

Capital Movements

How Harmful for Development?

MAINSTREAM ECONOMIC THOUGHT HOLDS that world capital should flow from developed countries where capital is abundant, to developing countries where capital is scarce and thus receives a higher return—much as rivers flow downstream.

Contradicting this theory, international capital movements have resembled rivers flowing upstream in recent years. In 2000, World Bank data showed developing countries were transferring more capital to developed countries than they were receiving in return. In economic terms this is considered a “current account surplus.” In 2000, the river of capital was flowing upstream—from South to North—to the tune of more than \$43.5 billion, or 0.8% of developing countries’ GDP (Gross Domestic Product).

East Asian countries accounted for much of this surplus from the South because they have, in effect, been financing a consumption binge in the United States. But, taking into account interest and dividend payments, the data also show capital moving Northward from Latin America and the Caribbean (LAC).

Many LAC countries accumulated large debts in prior decades—often to finance corrupt and repressive dictatorships. The public continues to pay interest on this debt, and continues borrowing to do so. In standard measurements of the current account, the aggregate of these transactions is counted as a capital transfer from the North to LAC. This is misleading because these countries are often not, on net, receiving any new money for development. They are now generally paying out more in interest than they are borrowing.

If LAC and the North had mutually terminated these transfers—so that the North made no new loans and LAC ceased to pay interest—then the region would have had nearly \$5.5 billion more in capital at its disposal in 2000. Instead, it suffered a \$45.4 billion deficit with the North.

South-to-North capital transfer also occurs through intellectual property (IP) claims, including royalties and licensing fees for copyrights and patents. Such claims impose a somewhat arbitrary cost on technology-importing countries. Without these protective government measures, a new invention can benefit anyone, with no cost for the right to use it. In fact, the vast majority of today’s developed countries ignored the IP claims of foreign governments and openly copied technology in their early phases of development.

That rivers of capital are flowing upstream contradicts neoliberal theory by suggesting developing countries are not necessarily capital-constrained and can grow quite quickly when there is demand for their products. Moreover, when interest payments are taken out of the equation, many poor regions have capital to spare.

When this adjustment is made, the LAC region is still only a modest net exporter of capital, relative to other regions, largely due to its poor export performance and low terms of trade for its products. And these factors, too, are influenced by the way the most powerful countries dictate the terms of international trade, further insuring the ongoing transfer of wealth from poorer to wealthier nations.

The current pattern of capital movements—where LAC compensates the North for loans that are not a net gain and for technological innovations that were free for the North in its “take off” period—partially explains why the continent’s development continues to be hindered. Indeed, these and related trends, enforced by policies promoted from the North, have been said to effectively “kick away the ladder to development” for many aspiring economies of the South. No wonder many East Asian countries decided to throw out most of Washington’s policy recommendations, instead becoming lenders to the very countries that sought to deny them a way up. ■

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