inflow of foreign

1 F. Benham and H.A. Holley, *op. cit.*, p. 71.

capital. With insufficient savings and little foreign introduced capital, development had to be financed by the Government, using as primary sources taxation and the creation of bank credits of almost inflationary proportions. Fortunately, however, after these bank credits had been created, they were eventually replaced by the voluntary savings of the public so that the rate of increase in production was much greater than the increase in price levels.

The formation of capital through inflation as well as through foreign investment may somehow be admissible under the present economic conditions of Latin America. It must be remembered, however, that an increase in bank borrowings does not imply the same magnitude of increase in the purchasing power of the Government because the prices of the goods and services which it can buy are also rising. Nor does a mere increase in the volume of notes and other forms of money in circulation automatically increase the physical volume of capital assets. In order for it to be useful to the development of the economy, an increase in the volume of money must also be accompanied by an increase in voluntary savings. Undeveloped natural resources, skilled labourers who can be shifted from the old and less productive industries to the new and more productive ones, and surplus materials and equipment will help, too. Otherwise, the economy would be paralysed by the price levels overtaking production levels.

In some countries, rich underground resources have contributed greatly to economic development and this in turn has largely been financed by the inflationary creation of bank credits. It is to the existence of such resources that Brazil owes its development rate of 7 per cent per annum which so far has been achieved in spite of the prices increasing annually by 30 per cent.

Inflation, however, has hindered much more than it has helped in the economic development of Peru, Bolivia and Chile. In Chile, the cost of living rose by 150 per cent during the period 1940–46, while the level of production went up by little more than 14.6 per cent. In the years 1947 to 1952, the cost of living rose up by 220 per cent or at an annual rate of 37 per cent. The gross national product, on the other hand, increased at a rate of only 4 per cent per annum during 1947–49 and at 5 per cent during 1950–52.[1] And the cost of living in 1957 was six times as high as that in 1953, while the level of production showed a slight decline during that period.

In Peru, the gross national product increased at an annual rate of 5.1 per cent in the years 1950 to 1957, but it declined by 0.1 per cent during the following three years when the cost of living continued to rise at the rate of 10 per cent annually.[2] The stagnation of the economy in these three years seems to be attributable to this rather mild inflation. The increase in the cost of living was very steep in Bolivia, too. The 1959 level was twenty-five times higher than the 1953 level. The gross national product, on the other

1 U.N., ECLA, *Economic Survey of Latin America, 1949,* New York, 1950, pp. 271–298; and *Economic Survey of Latin America, 1957,* pp. 199–201.

2 Banco Central de Reserva del Perú, *Plan Nacional de Desarrollo Económico y Social del Perú 1962–1971,* Lima, 1962, pp. 37–39.

hand, increased only by 7.8 per cent in the same period,[1] notwithstanding their rich underground resources as yet unused.

Poor social conditions seem to account for the slow rate of the growth of the Bolivian economy. This is also the case with the Peruvian economy, and to some degree, with the Chilean economy, too. Unless these social conditions are improved, they can hardly make the most of their natural resources no matter how much money they may lay out for development. In spite of inflation, some degree of growth has been possible in Chile, for the social indirect capital in that country is relatively well provided. As was once pointed out by a United States investigation team despatched to that country, however, development would have come to a complete standstill if the price level had risen at an annual rate of more than 50 per cent.

Table 4. THE GROSS NATIONAL PRODUCT AND THE PRICE LEVEL IN CHILE

Years	G.N.P. (in the 1950 price) (in millions of pesos)	Percentage of Increase in the G.N.P. over the previous year	Cost of Living Index (1958=100)
1953	185,251	5.9	13
1954	179,051	−3.4	23
1955	184,147	2.8	40
1956	179,346	−2.6	63
1957	180,083	0.4	79

Source: U.N., ECLA, *Economic Survey of Latin America, 1957,* New York, 1959, p. 206.

The system of agriculture, for instance, constitutes a brake on the development of the Chilean economy as a whole. The inflation of this country resulted from the increase of the prices of agricultural products. Under the present system of agriculture, characterized by an unequal distribution of land, agricultural production could not supply the increased demand generated by those workers in manufacturing industries whose incomes had increased as a consequence of industrial development.[2]

In many cases, the inflationary policies of many of the governments of Latin America have not lived up to expectations. These policies have done little to produce new capital assets. The increase in the production of consumer goods has also been very small in comparison with the amount of money laid out by the governments, with only resulting higher and higher price levels. So that such a policy supported by inflationary creation of bank credits may help their economic development, it is fundamentally important to eliminate the faults of the social but rather non-economic environment as well as those of the purely economic one.

Some of the Latin American countries had adopted plural exchange rate

1 Naciones Unidas, *Boletín Económico de América Latina,* Vol. VII, No. 1, Santiago de Chile, Octobre de 1962, p. 14; IMF., *International Financial Statistics,* Washington, D.C., December 1963, pp. 218–221.

2 Alberto Baltra C., *op. cit.,* pp. 201–202.

systems as a means of securing revenues to finance capital formation. Under this system exporters were required to sell to the Government all or part of their foreign currency receipts at a low exchange rate. The Government then sold the foreign exchange thus acquired to importers at a higher rate, leaving itself with a considerable profit on these transactions.

Foreign companies producing copper in Chile used to produce a large part of the revenues of the Government. The corporation taxes on these enterprises were computed on the peso, but they had to be paid in U.S. dollars computed at a fictitious rate. An equally unfavourable rate of exchange was also applied to them when pesos had to be bought, for instance, for labourers' wages. After the devaluation of the peso in 1953, the new official exchange rate was one U.S. dollar per 110 pesos. But actually importers had to pay more than 300 pesos for a dollar. In fact, not less than a quarter of the revenues of the Chilean Government came from this kind of transaction.[1]

Brazil adopted the so-called *âgio* system. *Âgio* meant the percentage paid on foreign exchange by the people in need of it. Under this system, all imports were grouped into several categories, each of which was allotted a certain amount of foreign exchange. Any import had to be paid for from the exchange allocated to the particular category. Next, the Government auctioned exchange quotas among importers. Because a larger amount of exchange had naturally been allotted to the more important categories than those of the less important ones, the quotas of the former categories were sold off more cheaply than those of the latter. In the former case, the *cruzeiro* was appreciated, and in the latter, it was depreciated, with the result that the importation of luxuries was more difficult than that of necessities.

The Government of Brazil also took several measures to stimulate the exportation, especially of those commodities which did not compete well with the products of the other countries. The Government by means of a 'bonus' subsidized those exporters whose commodities were not competitive on world markets. In this way, most of the income accruing to the Government from the *âgio* system was paid out in the form of bonuses to exporters. It must be noted, however, that in 1955 the Government still retained in its coffers about Cr. $ 10 billion, which was equivalent to almost 11 per cent of the aggregate savings of the country. (See Table 3.)

Under a vicious inflation, however, it was found to be extremely difficult to maintain these plural official rates at fixed levels. Adjustments had frequently to be made so that exports would increase and imports would decrease. Thus, many of the countries which had formerly adopted the multilateral exchange rates system began gradually to cease to make use of it. In Brazil, the *âgio* system was finally abolished in 1961.

And yet it must be remembered that the multilateral exchange rates system of this country brought in very important revenues to the Government, which, in turn, were applied to the industrialization of the country during the postwar period. The Government had placed more importance on secur-

1 F. Benham and H.A. Holley, *op. cit.*, p. 66.

ing higher returns in the manufacturing industries than those of the exporting industries. Coffee, for instance, which was competitive in world markets, had a rate applied in which the cruzeiro was rather appreciated, so that exporters would be encouraged to sell at a better price. Again, the Government favoured the importation of capital equipment and raw materials which were indispensable for their industrial development. In this way, the prices of these imported commodities could somehow be kept from going up very rapidly, although the general prices-levels continued to rise. Investment in the newly-established manufacturing industries was thus greatly encouraged.

5. *Role of the Financial System*

The role which the financial system plays in the accumulation of capital is of course very important. It syphons off the voluntary savings of the public and invests these funds in various industries either directly or indirectly by means of loans to enterprises. In Latin America the commercial banking system is very well organized. But with few investment banks, the domestic capital markets have not yet developed soundly. The shortage of investment capital has had to be supplemented either by governmental expenditures or borrowings from foreign countries. But the capital formation by the Government has very often been accompanied by vicious inflation. So an urgent problem has been what form their financial structures should take.

In Japan, the methods of financing economic development have been of an inflationary character, too. However, in the postwar period, Japan has used the so-called "over-loan" method of finance. "Over-loan" does not necessarily imply that banks lend more than they receive in the form of savings deposits, but simply that the ratio of bank loans to savings deposited with them is extremely high judging from the standard practice of banking in West Europe and the United States.

This method of finance would have failed completely were it not for the rapid progress which the Japanese economy has made to date. For it is known that the "over-loan" position of city banks becomes a major problem whenever the economy stagnates. The remarkable economic progress of postwar Japan is chiefly attributable to the over-loans of city banks, which was made possible by the loans made to them by the Bank of Japan. However, the inflationary character accompanying this typically Japanese method of finance was much milder than that which has accompanied the various methods of finance in Latin America. At any rate, some extent of credit creation of some kind or another seems to be necessary for a rapid development of a nation's economy where voluntary savings of the people are not large enough.

In contrast with the monetary institutions of the United States, Japan and West Europe, those of the Latin American countries can meet only a small portion of the industrial demand for capital.[1] In Latin America, as in the other underdeveloped areas, the monetary system itself is not very developed. It does not enjoy the confidence of the public, so it does not receive their savings. Even in Brazil, for example, where the banking system is comparatively well developed, there are a few large banks which enjoy the trust of the people, but most are small banks which sometimes become insolvent. Besides, the voluntary savings are small themselves, as has been pointed out several times before. The income level of the people is very low and they can hardly have much to save after buying their daily necessities. In addition, they are not accustomed to, nor do they wish to deposit their wealth with monetary institutions. They do not have any particular inclination to hoard it in the form of precious metals and stones. But they quite often invest in real estate. This hastens inflation and consequently causes it to become less and less profitable to deposit their wealth in banks with only a definite amount of interest in return.

Attention must also be given to how the system of finance has developed in Latin America. The first monetary institutions established here after political independence in the early part of the nineteenth century were foreign exchange banks whose primary purpose was to finance international trade transactions. They were not much concerned with the other economic affairs in general. Those established later were mainly commercial banks with characteristics aud functions similar to the older banks. They did not render much service to the agricultural and manufacturing sectors. As a result, foreign commerce was the only business to benefit by these institutions.

Some other institutions to take care of agricultural finance might have been necessary, because agriculture was no doubt the most important sector of the Latin American economy. Landlords and farmers wanted more long-term loans which the old banks were quite reluctant to make, because they

1 The following table shows the ratio of the loans of all the monetary institutions to the gross national product in Brazil, Argentina, Mexico, Japan, and the United States of America.

		Loans (A)	G.N.P. (B)	A/B (%)
Brazil (in billions of cruzeiros)	1958	469	1,306	35.9
	1959	611	1,776	34.4
Argentina (in millions of pesos)	1960	151,239	790,034	19.1
Mexico (in millions of pesos)	1960	39,736*	141,000	28.2
Japan (in billions of yen)	1961	9,770	17,130	57.0
U.S.A. (in millions of dollars)	1962	309,389	554,900	54.0

Sources: Superintendência da Moeda e do Crédito, *Relatório do Exercício de 1961,* Rio de Janeiro, 1962, Quadro 17; Banco do Brasil S.A., *Relatório 1961,* Brasilia, 1962, p. 227; Banco Centoral de la República Argentina, *Boletín Estadistico,* Buenos Aires, 1962, p. 12; Banco de México S.A., *Informe Annual 1961,* Mexico, 1962, Cuadro 17; Boards of Governors of the Federal Reserve System, *Federal Reserve Bulletin,* Washington, Jan., 1964, p. 59; U.S. Department of Commerce, *Survey of Current Business,* Washington, D.C., Feb., 1964, S-1; and Economic Planning Agency, *Keizai Haku-sho, 1963,* (Economic White Paper, 1963), Tokyo, 1963, Table 1 and Appendix Table 41.

Note: *Includes loans and investment in securities.

were more concerned with the finance of foreign trade and also because they did not like the rough and ready management of the ranchers. So the land-owning farmers demanded the Government to establish new banks which would finance agriculture. The manufacturing industries which began to develop after the 1930's also lacked proper financial institutions. They, too, urged the Government to establish industrial banks or economic development banks. And it was not until these new types of banks were established that they began to accumulate capital at a considerable rate.

Nacional Financiera of Mexico, Banco Nacional de Desenvolvimiento Econômica of Brazil, Corporación de Fomento de la Producción of Chile, for instance, have played an important part in the industrialization of their respective economies. Banco Nacional de Crédito Agrícola and Banco Nacional de Crédito Ejidal have also made a significant contribution to the development of Mexican agriculture, although their contribution may have been comparatively smaller than that of Nacional Financiera whose funds amounted to about one-third of the total funds of all the monetary institutions in this country. The system of agricultural finance has advanced to a certain degree in the Argentine. Banco Hipotecario Nacional is mainly engaged in making secured loans to the agricultural sector. Banco de la Nación Argentina, the largest commercial bank of this country, devotes considerable efforts to agricultural finance. Brazil has no banks which specialize in agricultural finance, although Banco do Brasil is becoming cognizant of the needs of agriculture. In other countries, too, there are several agricultural institutions which make loans on mortgages of real estate. Generally speaking, however, the system of agricultural finance is much less advanced than that of industrial and commercial finance.

A systematically organized system of banking is indispensable, so that all the various banks, each with their own character and functions, may work effectively together. Unfortunately, however, most of the Latin American countries are lacking in such a systematic money and capital market. Even the central bank, therefore, is in a poor position to implement efficient monetary policies. The supply of both short-term funds and long-term funds are not enough, and so, in the absence of institutions like investment banks, it remains for commercial banks alone to supply the short-term and long-term capital necessary to the economy.

This is a hardship commonly faced by those underdeveloped countries which are just starting their economic development. In Japan, until around the time of the Second World War, there was no clear distinction between those banks which supplied short-term capital and those which supplied long-term capital. In Germany also, commercial banks have acted as industrial banks, contributing to the capital accumulation of the economy. Even when a newly-developing country has no properly organized capital market, it would not pay if its commercial banks were to confine themselves to the supply of short-term capital as is taught by what we often call the "orthodox" principles of banking. They must try instead to make good the faults of the present monetary structure of the economy. So in Latin America, too, long-term capital will have to be supplied by commercial banks until the market for such capital is greatly improved. Although strenuous efforts seem to be being made recently, there is still much room for improvement in their capital market.

6. *The Role of Foreign Capital*

The role played by foreign capital in the development of the Latin American economy is so important that Latin American economic history is almost the story of its introduction. Recently, however, the germination of nationalism seems to have made the people reluctant to depend upon such capital for the promotion of their industrialization. Many governments are trying hard to eliminate borrowings from foreign countries and secure the necessary capital from within their borders. So the importance of foreign capital seems to be decreasing comparatively in recent years.

The inflow of foreign capital into Latin America tapered off in the 1930's, but it picked up again after the Second World War. There are no reliable data readily available which give the exact amount of direct investments made by foreigners. But it seems to have been more than six billion dollars at the least at book values in 1946 and have increased to thirteen billion dollars in 1958,[1] of which about two-thirds was concentrated in Venezuela, Brazil, Cuba, Mexico and Chile. And a little more than 70 per cent of this $ 13 billion invested in 1958 came from the United States.

Besides these direct investments, about $ 2 billion of private loans and credits (inclusive of short-term) were negotiated after the war up to 1958. Of these loans and credits, about one-half have been repaid already, the remaining half still being outstanding. The total sum of money furnished by foreign governments and international monetary institutions to Latin America after the war amounted to $ 4.5 billion, of which about $ 0.6 billion were gifts. The net inflow of this kind of capital was about $ 1.5 billion as $ 3 billion was returned. Therefore, the total inflow of foreign capital after the war is estimated at more than $ 9 billion.[2]

On the other hand, the Latin American countries have repaid a considerable amount to their creditor countries in foreign exchange. The Argentine, Brazil, and some other countries had accumulated large sums of foreign exchange during the Second World War. With these exchange reserves, they could afford to expand their power plants, improve transportation and communication facilities, and institute irrigation and land improvement schemes. At the same time, they tried to reduce the influence of foreign capital in their domestic economy. They paid back what they had borrowed from

1 U.N., *Foreign Private Investments in the Latin American Free-Trade Area,* New York, 1961, p. 9; *Presidential Report to the U.S. Congress on the Mutual Security Program, for the Six Months ended June 30,* Washington, D.C., 1958, p. 56; U.N., *The International Flow of Private Capital, 1956–58,* New York, 1959, p. 30.

2 U.N., *The International Flow of Private Capital, 1956–58,* New York, 1959, p. 9.

European countries, above all, from England. They also bought the railways and other enterprises which had until then been owned and operated by foreign capital. During the years 1946–50 the total amount of debts repaid by the Latin American governments was $ 526 million, and they bought up European assets worth $1,332 million.[1] As a result of these payments, the nominal investment of England in Latin America decreased from stg. £ 754 million in 1938 to stg. £ 245 million in 1951, and further down to about stg. £ 200 million in 1955.[2]

Notwithstanding this huge amount of repayments, Latin America has still had a net inflow of foreign capital. More than half of the inflow has been the direct investments by United States private enterprises, and a major part of the balance consists of credits extended by the World Bank and the Export-Import Bank of Washington. Out of the total balance of direct investments made in Latin America by private United States citizens, which are estimated at about $ 9 billion, $ 3,161 million went to the petroleum industry ($ 2,179 million to Venezuela), $ 1,693 million to the manufacturing industries ($ 659 million to Brazil), $ 1,291 million to the utilities sector ($ 344 million to Cuba), and $ 1,238 million to the mining and metal industries ($ 457 million to Chile).[3]

Private foreign capital has made a great contribution to the development of the Latin American economy, by helping their capital accumulation and thus giving a stimulus to productive investments; in particular, to the mining and petroleum industries and to utilities. It is difficult to estimate accurately the per cent proportion of foreign funds in the make-up of capital in Latin America. But it would be no exaggeration to say that about 8 per cent of the capital formation in the postwar years was attributable to such private foreign capital. The total percentage contribution of foreign capital would amount to between 12 to 15 per cent if account is taken of the capital which has been lent by foreign governments and international monetary institutions.[4] However, the foreign capital invested in the petroleum industry of Venezuela has been so large that, if it is excluded, the inflow of foreign capital into Latin America is no more than $ 500 million a year. It might fairly be said, therefore, that the inflow of such capital has not been large enough to induce the full potentiality of development of this continent.

7. *Problems of Real Capital Formation*

So far, we have studied capital accumulation in Latin America chiefly in terms of money. If we turn to the problems of capital formation in real terms, that is, how and where this accumulated capital is invested, we see

1 R.F. Mikesell, *Foreign Investments in Latin America,* Washington, Pan American Union, 1955, pp. 5–6.

2 U.N., *Foreign Capital in Latin America,* New York, 1955, p. 11; and Bank of England, *Annual Report,* every fiscal year from 1950 to 1957, London.

3 U.S. Department of Commerce, *Survey of Current Business,* Washington, D.C., Sept., 1959, p. 18.

4 U.N., *Foreign Private Investments in the Latin American Free-Trade Area.*

several conditions which are quite peculiar to this continent. One of these conditions is that too much money is spent on purchases of real estate and that, consequently, the savings of the people are seldom used for productive purposes.

In Latin America, land and buildings have always been popular subjects of investment and speculation, The aggregate savings of Brazil in 1947 are estimated at 600 million cruzeiros. Out of these savings, about two-thirds or Cr. $ 375 million was spent on the construction of various kinds of buildings, especially apartment houses for the high-income groups. The new factories built were worth only Cr. $ 25 to 37 million, and no more than Cr. $ 100 million was spent on the construction of houses for the low-income classes. But a major portion of the savings was no doubt spent on office buildings and luxurious apartment houses.[1] The formation of capital in Argentina is given in Table 5. The construction of buildings accounts for half of the formation of fixed capital assets. The expenditures on new machinery and factory equipment are much smaller than those spent on buildings.

Table 5. THE DOMESTIC CAPITAL FORMATION IN ARGENTINA

(in millions of pesos)

	1956	1957	1958	1959	1960
Fixed capital assets	35,258	52,863	67,845	112,905	164,315
Transportation and communication facilities	4,308	10,500	8,365	14,800	31,125
Factory machinery and equipment	11,255	17,595	25,750	45,400	71,475
Buildings	19,695	24,768	33,730	52,705	61,715
Inventory	−1,320	−1,695	−1,120	−2,305	2,955
Total	33,938	51,168	66,635	110,600	167,270

Source: U.N., *Boletín Económico de América Latina,* Octubre de 1962.

Another feature of the Latin American economy is that it is strongly influenced by the speculative motives of the people, which has been most marked since the old colonial days. Monetary institutions have advanced so many loans for speculative transactions that, as a natural consequence, they have no more funds to lend to the sectors which are most in need of money for development. Mortgage banks, investment banks, and credit banks have often been criticized for helping speculative investments in real estate and also for financing the sectors which are not very important for economic development. Commercial banks have also been a target of criticism because they have often hindered the development of the economy by stimulating through their finance the inflationary increment of the economy's effective demand.[2] Even social securities institutions have helped speculative purchases

1 Simon G. Hanson, *op. cit.,* p. 190.

2 Javier Márquez, "Financial Institutions and Economic Development," in *Economic Development for Latin America,* ed. by H.S. Ellis, London, Macmillan & Co. Ltd., 1961, pp. 178–179.

of real estate in the city instead of investing their funds productively.[1] This tendency has further been intensified by the inflation from which the economy of Latin America has often suffered.

Recently building construction has been quite active in Japan, too. But the ratio of the investment in construction (public works and construction of houses and non-house buildings) to the aggregate capital formation is no more than 40 per cent. The ratio of the construction of buildings only is much smaller. The greater the expenditures on construction, the less are the productive investments in other fields, because the total capital available in one economy is of course limited. No doubt, therefore, one of the most important problems of the capital formation in Latin America is that too much investment has been, and is still being, made in buildings and land.

8. *Conclusion*

We have found that the conditions of capital formation in Latin America are quite different from the conditions which pertained in Japan, for instance, at a similar stage of development. As a summary of what we have seen, these conditions peculiar to the Latin American Continent can be itemized as follows:

(1) Most of the Latin American countries are monoculture countries, whose economy depends to a great extent upon exports of one or two primary products. The volume of export of these primary products determines their receipts of the amount of capital available for accumulation. However, since the prices of these primary products are unstable and frequently decline, it is necessary for them to change this type of economic structure, so that they may be able to accumulate capital at a steady rate.

(2) The people in Latin America have been, and still are, reluctant to invest their idle capital for extended periods. So their savings have not been used for productive purposes. Instead, they are eager to gain profits from speculative transactions and the production of such commodities as will promise immediate returns. Their preference for investment in land and other real estate has hindered productive capital formation.

(3) The monetary institutions have played only a minor part in the accumulation of capital because the system of finance itself is not well advanced. Besides, the people have placed little confidence in the future value of their currency. Both these factors have made it difficult for the monetary institutions to syphon off the voluntary savings of the public.

(4) The insufficiency of the social indirect capital assets and the backwardness of the social environment, above all the unequal distribution of landownership with large estates in the hands of a small minority of people, have prevented industrial development by making investment ever made less effective than it otherwise would have been.

All these conditions prevent effective capital accumulation and economic development. There are, however, some conditions which contribute to the

1 J. Márquez, *op. cit.*, pp. 178–179.

development of this continent. Rather high rates of return available in many sectors of the economy enable enterprises to carry out voluminous investments which are themselves financed with their profits. Another contributing factor is the large inflow of foreign capital, without which it is quite certain that the Latin American economy would not have developed to the extent it has done. The dependence upon foreign capital for development is one of the biggest features of the Latin American economy. Japan, for instance, did not have the benefit of such capital when its economic development started in the latenineteenth century. With the small amount of the voluntary savings of the people and the persistent and grave inflation, the economy of the Latin American countries owes its development to high profit rates and the inflow of foreign capital.