

ver-
not
eep
in-
lly,
and
for
om
it,
ra-
We
of
ich

ur-

V. Capital formation in Latin America and the inflationary process

The margin of savings depends ultimately upon the progressive increase of labour productivity. Though the level of productivity achieved by some Latin-American countries is such that, by means of a judicious policy, they would be able to reduce the amount of foreign capital needed to supplement national savings to moderate proportions, in the majority of them this capital is admittedly indispensable. *not necessary*

In actual fact, productivity in these countries is very low owing to lack of capital; and the lack of capital is due to the narrow margin of savings resulting from this low productivity. The temporary help of foreign capital is necessary if this vicious circle is to be broken without unduly restricting the present consumption of the masses, which, generally speaking, is very low. If this capital is effectively used, the increase in productivity will, in time, allow savings to accumulate which could be substituted for foreign capital in the new investments necessitated by new technical processes and the growth of the population. *more really*

Throughout most of Latin America, the characteristic lack of savings is the result, not only of this narrow margin, but, in many cases, of its improper use. Saving means refraining from consumption and is thus incompatible with certain types of consumption peculiar to relatively high income groups. *definitely conclusion*

Great disparities in the distribution of income may be, as they have been in the past, a factor favourable to the accumulation of capital and technical progress. Although the influences of that factor in the Latin-American countries should not be overlooked, there are many well-known examples of how such distributive inequalities have fostered types of consumption peculiar to countries of high productivity. Considerable opportunities for saving and effectively employing monetary reserves for productive imports are thus frequently lost.

It is the increase in productivity that has enabled the United States, and to a lesser degree other industrial countries, to shorten the working day, raise the real income and standard of living of the masses, and considerably increase public expenditure, without impeding a huge accumulation of capital.

It is a well-known fact that fiscal expenditure, which, in the middle of the last century, formed a relatively small part of national income in the

great industrial countries, today represents a large portion of it. This has become possible only as a result of increased productivity.

The Latin-American countries have also followed this general tendency. If, where productivity is high and the accumulation of capital considerable, the increase in the proportions of public expenditure is cause for concern, it must be even more so in countries where a considerable part of the national income must be devoted to saving, since saving is necessary to attain that increase in productivity without which the aim of raising the standard of living of the masses would be a mere illusion.

The problem is essentially one of estimating needs. The resources available to satisfy the enormous individual and collective needs of the Latin-American countries are relatively small, and the possible contribution of foreign capital is also limited. Those needs must therefore be evaluated from the standpoint of the aim in view, in order that the limited resources may be most advantageously distributed. If the aim is to increase the measurable well-being of the community, the increase of capital per man must take very high priority. There are various types of public and private investment which are indisputably useful for this purpose, but since they do not increase productivity, they cannot bring about the increase in saving necessary for new investments. On the other hand, those same investments, if put into efficient capital goods, will immediately increase productivity and so develop a margin of saving which, transformed into new investments, will give rise to yet further increases in productivity.

For these and many other reasons, the problem of capital formation is of the utmost importance.

The considerable pressure of those individual and collective needs on comparatively scanty resources usually provokes inflationary processes such as those with which the governments are now so rightly preoccupied. At the same time there has grown up a belief, not only among the privileged, but also among those whose only concern is the general welfare, that inflation is an unavoidable means of forced capitalization where voluntary saving is evidently insufficient.

It is a thesis worthy of careful examination. Since the process is widespread, there is a wealth of data available for fruitful investigation which will later permit an appreciation of its value and range. Meanwhile, some comments may contribute to define this problem.

One indisputable fact stands out: the stimulus of monetary expansion has led to a high level of employment and thereby to a real increase in income. It appears, however, that a large part of that effect had already been achieved during a phase of moderate credit expansion which preceded the acute inflationary process. As that process developed, the increase in employment and real income became less and less marked, and that of prices more so, with consequent disturbances in the distribution of total income.

This experience provides both positive and negative lessons.¹ The positive lesson is pertinent to the subject since the growth of employment brought about an increase in the potential margin of savings. The negative lesson is also concerned with it. The exaggeration of the stimulus necessary for the achievement of maximum employment led internally to excessive inflationary pressure, which, with the rise in imports consequent upon the resumption of foreign trade after war-time restrictions, absorbed a large part of the gold and dollars which had been accumulated.

The fragmentary information available raises more than one doubt as to whether those reserves have been used in strict accordance with the needs of the economic development of Latin America. In order to throw light upon those doubts, it would be interesting to discover to what extent the aforesaid reserves have been used to import the most essential capital equipment, how far they have been spent on non-essential articles or those related only to the mode of living of high-income groups, and to what extent they have served to cover the capital outflow caused by the process of inflation.²

These different uses of foreign exchange are closely linked with the internal effects of inflation. The rise in prices, by creating exceptional profits, places in the hands of a comparatively small group great opportunities for saving, as always happens when income distribution is altered in such a way. It would be extremely interesting to ascertain to what extent these opportunities have been translated into collective savings and whether those savings have been put to the most productive use from the standpoint of the community.

If a large part of the profits arising out of inflation had actually been saved and efficiently invested, those who expound the foregoing thesis would have a strong point in their favour. Unfortunately isolated figures do not provide sufficient reliable evidence to justify any generalization. None the less, the information on Brazil presented by the Joint Brazil-United States Technical Commission is illuminating. In 1946 the large corporations reinvested 30 to 40 per cent of their profits and distributed the rest among the shareholders. The amount distributed by all the corporations is believed to have amounted to 12,000 million cruzeiros, of which one fourth, or barely 3,000 million, represented various forms of

¹ The possibility of a rational policy of employment of idle or ill-employed resources has been shown by experience. At one time exports had constituted the chief dynamic factor. After the world crisis, however, they proved insufficient to fulfil adequately their role of stimulating development. In the nineteen thirties, the weakness of the external dynamic factor had already been counteracted in some of the Latin-American countries by a policy of internal stimulation. In order to do so, as was explained elsewhere, it was necessary to reduce the import coefficient. The events of the Second World War showed how much further this policy could be carried. The war brought about a drastic reduction of the coefficient, while at the same time increasing the force of the external stimulus.

² It is interesting to note that Latin-American private deposits in the United States amounted to \$729 million on 30 June 1947.

saving.³ Taking the figures as a whole, only about 50 per cent of total profits would represent direct or indirect investments.

That being so, the proportion consumed would have been considerable. Since, moreover, the high-income groups have a high import coefficient, it is not surprising that a large part of the foreign exchange accumulated should have been spent on products not essential to economic development, as may be inferred from other information from the same source.

There is yet another aspect of the question to be clarified. Assuming that under given circumstances a certain amount of inflationary expansion is considered the most practical expedient, in view of the scarcity of savings, there would be ways of best achieving that purpose, at the same time mitigating the serious consequences of the inflation. The State has means of stimulating the investment of a large portion of profits and inflationary incomes through progressive taxation of the part spent and consumed, while lowering the tax or granting exemption on the part invested; furthermore, through exchange control or taxation, it can divert the part which tends to be used for imports incompatible with strong economic growth. Such means may, of course, also serve to increase unproductive public expenditure instead of savings, to the detriment of an increase in national productivity.

Logically, if some groups have benefited considerably from inflation, others must have suffered. Conclusive studies have not yet been made, but it would seem that there is no essential difference between inflation today and in the past. The middle class and the fixed-income groups have generally been those to bear the brunt of the transference of real income to entrepreneurs and other beneficiaries. The better organized labour unions have through wage increases managed to overtake, and at times surpass, the price rise, although usually with a lag. There are not enough reliable data, however, to ascertain to what extent the whole group has benefited and not merely certain sectors. Nevertheless, it should not be forgotten that the increase in employment during the first stage of the expansionary process has usually meant an increase in the real income of the working class family, even when wages have not been adjusted to rising prices.

All this redistribution of income brought about by inflation creates in the sectors that benefit the illusion that the total wealth of the community is increasing, even though real income ceased to rise to any extent, once the initial stage of moderate expansion was passed. It is an illusion peculiar to the stage of euphoria and prodigality; during that time capital equipment is not renewed, as in the case of transport and other public and private investments, and a large part of the previous increase in monetary reserves is spent in a short while. This means the consumption of accumulated capital and so must not be mistaken

³ Report of the Joint Brazil-United States Technical Commission, part III.

for a real increase in income. The illusion begins to fade during the second phase—that of increasing tension—and finally disappears during the third—that of painful readjustment.

The first stage seems to be over in Latin America, and as the second develops, acute social antagonisms are appearing, which threaten the efficacy of the existing economic system. An atmosphere unfavourable to the smooth development of that system is being created, and with it certain kinds of governmental intervention and fiscal measures prejudicial to private initiative and undermining the sense of individual responsibility. Thus the inflation that has greatly increased the remuneration of the entrepreneur ends by impairing his efficiency—a factor of vital importance for the growth of the Latin-American countries.

The State soon takes a substantial share of the entrepreneur's inflationary gains in the form of taxes. The increase in public expenditure resulting from that participation will present a problem no less serious than the others, when inflationary profits disappear and it becomes necessary to bring State wages and salaries into line with the cost of living, with the obvious risk that the proportion of national income represented by public expenditure will again rise, to the detriment of capital formation.

Sound conclusions regarding the value of inflation as an instrument for collective saving can be drawn only after an objective analysis of the above facts and of others arising out of it. Whatever the final figures, it will have to be admitted that inflation has tended to discourage typical forms of voluntary saving which had acquired growing importance in some Latin-American countries. Here may be found the source of future savings for industrialization, when monetary stability can be restored in accordance with the new rules of the game imposed by new conditions. In short, if the forced savings which accumulate through inflation are furnished by many sections of the community whereas the benefits thereof are passed on to favoured groups only, the question arises whether it is not possible to devise other forms of saving (either voluntary or collective) by which resources could be better devoted to productive ends, without the serious social disadvantages of forced saving.

Meanwhile an appeal to foreign savings appears inevitable. Unfortunately, in this connexion the problem inherited from the disastrous experience of the nineteen thirties is still far from solution. While the default of the debtor is still fresh in the memory of the creditor countries, there is a tendency both to forget the circumstances in which default occurred and to spread the mistaken belief that a recurrence of past events could be avoided by the observance of certain rules of procedure. At the root of this we find the same fundamental problem as was mentioned in connexion with foreign trade trends. This was pointed out by the United States Department of Commerce in a study published some years ago.⁴

⁴ *The United States in the World Economy*, Economic Series no. 23, Washington, D. C., 1943, page 6.

In 1929 the United States supplied the rest of the world with \$7,400 million in payment of imports, investments and other items; hence the rest of the world could easily pay the \$900 million due in fixed financial services on capital invested by the United States, apart from remittances of profits. In 1932, however, the supply of dollars was reduced to \$2,400 million, while the services, had they been paid, would still have amounted to \$900 million. The rest of the world would thus have had barely \$1,500 million to cover its imports and other payments to the United States, as against \$6,500 million in 1929.

In the light of these figures, it is not surprising that default was more or less general throughout Latin America. The few countries that continued to meet their obligations did so at great sacrifice, at the cost of a severe contraction of their internal economy and to the detriment of their monetary reserves. It is only natural that, after such an experience, they should be reluctant to find themselves once more in a position in which they must either fail to meet their obligations or sacrifice their economy.

Until a solution to the fundamental problem of foreign trade is found, care must be taken that dollar investments, where they cannot be used to further dollar exports, shall contribute, directly or indirectly, to the reduction of imports in that currency, in order to facilitate future payment of services.

From this and other points of view, it would seem imprudent to renew the active flow of investments of the nineteen twenties without adopting a plan to deal with the series of concrete problems which arise in this connexion. The existence of international credit institutions could be a very effective factor in the drafting of such a plan, in which the types of investment best suited to the development of Latin-American economy through their contribution to productivity and to the development of the necessary capacity for repayment may be considered in co-operation with the individual countries concerned.

There seems no reason why this plan should not include the field of private investment. Much is heard about the need for establishing a system of guarantees or regulations in order to promote it. All this is worthy of further consideration. New measures must, however, be developed in the light of past experience. There were many other difficulties besides the fundamental ones of the nineteen thirties, and the abuses on both sides should be fully admitted in order to prevent a repetition of the evil. In this way, and with effective technical assistance, it should be possible to develop an investment policy that would be welcomed by all concerned because of its reciprocal advantages.