COVERAGE AND SOURCES

Coverage of Transactions

The study embraces all capital transactions and nonmilitary official grants among all countries except members of the Sino-Soviet Bloc. The items covered are those reported during this period to the International Monetary Fund under the four categories of the capital account (official and private, each divided into long-term and short-term) and under official donations (nonmilitary grants by governments and international institutions). The inclusion of official grants is customary in studies of this kind.[1] Foreign aid consists of both grants and loans, and the distinction is tenuous in many cases, since loans have sometimes been converted to grants, or grants to loans, and since some loans carry only nominal interest or are interest-free.

Since, in principle, all capital transactions are covered in this study, short-term credits and changes in foreign currency reserves are included. Short-term credits have been of considerable importance in the supply of financial resources to some developing countries. Accumulations of currency reserves may also be drawn upon in lieu of other capital imports, and were so used by a number of countries. Moreover, the substantial increase in world currency reserves that occurred during the 1950–54 period meant large inflows for the United States and the United Kingdom, modifying their gross capital exports to some areas considerably. To obtain a complete picture of world capital flows, these movements must, therefore, be included.

On the other hand, this coverage is arbitrary in some respects. Three other items might have been partially or wholly included, but their exclusion is unavoidable. (1) The exclusion of military grants is cus-

[1] The OEEC/OECD studies have, for instance, the same coverage for all but short-term movements. In studies of "foreign investment," on the other hand, grants are omitted. See, e.g., Raymond F. Mikesell, ed., *U.S. Private and Government Investment Abroad*, Eugene, Ore., 1962.

tomary, as for instance in the *Balance of Payments Yearbooks* of the International Monetary Fund. While it may be debatable whether they should be included, sufficient details are not divulged. (2) If official donations are included, it might appear that private donations should also be included, but, again, the available data are not adequate for the purpose. (3) The definition of direct investment (part of private long-term capital) as newly raised capital plus reinvested profits [2] is somewhat arbitrary. The expansion of plant and equipment takes place also through the use of depreciation and depletion allowances. Their source is the same as that of reinvested profits, namely earnings, but the division between them depends to a considerable degree on tax laws and is, therefore, in an economic sense arbitrary. Direct investment does not, therefore, fully reflect the real gross investment that took place, but that is unavoidable.

Types of Transactions

To be able to observe differences in the distribution of government aid, private investment and loans of various kinds, and short-term capital flows, we have distinguished seven types or groups of transactions and have constructed a table for each one (called matrix tables) showing transactions between individual countries. There are asymmetries in the classification of reported data on loan capital because some transactions are reported as "private" on one side and as "official" on the other—for instance, bond issues if the borrowers are governments, or official loans if they are made to private borrowers. Since the motives of governments differ from those of private lenders, and since the distribution of long-term capital is largely determined by the lenders, the distinction between "government" and "private" loans in this study is made on the lenders' side. For short-term capital the distinction between liquid claims and credits seemed to be more useful for our purpose, and more feasible, than that between official and private flows. The seven types of capital distinguished here are listed on the following page.

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[2] From the point of view of the balance of payments, reinvested profits do not, of course, represent capital flows. But in this study they have been included because the use of profits for investment, no less than the use of remitted funds, results from the decisions of the investors.

Type I. Government Grants and Loans. This group consists of grants and loans (net of repayments) made by governments, or their agencies, and by international institutions. It includes International Bank for Reconstruction and Development (IBRD) loans, grants and loans made by or through the intermediary of the European payments organizations, the Intra-European Payments Agreement and the European Payments Union (IEPA and EPU), and UN grants.[3]

In the matrix, grants and loans are listed separately, though qualifications regarding this distinction have been noted above. Grants are not necessarily "aid" but include reparations and some other contractual payments. Loans include some providing for the delivery of strategic materials to the lending government.

Type II. Portfolio Investment. Here new issues floated in foreign markets are distinguished from trading in securities and redemptions. The latter two elements cannot be separated from each other, however, since redemptions are indistinguishable from ordinary market transactions in many cases.

Type III. Direct Investment. As indicated above, reinvested profits are included wherever possible. Where this could not be done for lack of data, the fact is mentioned in the notes to the table, and the possible distorting effect on the pattern of direct investment is discussed.

Type IV. Private Loans. Under this heading, loans by commercial banks and industrial or other business concerns are covered. They are largely intermediate-term loans.

Type V. Extraordinary Repatriations. These are return flows from borrowers to lenders or investors reported, or otherwise distinguishable, as repatriations of capital due to nationalization, compensation for previously nationalized enterprises, or sales of enterprises and other assets in the wake of independence of a number of countries.

Type VI. Short-Term Credit. Short-term credit represents the residual after elimination of changes in official reserves and in banks' corre-

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[3] The term "government" was used rather than "official" to avoid confusion with the IMF usage of "official" which included, during this period, commercial banks.

spondent accounts from total short-term movements (changes in claims with maturities of one year or less). In addition to ordinary trade credits, it includes changes in payment agreement balances and other payments arrears (i.e., movements which represent, in effect, credits, although they were not formally extended as such).

For short-term credit a matrix could only be constructed according to the IMF area system because in many of the accounts the country detail could not be ascertained. This matrix served only to infer the approximate pattern of the flows and is not reproduced in this study. Appendix Table B-VI shows instead the net inflows and outflows by country without source and destination, and the direction of the flows is discussed in the text. In the summary given in Table 1, the flow of short-term credit between groups is shown partly on a net basis (see the notes to Table 1).

Type VII. Reserves and Correspondent Accounts. These transactions cover changes in liquid assets, i.e., the international currency reserves of monetary authorities and working balances of commercial banks (including the sterling balances of some business concerns not separately shown). Gold flows, being part of reserve changes, but not part of capital flows, are included in Table B-VII in a separate column, but are excluded from the summary table.

Sufficient detail is available in balance-of-payments reports or other sources to make the foregoing classification feasible. There are comparatively few transactions that do not clearly fall under one of these headings; after inspection, either these were allotted to one or another of the matrixes, or their exclusion was indicated.[4]

The Design of an Area System

In order to relate the distribution of capital flows to levels of economic development, it was necessary to devise a suitable system for

[4] An eighth type of transaction is represented by the quota payments of new IMF and IBRD members and the resulting increases in holdings of member currencies by these institutions. Since these transactions are of little interest, they have not been reproduced in tabular form. The net contributions by the members to the institutions have been included, however, in the summary table. These consist of the increases in the countries' long-term assets (quotas) minus the in-

grouping countries.[5] For this purpose, countries were divided into
four groups according to stage of development. Within these groups,
they were further classified into subgroups according to their main
trade-orientation toward one of three centers, viz., the United States,
the United Kingdom, and the Continental OEEC countries.[6] This
area system is shown in Appendix Table A.[7] The division into four
groups was based on the following criteria.

DIVISION OF COUNTRIES INTO NET EXPORTERS AND
NET IMPORTERS OF INDUSTRIAL GOODS

Historically the main capital suppliers have been the industrial
countries. There are many reasons for this. Suffice it to say that to a
large degree foreign investment has been related, directly or indi-
rectly, to the financing of exports of industrial products and of im-
ports of raw materials needed for industrial enterprises. The division
of countries into net exporters of industrial goods and those that are
not is, therefore, relevant in our context.[8] Nine countries were found
to be net exporters of industrial goods: United States, United King-

creases in the countries' short-term liabilities (domestic currency subscriptions).
These net amounts are equal to the dollar and gold subscriptions, which result in
corresponding changes in the reserves of the members and the institutions (Type
VII).

[5] The area system employed by IMF for the balance-of-payments reports of
this period is a mixed geographical and currency-area system. Included in the
same areas are countries of very different economic structures and stages of
development, and the system is, therefore, not suitable for our purpose.

[6] The division by trade-orientation was developed by Woolley. See Herbert B.
Woolley, *Measuring Transactions Between World Areas,* New York, NBER, 1966,
Chapter 5, Table 5-1.

[7] The country and area designations used in Appendix Table A and elsewhere
in this study refer to the period 1950–54. Rhodesia consists of the federation of
Southern Rhodesia, Northern Rhodesia (now Zambia), and Nyasaland (now Malawi).
The European Overseas Territories include those countries that were dependencies
at the time.

The matrix tables cover, in addition to the countries in Appendix Table A, the
then existing nonterritorial organizations engaging in capital transactions: UN,
IBRD, and IMF, which are referred to in this study as "International Institutions";
and IEPA, its successor (July 1, 1950), EPU; BIS, and ECCS, which are called
the "European Institutions."

[8] Industrial goods were taken to mean SITC classes 5 (chemicals), 7 (machinery
and transport equipment), and 6 and 8 (other manufactured goods). The calcula-
tion was based on the data in the United Nations' *Yearbook of International Trade
Statistics, 1955.* It was made for the aggregates of the years 1953 to 1955, for which
the SITC classification is available for the first time in convenient form for a
number of countries. Data for Japan were available only for 1954 and 1955.

dom, Austria, Belgium-Luxemburg, France, Germany, Italy, Switzerland, and Japan.

Two countries generally considered industrial countries, the Netherlands and Sweden, were net importers of industrial goods. For the nine countries named above industrial exports not only exceeded industrial imports but they were also more than 50 per cent of their total exports, and industrial imports were, with the exception of Switzerland (54 per cent), less than half of their total imports. The Netherlands conforms more closely to this pattern than Sweden. For the Netherlands, industrial imports were less than 50 per cent of total imports, industrial exports were 48 per cent of total exports, and it was a net exporter of chemicals. Also Benelux as a whole was a net exporter of industrial goods. The Netherlands was, therefore, included in the industrial net exporter group. Sweden, on the other hand, conforms only in that its industrial exports exceeded 50 per cent of total exports. It is also convenient to keep Sweden with the other Scandinavian countries. Sweden was, therefore, not included in Group 1 but rather in Group 2. The nine net exporters of industrial goods plus the Netherlands form Group 1.

DIVISION INTO GROUPS BY PER CAPITA INCOME AND
AGRICULTURAL SECTOR

The net importers of industrial goods were divided into three groups according to economic levels as evidenced (directly) by per capita income and (inversely) by the relative size of the agricultural sector,[9] the latter variable being measured both by the percentage of the adult male labor force in agriculture and by the percentage contribution of agriculture to total product.[10] The reasons for using all three of these measurements are, first, for a number of countries only one or the other set of data is available; second, they provide a useful check on each other, since these data are known to have weaknesses; and, third, any one by itself may conceal some characteristic

[9] The negative correlation between per capita income and share of the agricultural sector is well known. See Simon Kuznets, "Industrial Distribution of National Product and Labor Force," *Economic Development and Cultural Change,* July 1957, pp. 8–9 and 20–22.

[10] Based on data for the period of this study; see the statistical notes to Appendix Table A.

that should be given more weight in the classification, as in the case of Venezuela (see note 11 below).

The three groups distinguished on the basis of these criteria have the following characteristics: Group 2 includes the other high income countries with agricultural sectors similar to those in Group 1; Group 3 includes the more advanced underdeveloped countries generally with per capita incomes of $200 to $250 and agricultural labor force proportions between 40 and 50 per cent; Group 4 includes the least developed countries with per capita incomes ranging from $160 downward and labor force proportions in agriculture generally of 60 per cent or more. The dependencies were included in Group 4 in toto (although some of them may belong to Group 3) because the capital movements cannot be broken down for them individually.

For some countries no data are available on the three criteria. But these countries are unquestionably among the least developed and have been included in Group 4. The one exception is Uruguay whose economic level was assumed to be similar to that of Argentina, and it was therefore included in Group 2. In some cases that do not conform to the general pattern, it seemed advisable to rely on only one or another of the criteria as the basis for classification.[11] In summary, Groups 1 and 2 include the advanced countries, Groups 3 and 4, the underdeveloped areas.

Sources and Nature of the Data

Our main source is the balance-of-payments data on capital movements and official donations reported by member countries and some nonmembers to the International Monetary Fund and published in the Fund's *Balance of Payments Yearbook*.[12] The rules for classifica-

[11] Thus, Venezuela was placed in Group 3 on the basis of its relatively large agricultural sector (since the high per capita income reflects mainly the high productivity of the oil industry); Iceland was included in Group 2 on the basis of its high per capita income (because the relatively large "agricultural labor" percentage is inflated by the inclusion of fishing); and South Africa and the Rhodesian Federation were included in Group 2 because of the small agricultural sectors for the European populations (that of Southern Rhodesia in the case of the Federation).

[12] IMF, *Balance of Payments Yearbook*, annually. The Yearbooks covering the period 1950–54 are: Vol. 5, 1947–53, Washington, D.C., 1954; Vol. 6, 1953–54, Washington, D.C., 1955; Vol. 7, 1954–55, Washington, D.C., 1956; Vol. 8, 1950–54, Washington, D.C., 1957.

Our data differ from those of the Yearbooks mainly because of adjustments and supplementary estimates made by us. Some unpublished revisions were incorpo-

tion of transactions and for the regional breakdown in the balance-of-payments reports are laid down in the Fund's *Balance of Payments Manual*.[13] According to this guide, capital transactions were reported during this period by changes in assets and liabilities under four major headings: private long-term, private short-term (items 11–14 in the Yearbook), official long-term, and official short-term (items 15–18). Long-term is defined as claims or investments with an initial maturity of more than one year or without maturity. Short-term claims are those of one year or less, or payable on demand.[14] Official capital includes, for the period covered by this study (and until 1960), the operations of commercial banks in addition to the transactions of governments and official bodies. These headings are further broken down by the more important types of transactions, and it is these breakdowns that we used for our classification. Grants are reported as official donations (item 10).[15]

The regional classification called for by the Fund's Manual distinguishes the United States, the United Kingdom, Canada, Rest of Sterling Area, Continental OEEC countries (substituted for the original Western Europe), Latin America, and Rest of the World (or Other Countries). The dependencies are shown separately, and some of the areas are further subdivided into smaller groups.[16] If this classification is observed in every detail by the reporting country, the transactions with the two most important countries in international finance, the United States and the United Kingdom, are revealed, although for the transactions with the rest of the world (except Canada) only the partner areas, and not individual countries, are known. However, since capital movements are not as widely dispersed as current account transactions, there are usually only a limited number of possible part-

rated, however, in this study. On the other hand, Vol. 8, which carries revised data for the period but without regional distributions, includes a number of revisions of which only the more substantial could be incorporated.

[13] IMF, *Balance of Payments Manual*, 2nd ed., Washington, D.C., 1950, which was the guide for this period. With the third edition (1960) the classification of the capital account and the requirements for regional details were changed.

[14] *Ibid.*, pp. 5–6.

[15] Those data that were not reported in U.S. dollars were converted at the official par rates given in the country sections of the IMF Yearbooks. In the case of Canada, for which no par rates had been established, the annual average rates were used, given in the Canadian section of the Yearbooks. For Syria and Lebanon, where transactions took place at various free rates, the free dollar rates were used.

[16] *Op. cit.*, p. 76, Table A.

ners within an area to the transactions of a given country. Moreover, breakdowns of types of capital or identifications of particular transactions by country are frequently available. Thus, it is possible to identify a great many types of transactions by country, at least on one side, from the reported data.

Supplementary data are published by a number of countries. The United States publishes breakdowns of most of its transactions. Further details were obtained through the courtesy of the staff of the Balance of Payments Division of the U.S. Commerce Department. The U.S. movements could therefore be identified, with minor exceptions, both by type of capital and by country. Moreover, since the transactions of the United States comprise the larger part of the world's capital movements, a great many transactions reported by other countries without adequate regional distribution could be identified with the help of the U.S. data.

Much less additional information was available for the United Kingdom and the Continental European countries. Their official transactions could generally be identified from the reported data. British private investment was, however, reported only net, in one item including all types of private movements, with a regional distribution, which is unreliable.[17] The Bank of England published for this period an annual series, *United Kingdom Overseas Investments,* with country breakdowns. These data, however, were of very limited use because they cover only fractions (ranging from one-tenth to one-third) of the (net) investment that took place according to the U.K. balance of payments. They cover only securities issued in the U.K., the U.S., and Canada, and, therefore, leave out all direct investment in the form of intercompany account entries, intermediate-term loans, and reinvested profits, which is usually the major part of direct investment flows. (The coverage is also incomplete in other respects.) Government bonds and loan and share capital of private companies are distinguished at nominal values, but the cash value of investment or disinvestment is shown only for all securities combined. These data were useful mainly in cases of transactions where, according to other evidence, only portfolio investment was involved and the cash figures were thus meaningful. But the data were not adequate for a

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[17] See the discussion of the U.K. account below in Chapter 3.

reconstruction of total private investment or even all portfolio trans-
actions. Another source, the *Midland Bank Review,* provided, how-
ever, annual data on security issues in the London market from which,
in conjunction with partner data, these issues could be estimated.

The French balance-of-payments publication supplies country break-
downs of gross inflows and outflows, distinguishing between official
and private, and between long- and short-term, but not by types of
capital. Since this distribution is also based on currencies, it is of
use mainly for soft-currency countries. The transactions with the over-
seas territories are not included, however, and had to be estimated
from OEEC publications.

Thus, transactions of the European capital exporters had to be
identified largely on the basis of information available for the capital
importers.[18] In this respect foreign investment censuses and break-
downs in balance-of-payments publications of the major sterling coun-
tries and some others generally supplied the information to establish
the direction, magnitude, and composition of the European flows to
these countries. A number of monographs on Latin American coun-
tries published by the U.S. Department of Commerce yielded similar
information on European investment in Latin America.

Information was also obtained from the *International Financial
News Service,* published by the Fund (mainly on loan transactions),
and from the British bank reviews, the London *Economist,* and other
financial news sources.

[18] Perhaps this is because countries with younger statistical offices follow the
Fund's reporting rules more closely than countries that have long collected data
according to their own rules.