

Richter, Peter

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# Are the Developing Countries in Reality “Exporters of Capital”?

by Peter Richter, Berlin\*

**The developing countries have missed no opportunity at any of the great international conferences in recent years to raise the demand for larger capital transfers by the developed countries. Whether compliance with this demand can really contribute to narrowing the North-South gap must however be doubted. According to the following calculations interest payments, royalties and – overt or hidden – profit retransfers have already reached such an amazing dimension that the developing countries would in reality have to be regarded as “capital exporters”.**

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**T**he discussion of the problems involved in the foreign trade relations between developing and industrialized countries has produced a wide consensus on two points:

The developing countries (apart from the rich oil countries) must resign themselves to a continual shrinkage of their real incomes because of the worsening trend of their terms of trade which was noted first by Prebisch;

Over and above this the developing countries (again with the exception of the oil countries) are suffering from a relative disintegration from the world market – in other words, this group of countries is experiencing a constant diminution of its share in world trade.

Both these phenomena stem in the final analysis – as has been explained theoretically by several authors<sup>1</sup> – from the fact that the countries of the Third World are still essentially exporters of raw materials, and this means of commodities with relatively low income elasticities and demand growth coefficients respectively, whereas the industrial nations find themselves thanks to the specialization pattern of their economies in exactly the opposite position. It is this dichotomy which the developing countries want to overcome by their demands for establishment of buffer stocks and a Common Fund and/or for access to the markets of the industrialized countries for labour-intensive finished products. Fulfilment of these demands, so the developing countries hope, will provide them with stabler and higher earnings and lead to a diversification of their trade.

No such general consensus exists about the facts in regard of capital transfers to underdeveloped countries. The lack of theoretical certainty about these facts is reflected by the non-existence of an operational and generally recognized definition for the

concept of international capital transfers. The meaning of the various concepts which – a further complication – are presented under different headings such as “Financial Resources” (OECD) or “Flows of Long-Term Capital and Official Donations” (UN) can only be inferred from the sum total of the variously subsumed forms of transactions (public development aid, direct investments, portfolio investments, export credits, etc.). As the theory is manifestly incapable of assisting the statistician by supplying him with an operational concept, there is only one common denominator left for international capital transfers, namely the rather trite definition of such transfers as the transmission of long-term financial resources from one country to another. In other words, the definition covers only the side of the donor and begs the question whether the provided means are in actual fact used by the international partner for a productive end. “Productive” is a term which – in this context – should be given a very wide interpretation, it includes infrastructural investments of a material, institutional and personal nature. But following the just mentioned definition expenditure on consumption is also financed by capital transfers; aid in the form of foodstuffs for example is counted as public development aid, and both investment goods and consumer goods are financed by export credits.

It cannot surprise therefore if the development politicians have only very rudimentary ideas of the effects of the inflow of external capital on the development and growth processes in Third World countries. Swayed by the theory of a vicious circle, they probably follow this basic train of thought: To catch up gradually with the industrialized countries, the developing countries need an enormous amount of

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<sup>1</sup> Cf., e.g., D. Beier, *Die Theorie der peripheren Wirtschaft nach Raul Prebisch* (The theory of the peripheral economy according to Raul Prebisch), Berlin 1964; and K. Dörner, *Probleme einer weltwirtschaftlichen Integration der Entwicklungsländer* (Problems of an integration of the developing countries with the world economy), Tübingen-Basle 1974.

\*Freie Universität Berlin.

private and public investments. Although it should in principle be the aim of development policy "to put the less developed countries as soon as possible in a position where they can realize their aspirations with regard to economic progress without relying on foreign aid"<sup>2</sup>, most developing countries are despite partly relatively high national saving rates at the present time unable to close their investment gaps by themselves. They have therefore still to rely on foreign capital. In view of the fact that the developing countries do not possess a modern investment goods sector – which is incidentally part of the explanation for the apparent contradiction between a high saving rate and a low national investment ratio – this is tantamount to dependence upon foreign resources (in the real-economic sense).

### Unspecific Demand for Capital Transfers

The developing countries have missed no opportunity at any of the great international conferences in recent years to raise the demand for larger capital transfers by the developed countries<sup>3</sup>. This demand is in general not presented in a specified form and may therefore be assumed to apply equally to all forms of capital transfer. If specific wishes are expressed, they are for "softer" terms for their borrowings or implementation of the generally recognized 0.7 % target of the "International Development Strategy of the United Nations for the Second Development Decade" which relates to the proportion of the gross national product which the industrialized countries are to devote to public aid. In the light of these demands it is clear that the concept of a world capital aggregate is more than a theoretical notion – it is of practical political relevance. The unanimity with which the demand for increased resource transfer is pressed must however arouse misgivings, seeing that the developing countries have by now incurred international debts of almost US \$ 200 bn<sup>4</sup> and the margin of difference between the per-capita incomes of the developed and developing

countries has not only not declined but even increased since 1960.

The venerable old transfer theory could serve as a theoretical backcloth for the identification of capital inflow with resource inflow. In its modern version which derived from the huge reparations burden laid on the German Reich after World War I it set out to answer the question "whether and under what conditions monetary capital transfer entails an equally large real transfer of goods and services (current account surplus) through which the autonomous balance of payments is ... restored to equilibrium"<sup>5</sup>. This formulation of the problem shows clearly that the transfer theory is less concerned with genuine capital transmissions, which are of course attended by countercurrent flows such as interest and profit retransfers and redemption payments, but rather with unilateral transmissions of assets between two nations. For an answer to the question about the transfer mechanism the protagonists of the reparations debate, Ohlin and Keynes, were able to draw on the classical economists although they turned to different authors<sup>6</sup>. One of the basic theorems of the classics is of course the automatic equilibration of the balance of trade – Ohlin adapted the Ricardian income mechanism for his line of argument while Keynes drew on Hume's price mechanism. Although their assessments differed, both theoreticians arrived in the end at the result that a monetary transfer will always be followed by a real transfer. Or, in Haberler's formulation, "capital can in the last resort only be transferred in the form of goods and services"<sup>7</sup>.

To be quite correct, one should say a monetary capital transfer only creates a claim to goods and services – including capital goods – of the capital exporting country. The foreign currencies in question can however be used equally well for increasing the international liquidity of the capital importing country, servicing a loan, transferring profits or even for countercurrent money and capital flows. This being so, a national "balance of capital transactions" alone can allow inferences to be reached about the actually effectuated real transfer. However, in view of the definition offered above for international capital transfers the use of the "net balance" – productive or unproductive – cannot be reconstrued.

Besides, it seems paradoxical that a capital transfer theory makes use of the postulate of an automatic adjustment of net balances by means of which the classic authors wanted merely to demonstrate the neutrality of money in the real sphere of the international goods exchanges. Through the thesis of

<sup>2</sup> Partners in Development, Report of the Commission on International Development (Pearson Report), 4th printing, London 1970, p. 11.

<sup>3</sup> Cf., e.g., the opening speech at the IVth World Trade Conference in Nairobi on May 5, 1976 by Secretary General Gamani Corea or the Declaration and Plan of Action for Industrial Development and Cooperation at the Second General Conference of UNIDO in Lima, Peru, on March 12-26, 1975 or the Coooyoc declaration which was adopted by the participants in an UNCTAD symposium on raw material utilization, protection of the environment and development in Mexico City on Oct. 8-12, 1974. In Manila this demand was again high on the agenda.

<sup>4</sup> Cf. the World Bank's annual report for 1978.

<sup>5</sup> G.F. Nierlich, *Volkswirtschaftliche Wirkungen internationaler Kapitalbewegungen* (Economic effects of international capital movements), doctor thesis, Mainz 1968, p. III.

<sup>6</sup> Cf. B. Ohlin, *The Reparation Problem: A Discussion* (1929), in: H.S. Ellis, L.A. Metzler (eds.), *Readings in the Theory of International Trade*, Philadelphia-Toronto 1950, and J. M. Keynes, *The German Transfer Problem* (1929), in: H.S. Ellis, L.A. Metzler (eds.), op.cit.

<sup>7</sup> G. Haberler, *Der Internationale Handel* (International trade), Berlin 1933, p. 57.

factor immobility they had after all deliberately disregarded capital transfers when considering the international relations and thereby in the last analysis prevented until today the evolvement of a real theory of the international factor mobility which is characteristic of our world<sup>8</sup>.

### Theories on Imperialism

The more recent theories on imperialism which hold the metropolies and the exportation of capital by them guilty of exploitation of the peripheral countries take an explicit contraposition to the thesis that real transfer proceeds more or less automatically in conjunction with and parallel to capital transfer, with one qualification however – they largely identify the exportation of capital as understood by Hilferding with direct investment. Exportation of capital meant to Hilferding “the exportation of values intended to bring forth surplus value in foreign countries. ... One can only speak of exportation of capital if the right of disposing of the capital used abroad remains in domestic hands and the surplus value generated by this capital can be disposed of by domestic capitalists”<sup>9</sup>. In other words, it is – as long as capital retains national character – a logical consequence of direct investments that the portion of the profit which is not reinvested on the spot reverts to the original starting point of the exported capital. The more recent theories on imperialism hold that this process of capital repatriation amounts to exploitation<sup>10</sup>.

Even these theories must however concede that the profit retransfer is attended, or has been preceded, by a counterflow – the original capital investment. It is for this reason that all empirical accounts of the disadvantages of foreign direct investments for underdeveloped countries decry the allegedly unfavourable ratio of capital inflow to capital outflow in Third World countries rather than the absolute level of the profits accruing to foreign capital. For them the capital relations between Latin America and the USA stand proof<sup>11</sup>.

It does not seem to worry the protagonists of these recent theories on imperialism greatly that by labelling the negative difference between the inflow of private investments and the outflow of profits as exploitation they move even farther away from their marxist basis than would be the case if they treated the making of a profit abroad in itself or profit transfers in toto as

exploitation. For if the latter is interpreted as exploitation of foreign labour, it follows – even if its specific relevance is put in question – that a count of the values or capital received by or handed to a nation cannot be presented as a yardstick of exploitation. If on the other hand exploitation is to have a different meaning from the original and normally assumed content of the term – for example the national income redistribution process as it figures in circulation theory – this would have to be stated and explained.

### Extension of the Concept

The idea of adding up what the developing countries receive in the way of direct investment and subtracting the retransfer of profits which they have to accept in return points in the right direction however for such a basically very simple calculation would show on one side to what extent the multinational enterprises are earning profits (incl. reinvestments) in the markets of the underdeveloped countries and on the other side whether direct investments as such bring about a genuine resource transfer. The assumption of critics of such a concept, like Nitsch who wrote that “a negative net transfer of resources can also be an indication that a country or region has developed so far that it increasingly substitutes domestic savings for foreign capital and gets out of the debtor position and away from the consequent dependence”<sup>12</sup>, is unlikely to reflect the true situation in Latin America or elsewhere in the Third World. And even the remark of the same author with reference to the asset and liability position that “the more foreign capital there is in a country the greater are the dividend and interest payments”<sup>13</sup> does not in any way alter the fact of the dependence of the underdeveloped countries on an externally financed inflow of resources. Even Nitsch does not deny its necessity and desirability in principle. Such “balancing” remarks are apt to cause confusion rather than to elucidate the real problems which probably arise from the fact that in spite of quite substantial capital inflows the countries of this group do not develop fast enough to increase their exports sufficiently to finance the necessary imports of investment goods with their own resources as the oil countries have of late been able to do.

Under the given conditions the non-oil exporting developing countries must certainly rely on capital imports for the long-term financing of their development objectives. To confine the concept of capital to direct investments as the theory of

<sup>8</sup> Cf. the brilliant essay by J.H. Williams, *The Theory of International Trade Reconsidered* (1929), in: H.S. Ellis, L.A. Metzler (eds.), op.cit.

<sup>9</sup> R. Hilferding, *Das Finanzkapital* (1909) (*The finance capital*), reprint, Frankfurt, p.426.

<sup>10</sup> Cf., e.g., P. Jalée, *Das neueste Stadium des Imperialismus* (*The latest phase of imperialism*), Munich 1971, p.131.

<sup>11</sup> Cf., e.g., A.G. Frank, *Kapitalismus und Unterentwicklung in Lateinamerika* (*Capitalism and Underdevelopment in Latin America*), Frankfurt 1969, p.300f.

<sup>12</sup> M. Nitsch, *Internationale Entwicklungshilfe für Lateinamerika* (*International development aid for Latin America*), in: K. Lindenberg (ed.), *Politik in Lateinamerika*, Hannover 1971, p.218.

<sup>13</sup> M. Nitsch, *Internationale Entwicklungshilfe für Lateinamerika*, op.cit., p.215.

international exploitation does is for this reason inconsonant with the real situation. Moreover, the retransfer problem is not limited to direct investments. An extension of the concept to apply to all forms of capital transfer would also be in accordance with Myrdal's intentions. In a fundamental critique of the capital statistics of the international organisations he claimed that all return flows, i.e. interest payments, royalty transmissions and profit transfers, would have to be taken into account in order to establish real net values. He argued: "The (various - author's addition) kinds of profit can in some cases assume almost phantastic dimensions, especially if they originate from investments . . . effected long ago"<sup>14</sup>.

### Bipolar Capital Flow

The following table shows the development of the capital transfers to the underdeveloped countries between 1964 and 1975. Nominally the capital flows from the developed countries (incl. the rich oil countries and the socialist countries) have grown almost exactly fivefold. In the last three years the bipolar capital flow may have increased at even higher rates.

It may be worth noting also that the public capital flows always amounted to about half the total capital transfers and that since 1973 the international bank credits have assumed greatly increased importance. The latter merely reflects the recycling of oil revenues over the Euro-capital market<sup>15</sup>.

It needs restating in this context that the figures in Table 1 do not show net flows according to OECD

**Table 1**  
**The Capital Flows to the Developing Countries**  
**(in US \$ mn)**

	1964-1966 Average	1970-1972 Average	1973	1974	1975
Public capital flows	7,359	10,352	13,886	19,386	23,463
Direct investments	2,068	3,543	6,710	7,060	10,200
Portfolio investments	948	1,503	3,543	3,725	7,695
International bank credits	-	1,900	8,500	8,000	9,500
Private export credits	911	2,140	1,196	2,481	4,067
Total	11,286	19,438	33,835	40,652	54,925

Source: OECD, Development Cooperation, Efforts and Policies of the Members of the Development Assistance Committee, 1976 Review.

**Table 2**  
**The Public External Debts of the Developing Countries and the Interest Payments Made on Such Debts (in US \$ bn)**

	1969	1970	1971	1972	1973	1974	1975
Indebtedness	45.0	51.3	59.9	68.9	82.6	100.2	121.0
Interest transfers	1.5	1.8	2.1	2.4	3.2	4.3	5.5

Source: World Bank, World Debt Tables, *ibid*.

terminology but only the difference between the gross transfers and the redemption payments or disinvestments. The obscurant terminology of the OECD creates however often an impression that real transfers of the stated dimensions are in fact being made to the developing countries.

The OECD cannot claim that the data required for the computation of the actually effected real transfer are not available. In regard to the compilation of the indebtedness of the developing countries as a result of long-term credits and the servicing involved in these in particular the World Bank has made great efforts in the past few years to establish a "Debtor Reporting System (DRS)" in which 84 developing countries are now included. The World Bank however records only debts which are a direct liability of a public corporation or carry a redemption guarantee from such a body. Because of the omission of not publicly secured debts the effective indebtedness of the developing countries is therefore probably higher than shown in Table 2, quite apart from the fact that the DRS does not, so far, comprise all developing countries<sup>16</sup>.

The upsurge of the indebtedness – in no more than four years, between 1971 and 1975, the total debt of the 84 countries reviewed almost exactly doubled – is a reflection of the problems inherent in the external financing of the underdeveloped countries. The countries belonging to this group depend on ever larger capital inflows because they have so far been unable to increase their exports sufficiently to meet their obligations from previously incurred debts (redemption and interest payments) and at the same time to finance themselves an increasing share of their investment goods imports, with the result of progressively increasing indebtedness and a further rise of debt servicing payments. This could explain why the statistically recorded interest payments have quadrupled in no more than six years. For a proper assessment of the proportions one has to bear in mind that the interest retransfer has in the past always involved a larger sum than, for example, the export credits granted to the developing countries.

### Profit Retransfer

A reporting system indicative of the profit transfer from developing countries is unfortunately not available. UNCTAD alone is trying from time to time to present

<sup>14</sup> G. Myrdal, Politisches Manifest über die Armut (Political manifesto on poverty), Frankfurt 1972, p.187.

<sup>15</sup> Cf. P. Richter, Der Kapitaltransfer in die unterentwickelten Länder – Eine theoretische und empirische Analyse seiner Wohlstandswirkungen (The transfer of capital to the underdeveloped countries – a theoretical and empirical analysis of its effects on prosperity), Berlin 1979 (in preparation), for a detailed analysis of the various forms of transfers and concise theoretical notes.

<sup>16</sup> The World Bank estimates the not publicly secured debts for 1975 at about US \$ 20 bn. Cf. World Bank, World Debt Tables, Vol.I, 1977, p.47.

aggregate profit transfer figures compiled from the IMF's balance of payments statistics. The underlying data currently relate to 47 developing countries and can therefore not be compared with the interest retransfer figures. The 47 countries however include some of the most important target countries for direct investments, and the UNCTAD data – reproduced in Table 3 – may thus be regarded as representative. In any case, the true retransfer aggregate must have been substantially higher.

Table 3 shows that the profit transfer from the developing countries has rapidly increased in recent years. In the six years from 1967 to 1973, the last year for which reliable figures exist, it has nearly trebled, from US \$ 4.1 bn to US \$ 11.5 bn. In all years it has involved appreciably larger flows than the direct investments (incl. reinvestments) at the same time. This fact is a function of the remarkably regular growth of the direct investment stock of the industrialized countries in the developing countries<sup>17</sup>.

It also emerges from the UNCTAD figures however that the profit transfer is in the main proceeding at the expense of a relatively small group of countries, the oil exporting countries. In 1973 for example the ratio of profit transfers from non-oil exporting countries to that from oil exporting countries was 1:6. This must be attributed to exorbitant profit rates in the oil industry on the one hand and the lack of reinvestment opportunities in the countries in question which clearly concentrated for a long time on the production of mineral oils only. For the non-oil exporting countries however UNCTAD also records larger profit retransfers than direct investments, except in 1973.

#### Channels for Disguised Profit Retransfer

So much about the profit transfers disclosed by the multinational corporations. For a number of reasons it may however be assumed that the multinationals are disguising their real profit transfers. There is for instance the fact that several developing countries have imposed statutory limits on the transfer of profits

– foreign investors must not transfer more than a fixed percentage share of the employed capital to their home countries. Nevertheless it is safe to assume in view of their monopoly or oligopoly position in many markets of developing countries that the multinational groups are making large profits which they wish to transfer for safety's sake in order to amortize their international investment in the shortest possible time. Tax considerations also play a role, and the multinationals may besides fight shy of announcing unduly high profit transfers so as not to mar the atmosphere<sup>18</sup>.

Royalties are according to Vaitos and others one of the channels used for clandestine retransfer of profits. If the royalties, which are sometimes designated as direct technology transfer payments and are thus regarded as consideration for past services, arise primarily between parent companies and their foreign subsidiaries – which the empirical evidence shows to be the case<sup>19</sup> – their justification or correct valuation cannot be checked. The multinational groups have it therefore in their hands to manipulate the royalty payments.

What is available in the way of statistical information about the royalties paid by developing countries is at best gappy. In preparation of its third session in 1972 UNCTAD held an inquiry among the developing countries about the direct (and also indirect) costs of technology transfer. UNCTAD had to rely on estimates as no more than 19 developing countries were able to give figures for their royalty payments to the industrialized countries. On the basis of the 1968 aggregate of US \$ 900 mn UNCTAD put the cost of patent and licence fee transfers of all developing

<sup>17</sup> The 1975 figure may be put at US \$ 75 bn.

<sup>18</sup> On the reasons why it is more than likely that the strategy of clandestine profit transfers is resorted to cf. also UNCTAD, Dominant Positions of Market Power of Transnational Corporations: Use of the Transfer Price Mechanism, TD/B/C.2/167, 1977, especially p.10ff.

<sup>19</sup> Cf., e.g., H.-G. Kiera, Zur Bedeutung des Lizenzverkehrs der Bundesrepublik mit dem Ausland (On the importance of licence arrangements by the Federal Republic with foreign countries), in: Mitteilungen des Rheinisch-Westfälischen Instituts für Wirtschaftsforschung, No.1, 1977.

**Table 3**  
**Outflow of Profits<sup>a</sup> from 47 Developing Countries and Territories (in US\$ mn)**

Region	1965	1966	1967	1968	1969	1970	1971	1972	1973
All non-oil exporting countries	821.0	1,124.0	1,212.0	1,428.5	1,554.2	1,470.9	1,335.1	1,433.3	1,853.0
of which:									
Africa	75.0	84.0	80.0	86.2	99.2	98.4	124.7	142.8	205.7
Asia	41.0	52.0	88.0	106.6	85.7	51.2	65.4	66.7	92.3
Middle East	31.0	29.0	30.0	48.8	55.2	55.6	40.6	35.2	39.8
Western hemisphere	674.0	959.0	1,014.0	1,186.9	1,314.1	1,265.7	1,104.4	1,188.6	1,515.2
Oil-exporting countries	2,636.0	2,939.0	2,938.0	3,613.4	3,827.6	3,979.6	5,312.5	6,776.9	9,655.9
All developing countries	3,457.0	4,063.0	4,150.0	5,041.9	5,381.8	5,450.5	6,647.6	8,210.2	11,508.9

<sup>a</sup> Refers to gross payments of direct investment income, debit entry item 6.1 of IMF balance of payments standard presentation.

Source: UNCTAD, Financial Flows to and from Developing Countries, New York 1975, p.68f. and IMF, Balance of Payments Year book, various issues.

countries in that year at about US \$ 1.5 bn<sup>20</sup>. This sum is almost exactly the same as that of the profit transfer from non-oil exporting developing countries in the same year. In a few cases UNCTAD was able to compile data not for one year alone but over a whole period, and from this information UNCTAD calculated an average annual growth rate of external technology outlays by the developing countries of 20 %<sup>21</sup>. This would mean that by 1980 the developing countries will have paid out as much as US \$ 9 bn in royalties. Seeing how the direct investments and profit transfers have grown such a sum does not look entirely utopian.

From a summarization of the data on the capital inflow into and the transfers from the developing countries there emerges a picture of net flows from developed countries which differs strikingly from the one presented by the OECD (see Table 4). Our calculation shows the net transfers in the period from 1964 to 1975 to have been of only about half the size indicated by the development reports, and this calls for a corresponding revision of the views on the "readiness to make sacrifices" in the developed world.

Corresponding to the relatively slow increase of net capital flows between 1964 and 1972 the net transfer also increased only very slowly in this period – from US \$ 5.9 bn to no more than US \$ 8.1 bn. From 1973 onwards the capital transfers to developing countries increased substantially however, and the net transfer from developed countries doubled correspondingly between 1972 and 1973 and again between 1973 and 1975. The year 1974 was an exception because of extremely large profit retransfers which were probably connected with the rising of oil prices and the ensuing world recession. If however allowance is made for the fact that the capital flows are invariably expressed in nominal terms and that the level of prices in the industrialized countries more than doubled between

1964 and 1975<sup>22</sup>, it is seen that the net transfer in real terms has at most trebled during this period, starting from a very low base (US \$ 5.9 bn in 1964).

### Potential for Internal Price Manipulations

The potential for manipulation in intragroup trade of multinational corporations has been left out of account here. We have unfortunately no global estimates as yet concerning the resultant losses to the developing countries, which is really surprising as it is widely agreed in the literature that intragroup trade provides the multinationals with their best opportunities for transferring profits from developing countries to the places with the most favourable tax situation or greatest apparent safety. Common to the other two channels for the transfer of profits – dividends and royalties – is the drawback that they can be ascertained and therefore also regulated whereas internal group settlement prices cannot be easily checked. Vaitos' Andes study to which reference has been made has shown that the multinational corporations must be expected to make very massive use of their opportunities. Thus, internal price manipulations by the multinationals cannot be left out of account if a realistic picture of the profit and capital transfers from the developing countries is to be presented.

The price manipulations can essentially take two opposite forms. One consists of spurious price increases – the so-called overpricing – of goods which the parent company or subsidiaries in the industrialized countries supply to the group enterprises in the developing countries. These may be typical input goods such as semi-manufactures or machines or else finished products to be marketed by the branches of the group. Imports generally account for a very high proportion of the total multinational group input – probably as much as 50-70 %.<sup>23</sup>

<sup>20</sup> Cf. UNCTAD, Major Issues Arising from the Transfer of Technology to Developing Countries, New York 1975, p.25.

<sup>21</sup> Ibid. p.27.

<sup>22</sup> Cf. OECD, 1976 Review, p.412.

<sup>23</sup> Cf. UNCTAD, Dominant Positions ..., op. cit., p.29ff. and the studies quoted there.

**Table 4**  
**Capital Inflows and Outflows of the Developing Countries (in US\$ bn)**

	Average 1964-1966 or 1965	Average 1970-1972 or 1971	1973	1974	1975
(1) Capital flows from developed countries	11.3	19.4	33.8	40.7	54.9
(2) of which: Direct investments	2.1	3.5	6.7	7.1	10.2
(3) Interest retransfer	1.0 <sup>a</sup>	2.1	3.2	4.3	5.5
(4) Profit retransfer	3.5	6.6	11.5	30.1 <sup>a</sup>	10.9 <sup>a</sup>
(5) Royalty payments	0.9	2.6	3.7	4.5	5.4
(6) Subtotal (3 + 4 + 5)	5.4	11.3	18.4	38.9	21.8
(7) Net transfer from developed countries (1 minus 6)	5.9	8.1	15.4	1.8	33.1

<sup>a</sup> Own estimates.

Sources: Cf. previous tables.

Another possible form of clandestine profit transfers is the fixing of unduly low prices – underpricing – for the exports by subsidiaries of multinational enterprises in the developing countries to their parent companies or other subsidiaries in the industrialized countries. What proportion of the total sales is exported by the subsidiaries in the developing countries depends of course on their orientation either to exports or to sales in their domestic market but it may be assumed in either case that the bulk of their exports will be handled by the parent company or its marketing organizations so that it mainly represents intragroup trade. A recent study on the activities of multinational enterprises in Brazil and Mexico, quoted by UNCTAD<sup>24</sup>, put the share of exports in 1972 at 73 % and 82 % respectively. The scope for manipulation of export prices corresponds to these figures.

### Empirical Evidence

There is some empirical evidence for both kinds of price manipulation, the overpricing of imports and the underpricing of exports. The most detailed study of overpricing is that by Vaitos to which reference has been made several times before. His findings rest on such a wide basis that they can be thought to be of general validity for he examined the pricing practices in four important branches of industry, not in one developing country alone, but in four Andean countries, namely Colombia, Ecuador, Peru and Chile and came across quite definite indications of substantial overpricing by the multinationals.

Only the data for Colombia, which may be regarded as representative for the Andes study, will be reproduced here<sup>25</sup>. Vaitos found the overpricing to be most marked in the pharmaceutical industry where the

import prices of the multinational companies at the time of the investigation exceeded the average world market prices by 155 %. The general level of overpricing in developing countries is probably reflected more accurately by the 40 % found out in Colombia's rubber industry, 25.5 % in the chemical industry and between 16 and 60 % in the electronic industry. Other investigations in the Latin American and Asian areas confirm Vaitos' findings of serious overpricing<sup>26</sup>.

The empirical evidence for underpricing is very limited. An econometric study by Müller/Morgenstern which is often quoted in this connection is based on material relating to the largest Latin American exporters of manufactures in 10 countries. It shows that the firms conducting their exports preferentially on an intragroup basis – mostly foreign-owned firms – value their exports on average by 40 % lower than nationally owned or joint-venture enterprises. The authors regard underpricing as the only possible explanation for this difference. The data relate however solely to exports to other Latin American countries. As far as exports to other areas are concerned, the authors were unable to ascertain significant results. A possible explanation for this is that there are large numbers of "tax havens" in Latin America, e. g. Panama, Barbados and Trinidad/Tobago, which the multinationals use as profit depots<sup>27</sup>.

### A Scenario for All LDCs

As mentioned, the hitherto existing studies focused on the Latin American area. To indicate the possible dimension of the losses suffered by all developing countries together through internal price manipulation

<sup>26</sup> Cf. R.J. Barnett, R. Müller, *Global Reach*, New York 1974, p.159, as well as UNCTAD, *Dominant Positions* ..., op. cit., p.38ff. and the studies quoted there.

<sup>27</sup> Cf. R. Müller, R.D. Morgenstern, *Multinational Corporations and Balance of Payments Impacts in LDC's*, in: *Kyklos*, Vol.27, 1974, p.316ff. The authors found confirmation for their results in various other case studies in Latin American states, cf. *ibid.*, p.306.

<sup>24</sup> Cf. UNCTAD, *Dominant Positions* ..., op. cit. p.25ff.

<sup>25</sup> Cf. C. Vaitos, *Inter-country Income Distribution and Transnational Enterprise*, Oxford 1974, p.47.

Table 5

### Estimated Losses of the Developing Countries (excl. Oil Countries) from Clandestine Profit Transfers by the Multinational Groups (in US\$ bn)

	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
Exports of the developing countries	29.0	31.5	31.8	34.3	39.2	44.2	46.0	54.7	80.4	122.8	117.9
Multinationals' share of total exports <sup>1</sup>	9.6	10.4	10.5	11.3	12.9	14.6	15.2	18.1	26.5	40.5	38.9
Loss to developing countries from underpricing <sup>2</sup>	6.4	6.9	7.0	7.5	8.6	9.7	10.1	12.1	17.7	27.0	25.9
Imports of the developing countries	37.0	40.6	41.4	44.3	49.1	56.5	62.6	69.5	96.5	136.5	151.0
Multinationals' share of total imports <sup>3</sup>	12.3	13.5	13.8	14.8	16.4	18.8	20.9	23.2	32.3	45.5	50.3
Loss to developing countries from overpricing <sup>4</sup>	1.7	1.9	1.9	2.0	2.3	2.6	2.9	3.2	4.5	6.3	7.0
Total losses	8.1	8.8	8.9	9.5	10.9	12.3	13.0	15.3	22.2	33.3	32.9

<sup>1</sup> Estimated proportion: 33%. See the explanations in the text on this and the following figures;

<sup>2</sup> Assuming 40% underpricing; <sup>3</sup> Estimated proportion: 33.3%; <sup>4</sup> Assuming 16% overpricing.

Source for export and import figures: UNCTAD, *Handbook of International Trade and Development Statistics*, New York 1976.



by multinational corporations the over- and underpricing rates ascertained in Latin America are in the following assumed to be equally valid for all developing countries. What is being presented is a scenario<sup>28</sup>. But there is nothing at present to suggest that the multinational groups behave differently in Asia or Africa than they do in Latin America.

The oil countries will however be left out of our calculations. Here the multinationals seem to be more inclined to practise a policy of overt profit transfers, as is shown by the fact that the overt profit transfers from the oil countries are many times larger than those from all other developing countries. The oil combines are probably forced to practise this policy because the oil prices are fixed and their host countries have set up a very rigid control system since they receive a share of the earnings from the oil business in the form of various levies. Besides, the oil combines are only to a relatively small extent acting as importers.

The notes to Table 5 show how the hypothetical losses of the developing countries from clandestine profit transfers by multinational groups have been calculated. The starting point for the calculation are the current export and import figures of the developing countries (including the backward countries of Europe but excluding the oil countries). The import figures for 1974 and 1975 have however been corrected additionally to allow for the higher cost of oil imports to avoid distortion of our results by this factor.

The estimates for the share of the multinational groups in the foreign trade of the developing countries are based on empirical studies, as are those for overpricing and underpricing, and that again with regard to the Latin American area. In a study quoted by Müller/Morgenstern for example it was established that US subsidiaries in Latin America in 1966 accounted for 33 % of all exports from the region<sup>29</sup>. An earlier study by Pizer and Cutler<sup>30</sup> had shown that US subsidiaries handled one third of all Latin American imports from the USA. Our calculations are based on these figures.

That the developing countries are shown to have suffered distinctly smaller losses from overpricing than

from underpricing is entirely due to the adoption of a very low overpricing rate – 16 %<sup>31</sup>. Even so the total losses of the developing countries from transfer pricing are of such amazing dimensions that there is no need to settle upon higher rates. On the stated assumptions the clandestine profit transfers would work out at nearly US \$ 9 bn for 1966, over US \$ 20 bn for 1973 and US \$ 30 bn in the following years. The hidden profit transfers would thus have been twice or three times larger than the official ones, and if the profit transfers from non-oil exporting developing countries alone are considered, the hidden transfer would be more than ten times higher.

### LDCs as “Net Capital Exporters”

An entirely different picture emerges if, as the next step, the profit transfers effected by the multinational groups through manipulation of their internal settlement prices are added to the other capital reflows as ascertained before. Instead of being net importers of capital the developing countries are now seen to be “net capital exporters”. Our estimates of the hidden profit transfers by the multinationals are admittedly hypothetical but a precise determination of the effects of transfer pricing on a global level is in any case impossible. A vast amount of information – in theory about every single settlement – would be needed for it, and this is out of the question, if for no other reason, because it concerns internal group transactions. We could therefore attempt no more than to indicate of what order the sum total of the clandestine profit transfers from developing countries would be if the findings of the case studies on underpricing and overpricing were universalized. However, if the covert profit transfers are even approximately of the stated dimensions – and so far everything speaks for it – the developing countries would in reality have to be regarded as “capital exporters”<sup>32</sup>.

Under the stated conditions the capital outflow from the developing countries – their loss of capital – rose relatively continually between 1964 and 1973 by US \$ 2.2 bn to US \$ 6.8 bn. In 1974 it advanced dramatically to US \$ 31.5 bn but this was not entirely due to the covert profit retransfers which may be assumed to have taken place in that year – the explosive rise of overt profit transmissions was a more potent factor. In 1975 the developing countries would even have recorded a small surplus of US \$ 0.2 bn. At the moment it is still impossible to say whether this points to a tendential change. The result would be in any case that the developing countries had on balance to bear substantial capital losses in the period under review.

<sup>28</sup> To err rather on the side of caution, the calculation uses the minimum figures.

<sup>29</sup> Cf. H.K. M a y , *The Effects of United States and Other Foreign Investment in Latin America*, Council of the Americas, 1971.

<sup>30</sup> Cf. S. Pizer, F. Cutler, *U.S. Exports to Foreign Affiliates of U.S. Firms*, in: U.S. Department of Commerce, *Survey of Current Business*, No.12, 1965. The same result was reached in a later study on Brazil. Cf. UNCTAD, *Dominant Positions* ..., op. cit., p.29.

<sup>31</sup> The losses attributable to overpricing would of course be correspondingly larger if a different rate of overcharging than that used by Vaitos were applied.

<sup>32</sup> The transfer pricing of the multinational groups also provides a further explanation for the tendential deterioration of the terms of trade of the developing countries.