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PRIVATE INVESTMENT IN
LATIN AMERICA

A REPORT

OF THE

SUBCOMMITTEE ON INTER-AMERICAN
ECONOMIC RELATIONSHIPS

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES



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LETTERS OF TRANSMITTAL

MAY 25, 1964.

To the Members of the Joint Economic Committee:

Transmitted herewith for the use of the Joint Economic Committee, and other Members of Congress, is a report of the Subcommittee on Inter-American Economic Relationships on its recent hearings on "Private Investment in Latin America."

Sincerely yours,

PAUL H. DOUGLAS,
Chairman, Joint Economic Committee.

MAY 25, 1964.

HON. PAUL H. DOUGLAS,
*Chairman, Joint Economic Committee,
U.S. Congress, Washington, D.C.*

DEAR MR. CHAIRMAN: Transmitted herewith is a report on our hearings on "Private Investment in Latin America" which we consider appropriate to make to the full committee, together with a statement of supplemental views by Senator Javits. The printed record of testimony has previously been made available to members of the committee and to the public.

We wish to thank the witnesses for their excellent papers and observations. The participating witnesses (some of whom, public spiritedly, came long distances and braved bad weather) were:

Mr. W. L. Clayton, Anderson, Clayton & Co.
Prof. A. A. Fatouros, University of Chicago Law School.
Mr. Francis E. Grimes, Chase Manhattan Bank.
Mr. Sperry Lea, National Planning Association.
Mr. John D. J. Moore, W. R. Grace & Co.
Mr. Aurelio Peccei, ADELA; Fiat Motor Co., Inc.
Mr. Philip A. Ray, International Bond & Share, Inc.
Mr. George Rublee, Agency for International Development.
Mr. Warren Wilhelm, ADELA.

Sincerely yours,

JOHN SPARKMAN,
*Chairman, Subcommittee on
Inter-American Economic Relationships.*

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INTRODUCTION

North Americans (and Western Europeans, as well) who live under and enjoy the benefits of a predominantly free-enterprise, private-investment market system of economic organization are increasingly concerned about the lagging rate of private investment in the Latin American development program. They are concerned also with the attitude of seeming indifference in many parts of Latin America itself to the potential contributions of the private sector. This local apathy is manifest in a concentration of energies on governmental development programs, the reported exodus of domestic capital, the flight from local currencies, and the persistent discouragements which private, and especially foreign private, capital seemingly must face.

Because of this concern, the Subcommittee on Inter-American Economic Relationships sought the views of investors and international experts at a series of hearings on January 14, 15, and 16, 1964. The following schedule of these hearings shows not only the direction of the subcommittee's inquiries but the list of witnesses who so public-spiritedly responded to our requests for information and guidance. The printed transcript of testimony at the hearings has been released previously.

PRIVATE INVESTMENT IN LATIN AMERICA

I. Cooperative Efforts to Encourage Private Risk Capital.

Improving the Flow of U.S. Private Investment in Latin America.

John D. J. Moore, vice president, W. R. Grace & Co.; Chairman, U.S. Inter-American Council. New York, N.Y.

Improving the Flow of Western European Private Investment in Latin America.

Aurelio Peccei, Executive Director for Western Europe, "Atlantic Community Development Group for Latin America" (ADELA); director, Fiat Motor Co., Inc., Rome, Italy.

Responsibility of Latin American Host Governments and Private Local Capital.

Philip Alexander Ray, attorney; chairman, International Bond & Share, Inc.; former Under Secretary of Commerce; senior research fellow, Latin American Studies, Hoover Institution on War, Revolution, and Peace, Stanford University; author, "Our Hemispheric Crisis: South Wind Red." San Francisco, Calif.

II. Investment Guarantees as an Incentive to Private Investment.

An Appraisal of Programs of Government Guarantees to Foreign Investors by Capital-Exporting and/or Host Countries.

A. A. Fatouros, professor, University of Chicago Law School; author, "Government Guarantees to Foreign Investors." Chicago, Ill.

U.S. Government Guarantees Under the Foreign Assistance Act of 1962 With Special Reference to Latin America.

George Rublee, Assistant General Counsel for Private Enterprise, Agency for International Development, Department of State. Washington, D.C.

PRIVATE INVESTMENT IN LATIN AMERICA—Continued

III. Trade Expansion Through Regional Economic Integration as an Incentive to Private Investment.

Progress Report on Latin American Free Trade Association (LAFTA) and Central American Program of Economic Integration (CAPEI).

Francis E. Grimes, vice president, area executive, Latin America, Chase Manhattan Bank. New York, N.Y.

Canadian-United States Free Trade Arrangement: Possible Characteristics.

Sperry Lea; associate director of research, Canadian-American Committee, National Planning Association; author, "A Canada-United States Free Trade Arrangement." Washington, D.C.

A Western Hemisphere Common Market—Potentials and Implications.
William L. Clayton, board of directors, Anderson, Clayton & Co.; former Under Secretary of State for Economic Affairs. Houston, Tex.

Starting from the premise that enlarging the freedoms from want and fear are prime objectives of all peoples, we did not specifically consider social reform programs as such. Neither did we try to probe the role of nationalistic motivations, although clearly they do have economic implications, as the late Professor Benham observed in stating an unfortunate tendency among developing nations that "nationalism, perhaps the greatest curse of our age, nearly always prevails over economic considerations."

We do not underrate these social and political "ends," but as a committee concerned with economic matters, we have limited ourselves to consideration of the "means" of resource organization and use.

SOME ENEMIES OF PRIVATE INVESTMENT

I. FAILURE TO APPRECIATE FULLY THE CONNECTION BETWEEN PRIVATE ENTERPRISE AND POLITICAL FREEDOM

The merits of policies encouraging private investment and private enterprise, as opposed to a heavy reliance on government, as a means for directing the employment of economic resources in Latin America and other developing nations, are both varied and real. Private investment is an effective instrument making for political stability: (a) by supporting the rise and vitality of a solid, articulate middle class made up of managers, property owners, and small capitalists; and (b) by providing a bulwark in support of individual freedom against the rise of arbitrary power, an ever-present risk under a "controlled economy."

*Private investment is an effective instrument promoting economic growth and economic stability: (a) by decentralizing decision making, rewarding risk taking, and diffusing losses; and (b) by its efficiency in making use of the initiative of millions of persons, households, and business firms as centers for bringing together the always limited resources of know-how, manpower, and property to achieve maximum output of wanted goods and services.**

The case for private investment is not, as many persons in the developing countries tend to assume, merely a call for larger foreign investment. It is a call for policies which ascribe a larger role to private investment, whether local or foreign. Measures which discourage local private investors may, indeed, prove particularly costly by sacrificing the advantages of local private initiative, thereby striking a blow at efficiency and freedom. Worst of all, they may prompt a flight of both capital and enterprises to more receptive climates.

It may seem to be flogging a strawman to begin a discussion of the need for encouraging private investment in Latin America by asking the question "Why care?" To the North American mind the case for private initiative, private enterprise, and private investment is so widely conceded that it is seldom explicitly stated. The advantages are so generally taken for granted and so self-evident that most North Americans and Western Europeans actually have difficulty in phrasing a defense or explanation of their system of economic organization if called upon to do so. Part of the problem in selling the enterprise market system to developing nations thus stems from our own inarticulateness.

Understanding and acceptance of the private capital market mechanism is, needless to say, less general in the less developed areas of the world. There the "shortage of capital thesis" tends to glamorize governmental investment projects, partly because they are satisfying to nationalistic spirits and partly because such projects are often rela-

*While Senator Javits substantially agrees with the report as a whole, he feels that a somewhat different emphasis should be made on the relationship of government to private enterprise in the developmental process. See his supplemental views at p. 26.

tively large and conspicuous and hence seem to be "getting there faster." Socialism-by-default is, consequently, an answer to urgency. This tends to be supported by the further argument, often heard, that private enterprise and private investment must, for some reason, wait until the supporting infrastructure of roads and community facilities (even national steelmaking plants) have been provided through governmental channels.

Those who take private investment for granted as the best instrument for economic development, because it has played such a large role in the development of the United States and other Western nations, either do not know or forget that some serious students today go so far as to urge a positive case against freedom of economic choice as the preferred path toward economic growth of underdeveloped countries. It is, incidentally, significant that during its own developmental period the United States was largely dependent upon private foreign capital and, like many developing nations today, was forced to finance its growth subject to the vagaries of world markets for one or two basic agricultural export commodities such as cotton, tobacco, and naval stores.

A case against private enterprise and its corollary, economic freedom, has sometimes been made not on ideological grounds alone but on outright economic premises as well. The logic runs that economic growth in areas of low per capita income depends upon increases in the stock of resources; that increases can be realized only by forcing the masses to save; that private enterprise lacks this coercive ability; and, hence, that growth will occur only if a minority imbued with the "growth perspective" initiates and sustains a measure of coercion involving a temporary decrease in economic freedom for the masses.

One problem of initiating and sustaining economic growth is certainly that of providing a set of institutional arrangements which will encourage the ability and willingness of the people to look beyond the immediate present and take a longer view. This is because most forms of progress call for saving and the use of present resources in ways which do not yield an immediate product. Private enterprise and private investment accomplish this by offering "the carrot," rewarding not only saving, as such, but initiative and innovation in the use of those savings. Those who argue that political government can make better economic choices for promoting growth show a preference for use of "the stick" for directing the energies and choices of the individual producers-consumers, savers-investors. The attractiveness and strength of the private enterprise system rest precisely on its success in relying on such a system of rewards rather than compulsions. It makes use, on a voluntary basis, of the alertness to opportunities and the priority ranking of needs to be satisfied which characterize the economic behavior of the large numbers among every people.

Those who treat the virtues of private investment as self-evident—beyond all need for defense—as the best path to growth and development tend to dismiss the fact that much of the literature and public thinking about developmental problems begins with the injunction "Let us plan" and, thereafter, measures success by the "comprehensiveness of the plan." The "Declaration to the Peoples of America" establishing the Alliance for Progress, among its 12 paragraphs on goals, includes one beginning, "To stimulate private enterprise * * *" which was put there, we are told, at the "insistence" of the U.S. delegates.

Or was it at the insistence of the Latin American delegates? The impact of this reference to private enterprise was somewhat damaged, however, four paragraphs later in the pledge that the United States, for its part, would supply financial and technical cooperation to achieve the aims of the Alliance, and to this end provide a major part of the minimum of \$20 billion, "principally in public funds," required over the ensuing 10 years from all external sources.

The Charter of Punta del Este itself contains some 3,000 words—nearly one-fourth of the entire document—on comprehensive national development programs, while the nearest reference to the private sector in the document itself is a 10-word phrase buried in a statement of purpose to accelerate the process of national industrialization by "taking full advantage of the talents and energies of both the public and private sectors." Private investment and private enterprise are not otherwise mentioned, except to the extent that they can be found implicit in such expressions as "private financial assistance," "private action in support of the development program," and a reference to the balance-of-payments effects of "external financing, public and private," estimated to be required for the execution of the program.

These bits of evidence, tending to treat lightly the expected role of private investment in Latin American development, have been cited only to help explain an erroneous initial impression as to the objectives of the Alliance. The prime focus of the Alliance for Progress was, and still is, on getting the job of social and economic reform, prerequisites to growth and stability, moving and moving rapidly. That a massive program of government effort was believed necessary, if the challenge of progress was to be met in time, was not intended to displace or detract from the role of private investment but instead vigorously to support it. What was new at Punta del Este was the sense of urgency. In the search for tools, special emphasis was, accordingly, given to the responsibility of government in making a maximum contribution. Unfortunately, the interpretation given to this new focus and new weight on government gave rise to a common belief, particularly in Latin America, that large amounts of U.S. Government financial aid conducted on a government-to-government basis were in prospect. This was taken to permit an attitude of indifference on the part of all parties to the needs for stimulating private capital flows.

Both would-be investors in the United States and businessmen and officials in the countries themselves were consequently prompted to devote an undue amount of their energies and activities to negotiations aimed at government-to-government grants and loans.¹ The task of economic development has been slowed to the extent that these motivations, primarily political in nature, have been distracting or have had the effect of channeling efforts and capital into shoring up inefficient governmental activities and encouraging outright antiprivate capital objectives.

Needless to say, those who fell into this misconception about the aims of the Alliance for Progress failed to appreciate fully the spirit which prevails in the United States. They gave insufficient weight to

¹ Compare the remarks of an experienced U.S. representative reported in one of our earlier reports: "Local government officials run the gamut of applying first to one public loan source and then to another, and may finally turn to private financing via Wall Street or San Francisco" ("Economic Policies and Programs in Middle America," p. 22).

the mutual commitments to rely upon "the creative powers of free men working within a framework of democratic institutions." Properly understood, no stronger or more explicit declarations in support of the system of private enterprise, private investment, and free choice could have been made.

Among our store of freedoms one of the most used—and least appreciated—is the freedom of choice in one's employment and the freedom of one's choice at the supermarket. Just as democratic institutions extend the sphere of individual freedom, economic freedom is the handmaiden of democracy. While it can be argued that free economic choice is not necessarily ruled out by, or incompatible with, undemocratic political institutions, experience and commonsense tell us that reliance on centralized governmental machinery for allocating economic resources puts a strain on both individual freedom and political democracy.

The worst enemy of freedom on all fronts is the concentration of power. On this score private investment with its diffusion of decision making and property ownership is one of the best atomizing forces. On occasion private enterprise itself has unfortunately gone beyond the bounds of genuinely disbursed power and has grown large and monopolistic. But these instances only illustrate the need to guard against concentration of economic power in any hands, since it carries with it hazards to political freedom and democratic institutions.

There is no need to say more here in defense of private enterprise and private investment. We concluded these hearings, however, with the feeling that the virtues of the free enterprise system itself need to be better understood and more aggressively presented and "sold." Along with certain members of the Commerce Committee for the Alliance for Progress "we are persuaded that the most important way in which the United States can help is by exporting the ideas implicit in a free economy. Certainly money and goods alone will not do the job."²

We strongly urge, accordingly, an orientation of U.S. policies toward Latin America to give even greater weight than at present to the encouragement of private enterprise and private investment as a means of advancing the social goals of accelerated progress, justice, personal dignity, and political liberty.

II. EXPROPRIATION ADDS NOTHING TO THE STOCK OF RESOURCES BUT DETERS NEW INVESTMENT

The magnitude and rate of foreign private investment in any country depend upon the hospitality accorded to it by the host. No nation or national leadership which has hopes of attracting external developmental capital can, accordingly, afford a reputation of expropriation, creeping expropriation, or downright harassment of foreign private capital or contract rights.

By the same token, foreign private investors poorly serve themselves and their role as free market "enterprisers" if they blacklist an entire geographic area such as Latin America because it contains some bad hosts. Opportunities for private profit and public good will be missed

² Hearings, "Private Investment in Latin America," Subcommittee on Inter-American Economic Relationships, Joint Economic Committee, p. 102.

if investors fail to differentiate the case of a country which confines seizures of private property to industries clearly affected by the public interest, and demonstrates a spirit of fairness in providing prompt and effective compensation whenever property rights have been nullified.

The occasion for these observations arises from the disappointing recent trend in the flow of external private capital into Latin America. Uneasy fears of expropriation and evidences of calculated discriminatory practices have beyond doubt played a major part. The effect of this adverse trend on the amount of foreign capital aiding development, coupled with other evidences of a substantial "flight" of local private capital from Latin American climates, is particularly disturbing, coming as it does at a time when a large and expanding role had been expected of private enterprise and investment in the social progress program.

In the face of substantial international efforts to increase the net flow of new external financing into Latin America, the record for 1962 was well below the average for the 2 preceding years. Judging from preliminary figures, covering the United States only, it was probably not much better in 1963. The capital outflow in the form of U.S. direct investments into the Latin American Republics in the decade 1950-60 which had averaged about \$325 million per year (\$219 million per year if oil investments in Venezuela during the critical Suez years, 1956-57, are excluded) fell to \$173 million in 1961, and became a net withdrawal of \$32 million in 1962.

The trend toward withdrawal continued throughout most of 1963, but turned about late in the year, ending in a modest amount of net new U.S. investment, estimated at \$78 million for 1963 as a whole. The reversal in the outflow of direct investment capital from the third to the fourth quarter of 1963 was largely accounted for, however, by transfer to the Venezuelan petroleum industry, which the Department of Commerce believes may have been associated with tax-payment needs.

Meanwhile, Europe has, to a large extent, turned away from Latin America, with the European capital outflow to the whole of Latin America estimated at less than \$80 million in recent years.

The record is admittedly less discouraging if one includes the "reinvestment" of undistributed subsidiary earnings amounting to \$255 million in 1961 and \$287 million in 1962 for U.S. corporations. As an act of free investment, the precise significance of these amounts is complicated by the influence of possible exchange conversion losses involved in repatriation, the tilt which the U.S. Tax Code provides against repatriation of earnings in the case of underdeveloped countries, to say nothing of the sheer business need for providing new working capital if one is merely to stay in business.

In any case, the net inflow of new private capital for industrialization and economic diversification, clearly lagging when measured against past levels, is far worse when measured against hopes and plans for the future. The target contemplated by the mutual undertakings at Punta del Este for private developmental funds with which to improve per capita income and the rate of growth over the ensuing decade was \$600 million a year of new foreign private investment, including \$300 million from private U.S. sources. This external

nongovernmental share was to supplement some \$8 billion per year of local funds generated by Latin America itself—"most of it by the private sector." The mere statement of the magnitudes involved in these plans should not only convince everyone of the inadequacy of the current private external capital inflow, but of the staggering blow to the development program implicit in the drying up and flight of local investment capital sources.

Before undertaking to account for this lagging recent trend, two comments from the record of our hearings are particularly relevant. The first of these observations, by the Bank of London & South America, Ltd., reminds us that this adverse trend is of recent origin. Direct investments, especially from the United States, have played a decisive part in the past economic development of Latin America. The bank's "Quarterly Review" notes that:³

It is perhaps worth recalling that until the Second World War almost all the capital that entered Latin America was provided by private investors. In a period of little more than half a century, from about 1860 to the outbreak of the First World War, the inflow of foreign capital which brought about a revolution in the economies of many of the Republics, proceeded almost without restriction on the part of either the supplying or the receiving countries, and such measures as host governments took to influence the movement were generally to encourage the inflow by means of concession contracts.

Turning to the role of private capital during the years between the two World Wars, the article continues:

After the First World War the United States of America became firmly established as the principal source of capital for Latin America. Investment conditions remained on the whole unchanged, both in the capital-exporting countries, where freedom of capital exports remained the rule, and in Latin America, where governments generally continued to allow the unrestricted entry of foreign capital, maintained full convertibility of their currencies, and kept taxes low.

An understanding of the causes of the shift in the role of private capital from this historical pattern must begin—and end—with the proposition made by the Department of Commerce committee of businessmen and bankers considering proposals to improve the flow of private investment to Latin America. That group of businessmen emphasized at the outset:

* * * the basic proposition that in free societies private capital cannot be driven or cajoled into new fields. There is a free market for private investment and nations, areas, industries, and institutions must compete for it in a free marketplace. In other words, investment must be attracted and experience teaches us that it will be attracted to those fields where the return is most promising, and where the safety of its capital is most assured.⁴

If the flow of private capital into Latin America can be neither "driven nor cajoled" but must be attracted and encouraged, one must look at the other side of the coin; what are the deterrents and discouraging elements which have contributed to drying up the flow? In the preceding section it was noted that a misreading of the Charter of Punta del Este may have been partly responsible by creating a feeling that the promise of large amounts of government-to-government aid reduced the role assigned to the private sector. Efforts to correct this mistaken notion have been initiated but still need to be pressed vigorously. Unfortunately, the immediate reaction to these efforts to

³ Hearings, "Private Investment in Latin America," pp. 442-443.

⁴ Hearings, "Private Investment in Latin America," p. 56.

put matters in proper perspective has, at least for the moment, tended to substitute a degree of disillusionment for illusion.

More serious as a deterrent to new private investment is the fresh memory of Cuban seizures of foreign investments and the confiscation of still larger amounts of privately owned property of Cuban nationals. The Cuban case has, indeed, cast a long shadow which private investors, for many years to come, will find difficult to put out of mind when considering new investment commitments in Latin America generally. It is ironic that the fall of Cuba into Communist hands should have had the joint effect of discouraging private investment in Latin America and inducing an actual capital "flight" while, at the same time, greatly adding to the need and urgency for stimulating private capital inflow in order to advance industrial development and provide jobs for a growing population.

But not all the blame for lagging investment can be put on the Cuban episode. The Cuban example has been kept vividly alive by almost constant forebodings and rumbling threats of seizure and harassment elsewhere. The melancholy list of talk or action includes nullification of oil contracts in Argentina and Peru, expropriation and the hungry eyeing of foreign-owned utilities and mining properties in Brazil, calculated confiscatory copper taxes in Chile, and utility rates frozen by decree in several countries. According to officers of the U.S. companies, decrees expropriating U.S. drug manufacturing operations in Brazil had been written and signed in Brazil prior to the April revolution.

It has been pointed out that "if a contract made with one government is likely to last no longer than the inauguration of the next government—particularly in South America—then the whole concept of long-term investment can no longer apply either, a conclusion which will be speedily drawn by potential investors everywhere."⁵ Even if the reverse twist could be believed, namely, that the threats of expropriation would end with the prevailing regime, the overlay of such political uncertainty on top of normal economic risks must inevitably discourage investors.

Only the behavior of the individual Latin American countries themselves can live down or overcome the fears which have grown out of these memories. This means that domestic appeals to nationalistic spirits expressing themselves in expropriation of private capital, which have so frequently prevailed over economic considerations, may have to be held in check and economic realities placed foremost. As we pointed out in an earlier report, seizure of title to existing assets really adds nothing to the capital stock or productive plant of a country.⁶ Considering the disruption and political instability, it may well detract from national well-being. This is especially true if, as may well happen, the enterprise is less efficiently run by its new, less experienced managers. If, for example, a shortage of capital for development of untilled lands prompts no more than seizure of already developed agricultural properties, the national loss in productivity may be more than the hoped-for social gains of land redistribution.

A fourth disquieting consideration about new investment in Latin America, along with the erroneous interpretation of the Alliance,

⁵ Hearings, "Private Investment in Latin America," p. 110.

⁶ Report, "Economic Development in South America," July 1962, p. 2.

the example of Cuba, and the rumblings of further expropriations is the suspicion that these countries are, in any case, socialistically oriented and at best doubtful territory for private venture. Contrary to a popular impression in North America, encouraged perhaps by the current emphasis on measures against social injustice which call for government action in the areas of agrarian and tax reforms, the Latin American countries are not necessarily committed to socialism or socialistic solutions.

The subcommittee was reminded, it is true, that most Latin American governments do own and operate a huge and growing array of business enterprises and that the extent of government intrusion, often by executive decree, into business life goes far beyond anything we have experienced. We were told at the same time, however, that there has been a surge of local private enterprise and the emergence of an important domestic business and industrial class in Latin America. "An authoritative estimate indicates that 70 percent of economic activity in Latin America is in the hands of private owners, while 30 percent is controlled by the government. Of the 70 percent of privately owned enterprises, some 90 percent is estimated to be owned by Latin Americans and only 10 percent by foreigners."⁷

While each country ultimately will have to make its own record against the adverse and deterrent factors, we urge that it is unfair and unwise of private investors to prejudice their investment decisions and those of others by dwelling upon the case of the bad actors. The necessity for reminding investors of this difference between countries stems from the deep-rooted tendency to generalize about Latin America as an entity simply because the 21 Republics are all south of the Rio Grande and have common cultural backgrounds.

Before a bad name for expropriation is generalized to the detriment of the flow of all private investment, another consideration must also be cited for perspective. Government sovereignty is, and must be, complete in terms of the rights to expropriate any property deemed necessary for public use, provided that the program for seizure carries with it a program for fair compensation. Even in the United States the right of eminent domain is recognized beyond dispute, and the condemnation of private property is well accepted for a wide range of public uses, as illustrated by highways, housing developments, parks, and bombing ranges. Subject to local preferences, it is frequently applied to public service industries such as electric power and traction properties. A homeowner in the path of a new expressway may not feel adequately compensated for the past love and care given to his lawn, or the manager of forest lands for his patience in nurturing the saplings, but they at least have the protection of an appraisal and, if need be, of a day in court.

The focus of the expropriation charges as they apply to Latin American countries should thus be on the fairness and equity of the compensation awarded, and not upon the seizure itself or the threat of seizure. To be fair, compensation must be prompt and effective. Prompt settlement is particularly important, quite apart from the sheer wasted energies and costs of delaying tactics. By the simple mathematics of present values, a dollar due, or awarded for payment,

⁷ Hearings, "Private Investment in Latin America," p. 57.

in 5 years is worth only 75 cents, assuming a 6-percent return, which may be well below profit expectations. Quite apart from the risks of erosion by inflation, a dollar of compensation promised 25 or 30 years after the actual seizure is worth only a tenth of the amount. To be "effective," compensation must be made in sound, convertible currencies so that the dispossessed owner has a usable asset for carrying on his business elsewhere or accepting other local investment opportunities.

Granting, however, the sovereign right to seizure for public purposes and assuming prompt and effective compensation, a series of expropriatory acts by a government complicates the investment-decision process by adding instability and uncertainty. A country indulging such policies has forfeited its right to complain of a shortage of capital. Harrassment, discriminatory taxation, or other devices amounting to creeping expropriation have a similar deterrent effect. A nation's leadership that is genuinely concerned with more than providing short-term distractions for its own people would do well to ponder the view of one foreign investor: "Capital goes where it is wanted, and stays where it is well treated."⁸

III. INFLATION DISRUPTS SAVINGS, MISALLOCATES CAPITAL, AND ADDS TO INSTABILITY

The most insidious and destructive of all forms of expropriation is monetary inflation in the extreme forms which have characterized some of the Latin American republics. It is insidious because it overtakes a nation so easily, steals—or "taxes"—so quietly, and produces a temporary glow that suggests prosperity. It is destructive because its expropriatory aim is that of a blunderbuss hitting savers indiscriminately without recourse or appeal, sparing the unjust at the expense of the just, while driving scarce resources along unsound paths and in wrong directions.

Private investment presupposes two things: First, an act of saving by someone, either local or foreign, before or after the investment; second, a faith on the part of the investor that the profit possibilities and safety of the investment can be reasonably estimated in advance for comparison with alternative opportunities.

Inflation and the threat of chronic inflation are enemies of growth by striking at both of these preconditions. When it becomes a way of life, inflation—

Discourages savings.

Erodes the value of investments if held in any liquid or working capital form.

Compounds investment uncertainty by making erosion and the rate of erosion prime considerations.

Drives capital in search of inflation shelters rather than in search of productivity.

Makes unused land a good "investment."

Encourages flight of savings and capital into more stable currencies.

Diverts the energies of enterprisers into trying to outguess the whimsies of those in charge of the monetary printing presses.

⁸ Mr. Thomas Braniff, quoted by Mr. W. B. Wriston, executive vice president, in *American Banker*, Feb. 28, 1964.

Accentuates economic stability by promoting speculation in inventories and premature additions to plant capacities.

Creates a national image of irresponsibility.

Accentuates political instability by its inequities and injustices.

Fosters the economic inefficiencies by making barter and neighborhood exchange preferred to cash markets.

Feeds on itself by nullifying attempts at sound government budgeting since expenditures inevitably tend to outrun planned receipts.

Inhibits sound growth in one or all of these ways.

So much has been said about chronic inflation and its corrosive effects that it seems futile for economists and international monetary authorities to continue to inveigh against it. One can only hope that by reiterated warnings, if not by experience, some heads of state may reluctantly be brought to see the long-run fallacy of such ways.

Perhaps two quotations will save us the effort of trying to state the inflationary problem and its consequences differently. Lord Keynes once wrote about the end of the road when degrees of inflation similar to some Latin American patterns were ravaging the economies of several European countries. Lord Keynes, whose defense of deficit spending is sometimes, quite erroneously, confused with an advocacy of inflation, in an oft-quoted passage, said:

Lenin is said to have declared that the best way to destroy the capitalist system was to debauch the currency. By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens. By this method they not only confiscate, but they confiscate arbitrarily; and while the process impoverishes many; it actually enriches some * * *.

Lenin was certainly right. There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose.⁹

Anti-inflationary policies and financial "orthodoxy," while likely to seem burdensome to capital-poor countries, are prerequisites to sound development and will speed progress since limited resources must be channeled to the best alternative uses. The need for efficient use, rather than a distorted misdirection of their allocation, is simple economics. It is not merely a set of rules or arbitrary restraints imposed upon the poorer countries by rich nations and international banking authorities.

One may heed some apt words on inflation by an international economist, not because he was a central banker, but because his words are another way of stating the economic facts of life:

In countries where inflation is endemic, such as some countries in Latin America, it is not difficult to observe the extreme and obvious forms such misallocations can take or to fail to see how they operate to retard growth. For example, one will find very frequently serious overinvestment in real estate. New construction of apartments and office buildings will be active despite heavy vacancies in existing structures. Meanwhile, capital is lacking for a wide range of projects that would contribute to growth. Also, it is common in such countries for a significant fraction of local savings to be sent abroad to be invested in more stable currencies. Thus, on both counts, the country where they were earned is deprived of the stimulus to growth that would have resulted from a more effective allocation of new investment.¹⁰

⁹ John Maynard Keynes, "The Economic Consequences of the Peace," p. 235. insurance of commercial bank credits and exporters directly, as provided in the Export-Import Bank Act of 1945, as amended in 1961.

SOME ENCOURAGEMENTS TO PRIVATE INVESTMENT

IV. GOVERNMENT GUARANTEES BY THE CAPITAL-EXPORTING OR CAPITAL-IMPORTING COUNTRY MAY REASSURE PRIVATE INVESTORS

When capital-deficient host countries are unwilling or unable to put an end directly to the domestic risks of expropriation and inflation, additional measures involving government guarantees of direct investments may ease the uncertainties for private investors by bringing to bear special indemnification commitments, that is, government guarantees, by either, or both, the capital-exporting and the host country.

The United States now has three programs of investment guarantees.¹¹ One of these, applicable in selected "underdeveloped" countries, insures against losses from the specific dangers of currency inconvertibility, expropriation, and damage caused by war, revolution, or insurrection. A more recent program extends the availability of guarantees to include the economic hazards of investments deemed to be of high priority in the development and social progress programs of less developed, friendly countries. Such extended-risk guarantees will be considered only for projects where it can be clearly demonstrated that the private investment would not otherwise be made.

Housing projects in Latin America are especially singled out and insured against all commercial and noncommercial risks involving pilot or demonstration projects similar to those insured by the Federal Housing Administration in the United States itself.

Governmental programs guaranteeing private investors against loss resulting from specific risks appear to be a simple way of encouraging the flow of external private investment into developing countries. Their appeal rests on the assumption that they involve only a contingent, and presumably moderate, public cost, while freeing the private investor from large areas of political uncertainties, thereby permitting a clear economic appraisal of the profit-and-loss potentials of a proposed enterprise.

That which seems so easily workable as a concept for public policy is, however, not without problems. A few questions will illustrate some of the difficulties.

What do guarantees really mean in cases where the receiving government is prone to ignore traditional commercial treaties "of friendship, commerce, and navigation" by repeated expropriations and consistently fails to control inflation? Is it wise, as U.S. law does, to accept as "contingent obligations backed by the full faith and credit of the Government of the United States of America," an undertaking to make good on the inadequacies or capricious acts of unpredictable regimes in another country? Does not the loss, or threat of loss, under a government guarantee merely shift the burden of settlement from the channels of international law onto the shoulders of diplomatic negotiators supported by various retaliatory governmental sanctions?

Can a direct investment remain genuinely "private" as to its inception and management when its very existence is induced and supported by a government guarantee? Can the risks underwritten, e.g.,

¹¹ In addition, the United States has programs covering export credit financing, including insurance of commercial bank credits and direct exports, as provided in the Export-Import Bank Act of 1945, as amended in 1961.

expropriation, civil disturbances, etc., be isolated from the consequences of poor or inept (not merely fraudulent or negligent) business management?

What schedule of fees, or country-to-country differentiation of fees, is appropriate for such guarantees?

We did not find wholly satisfactory answers to these and other basic questions during our hearing. Nor were we sure from the evidence presented that the executive agency in charge of administering the guarantee programs had found satisfactory answers either.

Guarantee arrangements entail a form of partnership between the government, which provides against certain political risks, and private investors who assume the economic risks and management responsibility. This concept of shared losses is, indeed, the best answer to the troublesome questions just cited. Such a partnership of government and private investors is preferable to advances or grants with government "going it alone," since the partnership arrangement does enlist the day-to-day strength of private management and business talent. Making use of private initiative may, as a byproduct, provide an object lesson to enterprisers and local investors in the host country. Since the liabilities of government are, moreover, contingent only, a given amount of government resources will go further than a reliance on grants and direct loans, even though the philosophy of the guarantee programs does present some difficulties in principle and operation.

At the outset it must be clear that there is little or no place for the professional actuary or actuarial sciences in the programs for government guarantee of foreign private investment. The risks involved instead of being homogeneous and depending on "the average," are more in the sphere of intuition reserved for the international political scientist or the historian.

In this sense they cannot be likened to insurance by a government agency of domestic home or farm mortgages, nor even the guarantee of short-term export financing. In these areas there are relatively substantial numbers of cases involving similar risks which can be grouped or categorized for actuarial purposes or, as in the case of commercial export financing, limited dollar commitments in transactions wherein the terms and enforcement conditions, as for example with respect to collateral, bear some similarity.

For the most part, these guarantees rest upon the prior negotiation of a bilateral treaty between the capital-importing country and the United States, with investment clauses supplementing the provisions of traditional commercial treaties "of friendship, commerce, and navigation." (West Germany and Japan have programs similar to, although differing in rate structure from, that of the United States. The British system of export trade financing, when applied to capital goods exports, has come to serve as a guarantee of foreign direct investments.¹²)

¹² The following was received from the Agency for International Development subsequent to our hearings:

"1. *Comparison of fees charged by countries issuing specific risk investment guarantees.*—It is not possible to compare precisely the fees charged under the Japanese and German investment guarantee programs with those charged by the U.S. program because of basic program differences: both of those programs provide only blanket coverage for all three political risks with no selection as under the U.S. program: they require self-insurance by the investor, 25 percent in the case of Japan and 10 percent in the case of Germany (reduced from 20 percent at the end of 1962) whereas no self-insurance is required under the U.S. program; Germany reduces the guarantee coverage of invested

Since these guarantees involve commitments on the part of the capital-importing as well as the capital-exporting government, an important part of their function goes beyond that of mere indemnification. They are intended also to prevent or discourage changes in the legal conditions under which an enterprise must operate in the host, capital-importing country.

In effect, the bilateral agreements between the nations formalize that which might be expected, in any case, in a generally more stable world of nations; namely, a willingness to allow domestic actions tending to injure foreign investors to be tested by the principles of international law rather than limited to domestic one-sided "plaintiff, judge and jury" proceedings. The guarantees covering inconvertibility and expropriation are especially thought provoking as to their effectiveness, since they are essentially reiterative by the host country to do that which it has been unwilling or unable to do directly by monetary controls, or providing prompt and just compensation for the takings of private property. The chief result of these treaties and contracts of guarantee is thus to add a superstructure of government-to-government responsibilities and provide channels of negotiation for determinations which might otherwise have been a one-sided matching of strength between a sovereign host nation on the one hand and a nonsovereign, private, alien investor on the other.

While the guarantee programs of the U.S. Government date back to the days of the Marshall plan, the momentum in South America has come largely in the last 2 or 3 years. In the last 2 years, the program has, in fact, more than doubled the activity in the preceding 12 years. As of December 1963, approximately \$400 million of guarantees were outstanding covering investments in Latin America, \$377 million of

capital on an escalated basis beginning with the fourth year and limits coverage of incremental earnings to 24 percent of capital invested and at a rate not in excess of 8 percent per year. Japan covers only 2 years earnings in addition to invested capital, whereas the United States as a general matter covers 100 percent of the invested capital plus earnings left in the enterprise to the extent of 100 percent of the value of the invested capital. Both Germany and Japan tend to guarantee for shorter terms than the United States.

"Germany charges escalated fees depending on whether guarantees are for 5, 10, or 15 to 20 years for which the respective rates are 0.6, 0.8, and 1 percent per year. Germany also has standby fees of 0.10, 0.15, and 0.20 percent, depending on the duration of the contract. Germany further charges an application processing fee of 20 cents per \$250 for the first \$2.5 million of coverage sought; 10 cents per \$250 for the amount in excess of \$2.5 million, and a maximum processing fee of \$5,000. Japan charges 0.76 percent for its coverage but has discretion to charge higher fees if it considers the risk abnormally high.

"The United Kingdom does not have a specific risk investment guarantee program but uses its export credit guarantee scheme to cover large capital goods export sales and in 1961 expanded its export credit program to cover 'financial guarantees' which provide guaranteed long-term credit to foreign buyers of capital goods and to construction contracts. The United Kingdom export credit guarantee is a combination of credit risk and political risk coverage. The United Kingdom fixes its fees on the basis of five ratings of countries A, B, C, D, and E (A indicating the best market and E the worst). For coverage of risks for a term ranging from 18 months up to 5 years and in the greatest risk market the fee might go up to '12 percent or even higher' (Export Credits Guarantee Department of the British Government, Laurence J. Menzies, Secretary, AMA Management Rept. 59, 1961, p. 107). This appears to be a single rather than annual rate.

"The differences in program and concepts make it virtually impossible to compare the fee structures; however, considering the flexibility and more generous terms of the U.S. coverage, the U.S. fees are not out of line.

"2. *Bilateral agreements to institute the guarantee program.*—Germany issues guarantees for investments in countries which have concluded bilateral investment protection agreements with Germany, or on a transitional basis in countries which adequately protect foreign investments through general legislation or other means such as assurances applicable to the particular investment. To date Germany has concluded 22 bilateral agreements (as reported in conversation with German authorities). This is similar to the U.S. method for instituting its guarantee program except that the German bilateral agreement is more complex and seeks broader undertakings than under the U.S. bilateral agreement.

"Japan does not require a bilateral agreement for instituting its program. It is our understanding there has been criticism expressed in the Japanese Diet over the omission by the Japanese executive branch to negotiate bilaterals."

which had been issued in the preceding 30 months. During the quarter ended December 31, 1963, 94 applications were received with a total value of close to \$800 million, bringing the total of guarantees under consideration for participations in Latin America close to the \$4 billion mark.¹³

The acceptance of the program by investors is even clearer when one remembers that guarantees under these programs are available only with respect to new investments. It remains for time to tell, of course, just how much actual dollar investment does in fact take place under these proposals now pending. It is said that "applications generally lie dormant for several years and then spring to life with a considerable sense of urgency,"¹⁴ but the lapse of time may be expected to take a substantial toll of "dropouts" falling by the wayside or abandoned.

While the U.S. Government guarantees of direct investments thus operate to relieve the businessman and investor of some of the non-economic hazards (and in the extended-risk program economic risks as well), the bilateral agreements between countries do not provide indemnification of the U.S. Government by the project countries.

The Foreign Assistance Act, accordingly, provides that funds for discharging any liabilities arising under the guarantees shall, in general, come in the following order: From fees collected in excess of those needed for meeting management costs; from funds realized from the sale of assets acquired by subrogation in connection with the guarantees; and from funds previously or newly appropriated under authority of the act.¹⁵ Losses to date have been quite small on the program worldwide. At the time of our hearings, none had been reported from the Latin American area.

As to ultimate losses, it will be remembered that the program is not treated as subject to actuarial calculations of losses and, hence, that the fee schedules charged are not cost oriented but are by law determined arbitrarily "in an amount to be determined by the President." Charges established for all of the specific risk coverages are the same in each of the countries where the guarantees are available—one-half of 1 percent each on the amount of coverage in force with respect to inconvertibility, expropriation, and war (which includes revolution and insurrection), and one-fourth of 1 percent on similar standby coverage.

This reliance on uniform fees is one of the principal question marks of the program as now administered. Beside the fact that there is no satisfactory actuarial basis supporting different fees, it has been urged that, since the uniform base rate is so low, significant differences would involve raising some fees to a point that would diminish the attractiveness of the program to private investors.

It is all too obvious, at the same time, that country-to-country risks such as currency inconvertibility, expropriation, and civil insurrection do, in fact, vary considerably. Without country-to-country differentiation in fees, much of the hoped for preventive strength of avoiding the feared events is in large part lost. Investments in countries which give little attention to the problems of inflation and earn bad expropriation records are accorded the same rates as those in countries which have in the past achieved, or at least strived for, lower risks.

¹³ Hearings, "Private Investment in Latin America," p. 176.

¹⁴ Hearings, *ibid.*, p. 172.

¹⁵ Sec. 222 (d) and (e).

It is a questionable program, indeed, which does not reward in some manner, as with a lower premium, those whose risks meet relatively high standards of good-better-and-best behavior.

Granted that the primary objective of the program is to encourage and augment the flow of private investment capital into all less developed areas, a properly oriented program ought to recognize the relative risks in countries which try and countries which refuse to control their own behavior so as to minimize the losses. "Penalize unacceptable behavior; reward that which is acceptable; differentiate between trusted allies and uncommitted opportunist states to the benefit of the former." That is the way one academic expert on Latin America put it writing to Senator Hickenlooper in commenting on the Senator's amendment to bar indiscriminate aid assistance to offending nations.¹⁶

This failure to distinguish between "good" and "bad" risks seems to us a serious and critical fault of the program. Its apparent acceptance by investors is, of course, not surprising even though it is in some measure discriminatory since the charges do not favor lesser risks.

From the evidence at our hearings we can only conclude that the administration of the guarantee program in the executive department has been confused as to objectives and how to best to achieve those objectives. In part, this may be a fault of the legislation, which provides that the program authorized under this title "shall be administered under broad criteria, and each project shall be approved by the President." At least twice since the authorization was originally incorporated into legislation the President has shifted the delegation of his authority for this project approval.

We recognize the difficulties involved and consequently limit our criticism largely to the fact that those charged with administering the program have not been more successful in overcoming these problems, or more vigorous in urging Congress to improve the basic legislation. From the evidence presented to us, they have instead apparently chosen to live with "awesome backlog figures"; to perpetuate an irrational system of pricing the Agency's services, charging the same rates today for risks in the newest and most incorrigible underdeveloped country as were charged 15 years ago in Western Europe; and to apply energies to negotiation of bilateral agreements rather than pressing for a multilateral program of applicable international law. All of this is done at the risk of unpredictable ultimate losses to the U.S. Government. Given the lack of wholly satisfactory answers, perhaps the greater present need is for Agency recommendations or suggestions as to how the guarantee program may be better oriented to take advantage of private enterprise and initiative and, at the same time, act as a positive force for international order and responsibility.

While our inquiry and comments have dealt primarily with the investment guarantee program, there are other established programs of the U.S. Government specifically aimed at promoting participation by private enterprise in foreign economic development. The Agency for International Development is prepared to share up to 50 percent of the cost of approved investment surveys of market opportunities, locations,

¹⁶ Hearings, "Private Investment in Latin America," p. 126.

raw materials, and labor supply undertaken by U.S.-owned business firms if, on the basis of the survey, the prospective investor decides not to undertake the investment studied.

The AID funds are also used to support private enterprise through local investment agencies which channel resources into top priority areas of the private sector, such as providing credit usually unavailable to small businessmen, farmers, and homeowners. The Agency has, for example, made 30 loans to help establish and support development banks, agricultural banks, and savings and loan institutions. While many of these commitments have the appearance of government-to-government loans or grants, the expectation is that these will be reloaned to local private enterprises.

V. SPECIAL TAX PROVISIONS BY THE CAPITAL-EXPORTING OR CAPITAL-IMPORTING COUNTRY MAY ENCOURAGE PRIVATE INVESTORS

Governmental measures which alter the potential profitability of new investments in less developed countries by offering tax "incentives" or tax "sparing" have been suggested and, on occasion, tried as devices for promoting private investment. Because of the broad application of such provisions they risk becoming little more than a windfall in some cases since it would be difficult or impractical to require a clear demonstration that the private investment in question would not have been made in any case. Provisions for tax equalization aimed at offsetting or limiting discriminatory treatment appear, in general, to have greater merits than so-called "incentives" as such.^{17 18}

Provisions for differential tax treatment constitute another area of possible Government intervention in the economics of private investment. Like guarantees against inconvertibility and expropriation, tax treatment of direct investments often involves a meshing of policies between the capital-exporting and the capital-importing countries, not infrequently depending on bilateral treaties as well as specific provisions in the tax codes of the several countries.

In considering tax measures designed to increase the flow of private investment into less developed countries, it is important at the outset to recognize that tax incentives do not possess magic power. They must be joined with, or supported by, other forces in order to create an economically promising investment opportunity.

The history of special tax inducements to investment in underdeveloped countries suggests, however, that such special inducements may have the disadvantage of drawing attention away from needed revision in the basic tax system of the host country. They overlook the prime consideration that private investment will flourish only in a

¹⁷ Representative Boggs believes that tax incentives are needed to encourage private investment in Latin America and other less developed areas of the world. He intends to introduce shortly a bill to provide a 30-percent tax credit for certain new investments by American business and industry in the less developed nations of the world. The 30-percent tax credit plan has the full backing of President Johnson's administration. It is designed to provide an increased rate of return for American investors and should thereby substantially encourage additional private investment in the developing nations. While generally endorsing the concept of the committee's report, namely, that the tax base needs to be broadened, Representative Boggs believes that in this particular area special fiscal measures are called for.

¹⁸ Senator Javits believes that the need and urgency for an accelerated flow of private investment to Latin America is overriding above all the other considerations, including those brought forward by the subcommittee, and accordingly believes that tax incentives are needed and appropriate. See his supplemental views at p. 26.

setting of political and economic stability, an important element of which is an equitable tax code, honestly administered.

The concession of tax inducements by the United States as the capital-exporting country has, moreover, two disadvantages: first, it runs contrary to basic American policy aimed at equal treatment of equal amounts of income from all sources; and, second, it tends to move against the objectives of simplification and broadening of the tax base by adding still another special case and another exception which may, in some circumstances at some future time, come to be labeled with the invidious identification "loophole."

A policy of offering special tax inducements to encourage new private investment in Latin America involves a difficult choice of distinguishing and ranking priorities as to national objectives. The need and urgency for an accelerated flow of private investment capital in Latin America is all too clear. This is admittedly a compelling consideration. On the other hand, sound and equitable basic tax structures and an overall fiscal policy for stability and growth are also matters of high priority in both the United States and the Latin American host countries. Because of the broad implications of such policy considerations they may, in the long run, be of surpassing priority to special purpose objectives. Tax measures aimed at encouraging new investment should thus give greatest weight to equalizing treatment and eliminating tax discrimination against such investment rather than singling out new areas for favored treatment.

The U.S. Tax Code already contains provisions giving special deductions to so-called Western Hemisphere trade corporations. These sections, which were introduced into the code in 1942, were designed to alleviate the alleged competitive disadvantage occasioned by the high U.S. wartime tax rates on corporations operating more or less exclusively in countries which imposed relatively lower tax rates on their own corporations or, as was often the case, completely exempted the foreign income of their corporations.

To qualify as a Western Hemisphere trade corporation, it must be a domestic corporation, all of whose business is done in any country of North, Central, or South America, or in the West Indies, deriving 95 percent of its gross income for a 3-year period from sources outside the United States, and 90 percent or more from active conduct of the trade or business. The special rate reduction granted to these corporations amounts to a 14-percentage-point reduction, accomplished through a special formula deduction against taxable income currently amounting to 28 percent.

The use that has been made of these provisions is attested by the fact that in the Government's fiscal year ended June 30, 1961, 682 returns for Western Hemisphere trade corporations were filed involving deductions of \$213 million, indicating a taxable return of nearly \$800 million. More than half of this deduction, or \$123 million, was accounted for by 15 returns involving enterprises with assets of \$250 million or more in a corporate group with which a Western Hemisphere trade corporation was affiliated. While information as to the operation of Western Hemisphere trade corporation groups is not readily available, it is said that a substantial number do look southward toward Latin America, although many of the largest may involve United States-Canadian trade.

Western Hemisphere trade corporations are largely concentrated in wholesale trade, since the requirements effectively void their general use for direct investment purposes. Investment and banking companies are barred by the requirement that 90 percent of the income be from trade or business. Use of the provision for direct investments in plant and equipment is discouraged by desirability or need, for business or legal reasons, of working through a corporation domestic to the host country, and the general provision taxing only the repatriated portion of income of subsidiaries of U.S. corporations operating in underdeveloped countries.

The limited availability of these tax reduction provisions accorded Western Hemisphere corporations for purposes of direct investment has led to proposals for an investment tax credit which would allow corporations to subtract from their tax bills a fraction (the President's foreign assistance message of March 19, 1964 recommends 30 percent) of new net direct investment in less developed countries, which by definition contained in the message would include all of Latin America. The proposal would doubtless encourage investment by the immediacy of its gains. Eligible enterprises would be permitted to make the deduction immediately and thus not have to wait until the enterprise was profitably earning taxable income against which the credit might be offset.

While the stimulus to direct investment in the proposed investment tax credit deserves consideration, it was proposed subsequent to our hearings. We, accordingly, reserve judgment since we have not studied it in detail. We would emphasize again, however, the need to weigh the wisdom of lengthening and complicating the tax code by some 10,000 words, and of creating a new specific departure from the tax-base broadening objectives. Good fiscal policy has an important role in aiding economic growth and stability, but ought not be too heavily burdened with nonfiscal, collateral ends, appealing as they may be on their individual merits.

We have not specifically considered or commented upon the role of tax incentive measures incorporated into the tax systems of the capital-importing host countries. It has not seemed particularly appropriate for us to suggest or dictate policies to these host countries. It seems obvious, however, that the proper place for investment incentives is largely in the hands of the receiving countries seeking developmental capital. In their hands, tax incentives or tax concessions would be merely an aspect of the receptivity and hospitality which we have noted as the cornerstone of any program seeking to attract external private resources.

VI. NEW AND IMPROVED INVESTMENT CHANNELS CAN ENLARGE THE FLOW OF PRIVATE CAPITAL

Given a measure of receptivity on the part of the Latin American host countries, external private capital is available and eager to aid in their development programs. Multinational private efforts on the pattern of a prototype private enterprise investment company, projected under the initiative of businessmen and leaders in the Atlantic community, can bring together the combined managerial skills and the pooled financial resources of local and external investors, while

*offering attractive profit potentials to the participants. Such enterprises and facilities deserve encouragement as instruments mobilizing, under promising auspices, the needed external capital for industrialization and development.*¹⁹

The advantages of cooperative efforts joining North American, West European, and Japanese energies and resources to indigenous Latin American energies and resources are important at all stages of capital investment. From the initiation of a project, continuing through its growth by reinvestment of earnings and the return of invested capital to a readiness position for participation in a second investment cycle, the vigor and skills of management and ownership can be brought to bear in advancing Latin America's overall growth and political stability.

First of all, consider the needs for investment information and business "intelligence" facilities. Before potential external investors can undertake specific investment projects they must have accurate and factual information on Latin American economic trends and business opportunities. This need is present not only initially but continued access to channels for understanding and interpreting business attitudes and developments as they evolve will most certainly be required. Organization to provide such a flow of objective business information to nonresident capitalists is a matter in which the joint participation of Latin American investors, the inter-American agencies, and local participants can be peculiarly advantageous to all concerned.

Cooperative efforts taking the form of joint private enterprise investment companies would, moreover, accord the Latin American governments and Latin American investors a large role in the determination of developmental priorities. At the same time, the presence of local representatives in the counsel rooms of investment companies and as participants in the business risks involved will dramatize for them the advantages of stable and receptive governmental policies toward private investment generally.

Conversely, by allying his productive efforts with those of foreign capitalists the Latin American domestic investor may find an understanding voice interpreting Latin American problems to bankers and investors in the financial centers of the world. A continuing and far-sighted international policy toward Latin American countries and their financial and currency problems is obviously preferable to haphazard, last-minute intervention to prevent the financial collapse of these countries when currency or commodity difficulties arise.

Multinational private investment efforts assist the private sector specifically, and the development program no less surely, by diffusing the financial risks while bringing together and focusing the highest quality of managerial abilities available in each of the countries involved. The mere presence of such a pool of capital and managerial abilities will, moreover, tend to prevent vacuums which may arise and almost certainly be filled by recourse to the public sector if national planning and financial agencies are the only instruments readily available.

¹⁹ The Atlantic Community Development Group for Latin America—ADELA—Initiated within the Economic Committee of the NATO Parliamentarians' Conference, is described in the hearings "Private Investment in Latin America," pp. 129-153.

Joint and cooperative efforts of external investors in cooperation with domestic capitalists will present attractive profit potentials to those concerned. At the same time they will create influences countervailing the ever-present threats of expropriation or anti-foreign-capital discriminatory taxation. The diffusion of control, including substantial domestic interests, will lessen the local temptation to discrimination and seizure and, by the same token, lessen the fear of outside investors of their ventures becoming targets of nationalistically inspired harassment. A diversity of interests in a large number of moderate sized manufacturing and trading undertakings is certain to be received more hospitably by a host country than the specter of a giant foreign operation casting a shadow of power matching that of the sovereign itself.

Management is a crucial ingredient of every project, and the enterprise-investment type of company will have the advantage (1) of drawing upon the large talent potentials available in the sponsoring foreign companies, and (2) of being in a position to utilize the potential skills and the wealth of human resources of trained Latin Americans which are now held back by the slow rate of growth and development.

Such multinational, multilateral companies, moreover, offer a substantial measure of flexibility and the power to maneuver, since they may be designed to invest in loans, equities, participations, managerial contracts, or licensing arrangements, as well as outright ownership.

A number of investment companies programed or active as offshoots of specific private industrial enterprises are already operating in Latin America. While the development of these corporations has been cautious and surrounded with difficulties, there can be no doubt but that they are making an impression on the economies of those countries which have held out a welcoming hand toward their initiative.

We were impressed by the efforts, sincerity, and enthusiasm which businessmen and leaders in public and business life in this country and in Western Europe have been giving to the Latin American private investment problem. The unleashing of these resources of capital and enterprise hinges not upon some favored tax or monopoly concession at home or abroad, but upon fair and equitable treatment as an aid to growth and progress. Their success in channeling investment funds will depend largely upon whether the Latin American governments themselves are encouraged to see the wisdom of turning away from totalitarian, inefficient, state-controlled economies and fostering instead an economic and political system of greater freedom by bringing to bear the forces of private ownership and enterprise as the surer path toward an improved standard of living for their citizens. We urge an attitude of receptivity on the part of the developing Latin American countries and recommend the encouragement of these cooperative efforts.

VII. ENLARGED MARKETS RESULTING FROM REGIONAL ECONOMIC INTEGRATION WILL WIDEN PRIVATE INVESTMENT OPPORTUNITIES

The stirrings of economic integration in Latin America are a promising and hopeful development for extending the economic gains of private enterprise and the international division of labor. The

success of these movements in South America and in Central America has called, and will continue to call, for some sacrifice of narrowly nationalistic spirits by countries, but in a dynamic and growing world the alternatives might be to remain stagnant, nonviable economic units. The potential gains from integration are enormous and their success should operate to encourage private investment and advance economic and social well-being.

It is hard to say how much the higher level of incomes and levels of living in the United States itself are attributable to the fact that, despite some regional frictions, the United States is the greatest common free market in the world. It is not difficult to say, however, and the facts speak for themselves, that large markets in the United States have made for more efficient use of resources and hence for more rapid growth and higher per capita incomes. The success of the North American common market is suggested by the active interest and consideration which are being given to extending the already high degree of economic integration between the United States and Canada.

At the subcommittee's hearings, a forward-looking and thought-provoking suggestion involved Western Hemisphere integration as an ultimate goal. We commend to the nations involved a careful consideration of this forward-looking discussion.

CONCLUSION

These concluding comments are made essentially by way of summary although, in a limited sense, they may also be taken as informal recommendations. As recommendations they are, of course, tentative and based only on the testimony at our own subcommittee hearings.

1. The case for private investment as a source of capital in less developed countries needs to be restated to emphasize the important role which private enterprise has in organizing economic resources for the satisfaction of the people's wants in the order of their urgency and under conditions which foster a maximum of political liberty.

Most references to private investment in speeches and literature on the growth problems of the less developed, capital-deficient countries now tend to be couched solely in terms of the usefulness of private investment as an added avenue of access to external capital and savings. Rarely do such references adequately point out "why" or "how" private investment releases enterprise, allows individuals a maximum opportunity to choose for themselves, while offering, as a bonus, political liberty more surely than socialism can or does.

2. It seems incongruous that the U.S. Government itself, in administering its program guaranteeing against foreign investment risks, should fall into the common error of treating the 20-odd Latin American Republics as an entity by failing to distinguish between countries which welcome private enterprise with hospitality and those in which foreign capital is continually harassed and frequently threatened with expropriation. Granted, there is no sound actuarial basis for fixing charges under Government guarantee programs against losses by expropriation and inconvertibility. It would seem, however, that such a governmental program might be made a greater positive force for international good behavior and national development programs if the risks were at least broadly classified. Whatever the diffi-

culties may be in forming a judgment as to a proper schedule of fees to be charged, it does not seem either logical or wise to treat "good" and "bad" risks alike since the acts and faults in question are controllable and certainly differ from country to country.

3. While present guarantee programs are largely founded upon a system of laboriously negotiated bilateral treaties between the United States as the capital-exporting and the several capital-importing nations, strong efforts to establish a multilateral guarantee system founded upon international law would be a highly desirable development. In essence, the present system of guarantees against losses through expropriation or currency inconvertibilities does little more than supplement procedural and "due process" techniques which would be good international law in any case. In the case of expropriation, international justice and equity among nations generally presupposes fairness and access to review as rights extended to non-citizens as well as citizens. This is all that is asked under specific guarantee treaties. In the case of currency convertibility, the availability of international monetary agencies to assist nations over difficult periods, coupled with an acceptance of the domestic disciplines of financial responsibility, should make an overlay of bilateral treaties unnecessary.

4. The efforts and initiative which private investment capital has already demonstrated, with the support of leaders in the Atlantic community, offer advantages to all parties which clearly call for support and encouragement. Receptivity and hospitality on the part of the host countries are the foundation of all private capital imports, and governments interested in economic development will do well to welcome new and improved channels such as private investment companies.

5. Many proposals for improving the flow of private investment in Latin America or other less developed countries attach great importance to the virtues of special tax inducements. While recognizing the efficiency of tax "incentives" for investment, they may represent a windfall to investments in the case of projects which would have been made in any case. Special tax inducements would be better thought of as tax equalization measures designed to offset discrimination in the various tax systems. Their merits are clearest when used to offset deterrents rather than inject an added and new statutory "plus" element into appraisal of economic opportunities. They carry with them, moreover, the risk of diverting attention from needed revisions and the simplification of tax codes in the direction of equal treatment of equal incomes.²⁰

6. The economic integration movements in Central America and on the South American Continent, with their promise of expanded markets, should certainly be encouraging to private investors. Politically and economically it is important for the Latin American countries to find avenues of escape from their present dependence on agricultural and extractive industries. A first step in this direction is to provide,

²⁰ See Representative Boggs' statement above, p. 18, and Senator Javits', p. 26.

without fostering monopoly, for reasonably economic-sized areas for industrial diversification and production. The rules of GATT permit members to enter into Common Market arrangements reducing duties to insiders upon the express condition that duties to outsiders will not be raised. The further the multilateralizing and expanding of such areas is carried the greater the potential economies and market efficiencies. While the concept of a fully developed Western Hemisphere common market seems, at the moment, distant and fenced in by nationalism, it holds a sufficient hope for advancing the economy and industrialization of Latin America and the entire hemisphere to deserve the study of trade experts everywhere.

SUPPLEMENTAL VIEWS OF SENATOR JAVITS

While I substantially agree with the subcommittee's report, I wish to make my position clear regarding the relationship of government to private enterprise in the developmental process which received, I believe, insufficient emphasis in chapter I, and regarding the Alliance for Progress which differs in some respects from that of the subcommittee.

Latin American nations need to find means for improving the climate for private initiative, while at the same time providing for social justice. These ends are not in the least incompatible. But we must recognize that Latin America is trying to achieve in a decade what has taken a century in the United States and is even yet far from perfected there—the operation of private business in the public interest. What is needed is a new spirit both on the part of the Government and of private enterprise in the achievement of common goals of progress without sacrificing the business initiative of self-interest. In many Latin American countries, leadership in developing such a spirit has been demonstrated to a heartening degree.

There continues to be a need for massive government effort to supplement private enterprise in satisfactorily advancing the social progress of Latin America in the face of increased challenges in such areas as housing, education, and transportation. I believe, however, that private enterprise and the cooperation of private interests are essential and need encouragement, both from Latin American governments and from our own.

There are responsibilities that properly fall within the sphere of Government. These include responsibility for regulating domestic and foreign commerce, for supervising the private banking system, protecting the public against fraud, for the overall levels of employment and price levels, for the protection of the public against the over-concentration of economic power in the hands of individuals or corporations. On the other hand, there are those responsibilities which are properly those of the private sector. These include, first and foremost, the ownership—as widely diffused as practicable among the people—and management of the means of production in the public interest. This responsibility includes an effort on the part of management to make a maximum contribution to society through the constructive disposition of profits, to use resources efficiently to create jobs, to save and invest and to create new enterprises, to increase the economic well-being of the maximum numbers in the society.

Taking into consideration the respective roles of the government and the private sector, Latin American governments need to recognize the fundamental advantages of encouraging the development of a healthy private enterprise sector to more rapid and effective economic development and to the growth of democratic institutions.

Regarding the Alliance for Progress, I reaffirm my support of its fundamental goals and believe that its continuation is essential to

achieve the peaceful transformation of Latin America into a truly democratic and stable society.

Despite criticisms which may be leveled against some aspects of its implementation, the Alliance is already achieving one of its fundamental objectives—to create an awareness throughout the hemisphere that comprehensive and well-planned social policies and reforms are essential to achieve accelerated economic development in a democratic framework. The new atmosphere created by the Alliance appears also to be exercising a major influence on the internal politics of a number of Latin American countries.

While it may be said that there has been undue emphasis placed in basic Alliance documents on the role of government in the achievement of Alliance goals, the signers of the Charter of Punta del Este agreed that success could be achieved only with the fullest participation of the private sector. As the charter puts it:

The countries signing this declaration have agreed to stimulate private enterprise in order to encourage the development of Latin American countries at a rate which will help them to provide jobs for their growing populations, to eliminate unemployment, and to take their place among the modern industrialized nations of the world.

The Finance Ministers of the Alliance countries at their Mexico City Conference in 1962 declared similarly that—

taking into account the limitations of the availability of public funds, it is clear that the objectives of the Alliance cannot be achieved without the full participation of the private sector, and adequate measures must be taken to assure maximum contribution to growth by the private sector.

Of course, the scarcity of public funds is only one reason for desiring the full and active leadership of private enterprise in development. Among these are the stimulating effect of private initiative, the diversity and depth of private know-how and the economic and political advantages of individual ownership.

Having said this I concur with the subcommittee that there remain many individuals—both in the United States and Latin America—who have not yet accepted fully what is clearly called for in the Alliance Charter.

I also wish to make my position known regarding the subcommittee's views on tax incentives. I believe that such incentives are necessary to encourage private investment in Latin America and other developing countries. The need and urgency for an accelerated flow of private investment to Latin America is overriding above all the other considerations including those brought forward by the subcommittee.

