

CAPITAL MOVEMENTS IN LATIN AMERICA  
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CAPITAL MOVEMENTS IN LATIN AMERICA

It is with particular pleasure and deep honor that I attend this meeting.

As we are all aware, we have here another opportunity to discuss important and timely topics.

I have been requested to comment on the subject "The Flow of Latin American Capital Abroad: Its Causes and Effects." Unfortunately, this is one of many topics which little reliable information exists. These topics are created or kept alive by stereotypes, prejudices and distorted views.

I shall attempt to divide my presentation into two parts: one will be devoted to certain elements concerned with the outflow of capital from Latin America and the other will be devoted to describing an experience which I had while Director of the Development Plan for the Northeast of Brazil through SUDENE.

I have preferred, therefore, to handle the subject in two ways:

First, in a very general manner, I should like to give an idea as to the scope and magnitude of the problems in Latin America of which there exists unfortunately very little information. Second, I considered it appropriate to outline a good example here, a concrete case, concerned with the current attempt at regional development in the Northeast of Brazil, an immense and underdeveloped region whose local economy not only seems dormant or even non-existent but also needed to attract funds from other regions of Brazil and from abroad in a massive and progressive manner.

Let us now review and discuss the first part, the movement of capital with regard to Latin America.

## I. CAPITAL MOVEMENT IN RELATION WITH LATIN AMERICA

The most prevalent question currently being asked in many quarters concerns the extent to which capital flight takes place in Latin America. This idea is connected closely with the possibility of net capital outflows from the region to the rest of the world. It is true that capital outflows include some capital that leaves Latin America for a safer environment, but on the whole it includes outflows which are related to either autonomous movements or to compensatory finance.

By capital flight one usually means outflows of capital funds from countries where government action or the general unhealthy economic conditions place great risks on the ownerships of such funds. The reactions of the capitalists are, in cases where such a situation exists, to look for external safekeeping. In so doing they engage in secretive and illegal actions, when such transfers are prohibited by law.

Capital flights are therefore not reported to national authorities, whose official statistics cannot be relied upon to measure the magnitude of such an event. But statistics compiled by recipient countries cannot be relied upon either because in some cases the authorities are engaged in a policy of secrecy just to attract these sorts of funds through overevaluation of imports or the underevaluation of exports.

It is therefore extremely difficult to give an accurate estimate of capital flight in Latin America. For one thing it is not known to what extent exports are undervalued and imports overvalued. For another the net errors and omissions item in the Balance of Payments, though giving hints of the probable magnitudes, is not a reliable indicator, because it is a balancing item which includes the errors involved in

estimating the accounts. What part of this item can be charged to the estimating error and what part to omissions is anyone's guess. Available statistics give, however, some idea of the flows both in capital and current accounts in the overall balance of payments of Latin America.

Recent studies made by the Secretariat of CIAP point out the following trends in the region's international situation:

1) Since 1964 the region has incurred increasing deficits in its current account, that is, it has imported more goods and services than it has sold to the rest of the world. The future prospects are for a continuation of this tendency, both on account of the precarious outlook for the region's exports and of its increasing needs for imported capital goods and raw materials, which will increase with an acceleration of the region's growth of income. For the years 1964 through 1967 the region's deficit in current account has amounted to \$631, \$446, \$878, and \$1,410 millions respectively.

2) During the same period the region has experienced a net outflow due to greater amortization of the public and monetary sector than what has been received in official disbursements, including transfers. The data are as follows:

	<u>1964</u>	<u>1965</u>	<u>1966</u>	<u>1967</u>
1. Repayment (Amortizations of the public and monetary sectors)	1272	1922	1462	1329
2. Disbursements	<u>1138</u>	<u>1125</u>	<u>1325</u>	<u>1420</u>
Net	-134	-797	-137	+ 91

Note: (-) means outflow' (+) inflow; figures in millions of dollars.

3. Registered capital investment during the same period has fluctuated from \$290 million, a decrease, to an estimated \$500 million in 1967.

4. There has been a noted reduction in "supplier's credit," banking credit and extension of exchange agreements since 1964, when the

even when one considers the existence of negative rates of interest in some Latin American countries in which the rates of inflation have been rather high. In these cases profit rates and liberal credit policies do compensate for interest differentials and cause capital to stay at home.

As it has already been stated, there is difficulty in determining the size of the capital outflow from Latin America. We can, however, form an idea of the magnitude of capital flight. For this purpose, let us consider how it is undertaken. Someone must take out either goods, gold or money. When the goods taken out, however, bring in money which is returned to the country there is no capital flight. Likewise, if gold and money are taken out and goods of foreign origin are obtained in exchange which are returned to the country in Latin America, likewise there is a commercial transaction and no capital flight. Now we can see what the upper limit of capital flight may be: All the goods, money, and gold taken out less what is brought into the country in exchange. It may, of course, be much less than this upper limit because what is taken out sometimes are honest-to-goodness investments, payments due for earlier services, donations and a few other matters.

On the basis of such rough estimates, we perhaps could venture a guess that the capital flight from all of Latin America in the new year is likely to have amounted to more than one billion dollars. Of course, there are huge differences from country to country. But some outflow probably will take place from every single Latin country. Now what would such a magnitude mean? A billion dollars is about the same amount as the total annual flow from the World Bank, the Monetary Fund, the Inter-American Development Bank, U.S. AID, and similar Washington-based official agencies to Latin America. This, in turn, may be from five to twenty percent of the country's yearly capital and other expenditures to take care of its economic and social development needs.

region received an estimated \$1,000 million dollars of new short-term credits.

With respect to the net flow of private capital, it is opportune to quote a recent CIAP study"

For the first time in several years, it appears that in 1966 a net positive increase has been obtained in private foreign investment, although it is relatively small. This is attributable to the reduction of foreign capital repatriation particularly from Argentina, Brazil and Venezuela. Preliminary data on the increased flow of private capital from the United States and the prospects for a further decrease in repatriation, give some basis to the net amount estimated in the country reviews which reached \$500 million in 1967, and represents an increment of nearly \$350 million above the preceding year. In any case, as experience has proven, it is extremely difficult to estimate the development of this item, since it is so very sensitive to changes in local conditions and has a high propensity to experience pronounced fluctuations."

In the context of the CIAP work it has been estimated that for 1967 the region's additional capital requirements was in the \$500 to \$800 million level. This means that after account is taken of all possible sources, this amount was still needed in order to permit the region to finance its deficit in current account, its commitments with the financial international community (amortizations of the public and monetary sectors), and the modest increase in the regions reserve position.

Whether there is a substantial net short-term capital outflow from the region due to interest rate differentials is a matter which needs to be studied in detail. There is the presumption, however, that this sort of capital is sensitive to interest rate differentials,

Obviously, the cure for capital flight therefore is intelligent and moral behavior on the part of governments as well as on the part of wealthy individuals. The objective comprehension of the social doctrine of the Church must play an important role in achieving this. Governments must learn economics and to behave in a moral way so as not to confiscate property capriciously for the benefit of a few. Wealthy individuals must be convinced that private property is not only a right but also a social obligation, that it must be used in socially constructive ways, and that the authorities are entitled to transfer a certain amount from the rich to the poor and to insist that the rich be willing to bear a much heavier share than heretofore in financing worthwhile economic and social programs of the nation. The latter is an interesting point in a Latin American society where, in many cases until recently, wealth was considered exclusively a privilege and not an obligation, and where what social obligations were recognized in existing cultures, took usually the form of charity and alms, sometimes with the Church as intermediary, but never with the government as main agent of transfer.

The moral and ethical aspect of the whole business can also be illustrated in a slightly different way. Capital kept at home cannot be hidden and therefore can be easily taxed. Capital transferred into a huge industrially developed country frequently can be hidden with much more ease, or is made subject to much lower taxation by the authorities of the foreign country who try to attract this capital. It is natural and justifiable if the authorities try to put an end to all capital flight motivated by this fact by means of laws which heavily punish perpetrators of the crime of capital flight. But this is not enough, no government has ever been able to control such flights by force. On the contrary, punitive laws against capital flight usually have the opposite effect from that expected because they increase

This percentage may be much less. But, if we take capital flight at one billion dollars, it means that a billion dollars worth of foreign goods and services could have been obtained for Latin America had the people engaged in capital flight chosen to obtain these goods and services for use abroad rather than to leave their capital abroad.

Thus it is obvious, that capital flight does great harm to Latin America. For it must be remembered that the lack of capital goods and technical know-how is one of the main sources of poverty and social unrest in Latin America. Having established this, we now first must find out what has caused capital flight in the past.

The oldest but probably no longer a very important cause is political in nature, pure and simple. Some governments in the nineteenth century and earlier, at times, confiscated the property of the wealthy. This probably is unacceptable nowadays, but as the cultural lag persists, it may take centuries to eradicate. Here moral suasion, education, and appeal to public virtue may help.

Secondly, there is a fear that government actions in carrying out its social and political objectives might justify bringing about a redistribution of wealth through taxation. Closely connected to this is the fear that governments may tax away property or income to finance activities of the public sector which are thought to be in the common interest or to be socially just. Finally, there is a fear that unwise government policy may cause a destruction of any wealth of great magnitude kept at home. To illustrate this perhaps last, somewhat obscure point, keep in mind that all wealth must be held either in the form of financial assets or real property, most of the latter taking the form of some type of investment in goods which may deteriorate through inflation. It is obvious that all these forms, if the government doesn't follow wise policies, will lose value over time.

the near future. During these past five years most private investment in the region has originated from the United States. During the period 1960/1965, according to the Organization for Economic Cooperation and Development, the total bond issues of some Latin American countries on OECD capital markets reached US\$490 million of which \$390 million were bond issues of Mexico. Latin American regional institutions are trying to channel European financial resources to the region. In addition, the multilateralization of the Alliance for Progress Program should proceed at an ever increasing pace.

I would like finally to stress that my "guessing game" has been more for illustrative purposes than a technical estimate on capital outflows from the region. One can say however, that there is, as was pointed out in an article two years ago, a significant capital outflow from Latin America. Perhaps it is worthwhile to quote parts of the conclusions of that article; it said "There is some incontrovertible evidence in U.S. statistics of an appreciable outflow of capital from Latin America and some indirect indications in Latin American statistics of further large outflows. But to derive precise figures from such evidence as exists would be an excessively hazardous task." (1)

In the near future perhaps some of you would like to attempt to straighten out the complex problems involved in making accurate and reliable estimates on capital flight in the developing countries

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(1) Poul Host-Madsen, "How Much Capital Flight from Developing Countries?", Finance and Development, Vol. II, Number 1, March 1965, pages 32-33.

apprehensions about the intention of the government and thus induce further capital flight. This impasse can be solved only if, on the one hand, the authorities follow long-term policies, which eventually convince potential perpetrators of capital flight of the social responsibility of such governments and of the benefit of such policies.

On the other hand there must be a change in attitude of many Latin American capitalists, so that they recognize, in the first place, it is immoral to break laws aimed at furthering the welfare of the nation as a whole, and, secondly, that law or no law, they have a moral obligation to utilize their wealth in a way which is in accordance with the best interests of the nation. This is an area in which government, Church and lay leaders have a very important role to play. And they are not only conscious of the need for change; but they are also working to improve the situation.

Latin America's future economic growth depends not solely on what is done internally. The efforts of most governments in the region have been significant, although they are not sufficient to finance all development programs. The export prospects for the region for the next few years are not too bright and the needs will be increasing as more programs are launched to redirect the social and economic situation of most countries in the region. This is one of the greatest problems of our time. The rich countries are not paying enough for the basic products from these poor countries. (This issue is the object of a very important meeting scheduled this month in New Delhi - The Second U.N. Conference on Trade and Development.) The financing gaps will then have to be filled by the international financial community.

Since there is no doubt anymore of the potential of the region, foreign private capital will have greater incentives for investment when new plans for economic integration begin to be implemented in

low prices for its export products, and a low level of technology. In addition, from 1956 to 1963 the equivalent of US \$150 million originating from its exports left the Northeast for the South. Above all, the region was not creating sufficient employment for an extremely prolific population. The result was that those persons who were not able to leave the region to seek work in other regions were systematically subjected there to the process of an ideological message. The "peasant unions" which were set up then had the purpose of arousing the awareness of the rural peasantry that the situation had to explode, thus opening up at that time a bridgehead for international communism.

2) ACTION WAS URGENTLY NEEDED - THE CREATION OF the Superintendency of Development for the Northeast (SUDENE)

Pressed by all of these factors, the government, under the pressure of public opinion, decided to take action. An overall development plan for the region was prepared and approved by the Congress in 1959. SUDENE was created. Up to now it has been operating on the basis of three-year plans which are periodically modified to take experience into account. The Plan is not politically oriented. The interests of parties and individuals do not negatively affect the preparation and execution of the plan in the appointment of its leaders and technicians, or in the emplacement of the great industrial, agricultural projects, and infrastructural or communal services. It has outlived governments, pressures, and difficulties. It was able to mobilize close to 1,000 technicians from the region itself who would otherwise have departed for the more developed southern region. Almost all of them had complete university training and many had taken specialized courses and graduate courses in the South or abroad. The region was aroused to its future of growth. Regional leadership

## II. THE EXPERIENCE IN THE NORTHEAST REGION OF BRAZIL

I shall now comment upon the regional experience in the Brazilian Northeast and the efforts which are being carried out by private capital and savings to promote this development.

For many planners and ideologists of today, disregarding the groups of the militant left, the development of a region such as this one would only be possible by means of extremely harsh and violent measures, the banner and the message monopolized by divinely-inspired leaders. Our case, however, constitutes the modern example of the overall development of a vast region of which its population is equivalent to that of a country within another country. The program comprises policies and mechanisms aimed at stimulating development, using capitalist and democratic ingredients without hampering some measures which were taken or should be taken on behalf of social justice.

The transformation which is occurring there is sufficiently significant to arouse the interest of this Conference.

In order to illustrate the topic which I have undertaken to present, let me give the following data.

### 1) The Area

This is a vast region with 1,600,000 square kilometers. Among the countries of South America only Argentina is one which exceeds it. It is perhaps the largest and most populated underdeveloped area in Latin America. The per capita income there is US \$130. In the entire Western Hemisphere this figure is exceeded only by that of Haiti, Bolivia and Paraguay.

The region is well endowed with natural resources and with an active, intelligent population.

Its economic base has been agriculture and livestock raising, traditionally affected by three negative factors: periodic droughts,

rich and developed regions to the underdeveloped Northeast.

Efforts of a profit-making nature, particularly in the industrial and agricultural sectors, were reserved to private capital which is attracted to the infrastructure projects and by various other incentives which I shall discuss in greater detail later.

#### 4) The Role of Private Capital

Private capital is playing a decisive role in this process of development in the Northeast. Attracted by specific financial, tax and other incentives, private capital began to appear in the region itself. It has previously been said that local savings were not available because all of these savings had been transferred to the South or abroad. Experience proved that the situation was contrary to what stereotyped thinking led one to believe. An investigation carried out by Professor Asimov from the University of California at Los Angeles (U.C.L.A.) had shown that it was possible to uncover and mobilize capital in economically-backward areas of the Northeast itself, provided that specific opportunities existed, in other words a project which was technically and economically viable, capable of offering security and profit for the investment. (1)

In addition to local savings, also attracted by it and strictly associated with it, I witnessed growing flows of capital from the South which is earmarked for developing the Northeast.

How was this semi-miracle achieved?

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(1) The Project Rita. More information is obtainable from USAID's Office of development Finance and Private Enterprise, New State Building, Washington, D.C. 20534.

joined hands without regard to political or religious cleavages. The universities and technical institutes are changing their traditional structures, curricula, and programs to fulfil their role within the struggle of all. The Government and the Church, although differing possibly on subjects concerned, joined forces in the need to face the problems of the Northeast.

The result, briefly expressed, is that today the Northeast is the region in Brazil which is experiencing the greatest development. In the last four years this region achieved an economic rate of growth of more than 7 percent per annum. It is also the region to which a steady technological flow is being directed, together with the installation of hundreds of industrial and agricultural projects which will provide 200,000 new jobs at higher salary levels.

### 3) Public and Private Investments

The development of this entrepreneurial rebirth is primarily the result of an intelligent policy of public and private investments gathered in almost its entirety in Brazil itself, with external financial and technical assistance only required in supplementary form. These external resources emanate from multilateral and bilateral entities, particularly from the governments of the United States, Germany, France, Japan, Israel and others.

The public investments from the federal government and from the states are directed to those sectors which are inherently related to government action, i.e. infrastructure projects (transportation, electric power, water supply), education, health, research and seeking scientific development of the natural resources of the Northeast. Some international loans have also been directed to these vital sectors. Proceeding in this manner, the government tends to create conditions which are essential to attract interest, know-how, and capital from

There is also the import licence without exchange cover, and, in addition, the firm can reinvest its profits without having to pay income taxes.

(e) Where to collect the deposits

These resources can be deposited in the Bank of the Northeast (Banco de Nordeste), an institution of regional financing, in a blocked account without interest.

The company has a maximum of 3 years in which to apply these resources. If this is not done, the right to such resources will be lost.

The Bank of the Northeast and SUDENE work in complete agreement as parts of the same program and of the same process.

(6) How the Mechanism Functions

There are two main systems, i.e.:

(a) Without Financing

A financing of 100,000,000 cruzeiros can be applied with 25,000,000 cruzeiros of the firm's own resources and 75,000,000 cruzeiros from deposits coming from the income taxes.

(b) With Financing

In this case the own resources are added to the deposits from income taxes and to financing on the part of the Bank of the Northeast of Brazil (Banco do Nordeste do Brasil) (BNB), or in other words:

<u>Without Financing</u>	
Own resources	25
Income taxes	<u>75</u>
Company capital	100

## 5) The Incentive System

When the National Congress studied and approved the Second Director Master Plan, it introduced amendments which, by their simplicity and ingenuity, actually provided a new dimension to the institution's working plan.

It consists of a system of incentives which entails, briefly, the following two main features:

### (a) A Fifty-Percent Income Tax Deduction

Any juridical person, national or foreign, can deduct income tax and any other additional tax to which he may be subject up to 50 percent of the value of the tax in order to reinvest it or apply it to industrial, agricultural or telecommunication projects in the area of SUDENE's jurisdiction which have been declared by this agency to be essential to the development of the region.

### (b) Contribution on the part of private capital

In order to recover the 50 percent deduction which the Government granted, the legislation requires that the enterprise firmly agree to the financing of the total projected capital investments from its own resources (never less than one-third of the total capital planned for the project) and, secondly, that the enterprise conform to the standards of priority established by the agency.

### (c) Exemption of any duties on the import of certain Equipment

The law ensures the exemption of any duties on the importation of machines and equipment not produced by the national industries and which are indispensable to the projected enterprise.

### (d) Other Incentives

The states of the region also offer tax exemptions for periods of time covering from 5 to 10 years to those companies which move to the areas and are designated by the agency as priority areas for the region.

provide all the jobs needed in the region. And there is not yet an answer on the way these riches have been distributed.

However this program is creating 200,000 new jobs at salaries higher than the traditional standards of the region. An industrial park which is more modern than the one in the South is being constructed. The agricultural sector is also beginning to gain momentum, although more slowly. This region is furthermore endowed with natural resources, cheap manpower, a large potential market, and favorable local conditions.

Professor Albert O. Hirschman of Harvard University, who visited the Northeast only a few months ago on a mission for the Brazilian Government, stressed, among other things, two points which deserve mentioning. He stated that this incentives policy:

(a) "is by far the most significant economic forward move to take place in Brazil's Northeast for many decades,"

(b) "The advantages of (this) service shall make this particular policy instrument attractive to 'developers' in other lands."

#### 8) The Church's Role

Now, prior to concluding, I should like to explain what the Church is doing with regard to this topic. The Church most assuredly has had and is continuing to have a role in handling this complex problem.

As regards the Northeast of Brazil, the Church has been and is continuing to participate actively -- the Church and all religious denominations -- with definite views and ideas on social action and economic development.

The Church was an active force in the discussions on the problems of the Northeast, including those concerned with the migration of its know-how and capital. It had a great hand in creating the awareness,

With Financing

Own resources	15
Income taxes	45
Financing from the BNB	<u>40</u>
Investments	100

A project is approved by SUEDENE only after a complete study has been made as to its financial viability and technical feasibility, its relationship to the priorities of the plan is established and after the competence of the management and shareholders has been verified. The approval or rejection of any project is not subject to the slightest political influence.

7) Some results produced by the system

Even though it has only recently been created, this system is bringing about a revolution in the country's investment policy in a large underdeveloped region, particularly since 1964.

More than 20,000 payments of income tax collected by the Bank of Northeast Brazil have netted some NCr\$850 million, in U.S. dollars approximately 300 million. To these 300 million will be another 300 million obtained from private resources and/or from complementary financing.

In other words, this legislation promoting fiscal and credit incentives has brought to the Northeast more than US\$600 million in national currency.

Two-thirds of these resources were committed to 350 industrial and agricultural projects approved as of last December. The remaining one-third is being committed to 150 projects which SUDENE is currently studying and approving.

We know, however, that there are many problems still without answer. There are serious doubts as to the capacity of this work to

the problem.

At this point I should like to mention a problem. It refers to the need to define clearly what the role of the religious sector should be vis-a-vis development. There has been some confusion that has engendered a certain amount of tension with civil authorities. It is hoped, however, that the recent recommendations given by the Council on The Development of the Peoples and also the common sense of both religious and civil leaders will direct themselves towards effective and useful cooperation with each other. In addition, there is resentment in that certain religious authorities limit themselves to criticizing, by using harsh words, the existing poverty without, however, helping objectively solve these problems.

#### 9) Final Word

I wish to apologize for perhaps having presented too lengthy a discussion of this Brazilian experience which, being so successful, has just been extended to the Government of Amazonia.(1)

Instead of speaking about theories relative to the flight of capital, I have considered it more appropriate to focus attention on an actual example in our own hemisphere, in a region which seemed destined by fate to become another field for experimentation of interna-

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(1) The Executive Branch and the Congress have recently implemented legislation and plans, similar to those of the Northeast, that are adapted to the needs and the potential of Amazonia. A regional planning agency was created (the Superintendencia do Desenvolvimento Regional, SUDAM, or Superintendency of Regional Development) in addition to the approval of incentives legislation which is more liberal than the one described for the Northeast and the reformulation of the entire basic policy of the Bank of Amazonia (Banco da Amazonia).

first in the region itself and then throughout the country, that it was necessary and urgent to find the solution to this problem of the Northeast in a planned manner. It was even able at times to force the Government into preparing projects for which it signed assistance agreements with the Government.

The Church assisted in clarifying the problems.

The Episcopate of the Northeast, confronted with the challenge of the surrounding society, was anticipating the Church of the Second Vatican Council itself.

In summary, the Church:

- encouraged the Northeast to discover and appreciate its natural and social potential,
- called the attention of the developed areas and regions of Brazil to the underdeveloped Northeast, a clear threat to national integrity itself,
- attracted interests, resources, and technical leadership from outside of the region into it,
- is providing an example to other Episcopal Conferences of the so-called "Third World."

Members of the Church are also presently discussing incomplete facets of SUDENE's working plan, which are designed to improve, and adapt it better to present-day reality.

I will not say that the Church should intervene in problems which by their very nature, belong to the specific sphere of action of the Government, in view of a policy of separation of the two powers reflected in republican tradition and in the National Constitution.

But it most assuredly has a responsibility of its own in the sense of discussing the topic, suggesting appropriate solutions to it in terms of its social doctrine, and mobilizing public opinion to solve

tional Communism in America or to become another Vietnam.

Now, in spite of so many problems still to be solved, this is turning into the most positive experiment in regional planning of the entire hemisphere.

Thank you very much.

The ideas and opinions contained in this paper are solely the responsibility of the author, and not of the agency for which he works -- the OAS.

This paper may be quoted in whole or in part in any manner that will promote the interest of the Church in Latin America. Please acknowledge the CICOP Conference of the U.S. Bishops' Committee for Latin America. Mimeographed copies may be purchased at the CICOP Headquarters, Box 946, Davenport, Iowa 52805,