INTERNATIONAL CAPITAL MOVEMENTS

By BERTIL OHLIN

THERE is perhaps no other branch of economic theory which has been subject to so much scientific discussion in the 1920-ies as the theory of international capital movements. The litterature in this field has become enormous. Carl Iversen has rendered a great service to all economists in presenting a complete picture of this whole doctrine, including its development from the classics and up to its present status. It is safe to say that his »Aspects of the Theory of International Capital Movements«[1]) will for a long time remain the standard work in its field. Iversen shows a rare ability to summarise the essentials of the theoretical constructions of others, even in the case of authors who themselves completely lack ability of presentation.

There is, of course, a danger in the mastership Iversen has acquired in presentation of doctrines presented by others. Attention may be drawn from the task of making new and original contributions. Iversen has attempted very little of this in the present book. But this does not mean that his work cannot be regarded as a real scientific achievement. At least for my part, I refuse to accept the not uncommon but curious standard of valuation, which, in science, regards as important only the invention of new ideas. It is often more difficult and much more important to put the pieces of material provided by others together to a well balanced whole. Considerable waste of effort would have been avoided in economics, if economists had been brought up, as workers in the natural sciences have been, to start from the points reached by others instead of assuming that a cursory glance at a few earlier writers is all preparation required.

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limitations of the existing theories lie and the need for their expansion. But he makes very little attempt to follow up his own suggestions or those which he has taken over from others, pointing out that they are well justified.

I find very little — and nothing important — to criticise in the way in which the author has dealt with the existing theory. He has, perhaps, exaggerated the difference between the »classical« and the »modern« doctrine. Instead of discussing such questions of emphasis I shall in the following deal exclusively with questions, where there seems to me to be a real need of analysis beyond the points where it has been pushed so far in this field. What I have to say is, therefore, indirectly a criticism of the whole existing theory in this field including my own writings, quite as much as a criticism of Iversen's book. But I shall connect what I have to say with certain passages therein.

1. Like Nurkse, myself and others, Iversen bases his whole reasoning on static equilibrium ideas. Such a construction is rather different from the theory of international capital movements which must necessarily be an account of a time using process. Iversen is not, of course, unaware of this fact that a theory of capital movements must be a description of a process (see p. 486) or that anticipations are important (see p. 505), but like earlier writers he underestimates the obvious consequences concerning the limited usefulness in this field of the equations of the Walras-Cassel type (see, however, p. 13). He also neglects to describe in detail the different stages of the process which is started by a new capital movement. On the whole, he confines himself to a discussion of the »mechanism«, which seems to take a couple of years into account, and a brief treatment of the long run effects. In my opinion, analysis of the extent of the price changes caused by capital movements is impossible, if one does not consider a number of successive stages. The distinction between the »mechanism« and the »long run effects« needs to be carefully scrutinized. How can one know anything about the latter without having first followed up very carefully the process of change over a number of years? Can one rule out the possibility that the special circumstances, which may dominate the »mechanism« in some cases but not in others, will have so much influence on the later long run effects that the conventional static analysis of the latter is unsatisfactory? E. g., borrowing abroad may lead to »overinvestment« and a pronounced boom, followed

by a severe depression, and this process may involve so much waste of capital that the increased supply of the latter which is supposed to be the »long run« effect of the borrowing fails to appear. In brief, is there any other legitimate method of analysing the effects of international capital movements than one which takes step by step? Iversen would probably like myself answer this question in the negative, for he says explicitly that the theory of international capital movements at present belongs to the realm of »historical dynamics« (p. 13).

Anyone who attempts to make the theory more »dynamic« in this way will probably have to pay a lot of attention to recent monetary theory which has made some progress towards the working out of a usable methodology. It would seem that e. g. Mr. D. H. Robertson's writings and the Stockholm theory of saving and investment have some contributions to make to the theory of international capital movements[1]).

2. The failure to utilize the recent litterature in monetary dynamics is reflected in Iversen's treatment of so fundamental a concept as »buying power«. Particularly for the theory of capital movements, which he adheres to, and for the analysis of the monetary transfer this concept is fundamental. Iversen seems to accept my earlier definition — which was made at a time when the theory of money was much less developed than to-day — that the available buying power is governed by the aggregate of incomes, depreciation, international capital movements, and inflationary or deflationary credit policy. A construction of this sort obviously implies that income during period number 1 is only »available« during period number 2. Otherwise, the buying power obtained through an inflation of credit cannot be added to the buying power obtained from income. Such a construction and use of the period method is very different from the static equilibrium constructions which the author usually bases his reasoning on. One has the feeling that he is not quite aware of this. A treatment of »buying power« in the alternative way, which I have used in my book of 1934 (»Penningpolitik etc.«), would have been more easily brought into harmony with a theory of the process of capital transfer. On the whole, Iversen does not seem very clear on the complex of problems connected with the distinction between ex-post and ex-ante (see p. 24).

[1]) See particularly Hammarskjöld, Konjunkturspridningen, Stockholm 1933.

Another important question, which has not yet been answered clearly, is also raised by Iversen's book: W h a t is it that is transferred through an international movement of capital? In other words, what meaning is to be given to the word »capital«? His answer is »f r e e c a p i t a l d i s p o s a l«, the source of which is new savings or depreciation. The latter is the same as the amortisation of capital assets or »the quota of the capital disposal previously invested which is set free«. Personally, I have come to regard this »capital disposal«, when it is not used only as a summing-up concept in an ex-post book keeping, as an unnecessary mystification. Is there more in the talk about a transfer of capital disposal than the following: Certain monetary units or credit instruments are handed over from some people in one country to some people in another country? The consequence of the use of these instruments for purchases elsewhere than where they would otherwise have been used, if at all, is that certain stocks of commodities move to the borrowing country or fail to move from it. Thereby the supply of such commodities is increased there and reduced in the lending country, with certain important qualifications connected with the possible influence of this process on the quantities produced in the various countries. Or, to put all this briefly: Means of payments and commodity stocks, i. e. real capital, move. Is there anything more in the talk about »free capital disposal«? Not as far as I can see. But the term suggests that something which is not embodied in capital goods is transferred. This is wrong. Just as it is impossible to store up free capital disposal, so it is impossible to transfer it internationally. Iversen points this out (p. 44), but his terminology may obscure it. In my opinion, to describe ex-post what has happened in terms of a transfer of capital disposal is t h e s a m e t h i n g as to explain the movement of the commodity stocks. Therefore, one cannot deny that it is »real« capital that moves. And it would be wrong to suggest that the thing that moves is »free« or available for investment any more than other commodity stocks.

Touching upon the question of transfer, I should like to add something about the »causa efficiens« of the »real« transfer, i. e. of the movement of commodities. Is this primary cause »the monetary transfer« which takes place in the form of a movement of gold or foreign exchange? Can nothing happen until a f t e r the monetary transfer, unless the supply prices of international goods are changed? In my opinion the answer is in the negative. The mere agreement about an international loan may lead to a credit

expansion in the borrowing and a credit contraction in the lending country, without any international monetary transfer. Thus the foreign trade may be affected before the time when the monetary transfer begins, as is also stressed by Iversen. One can go one step further and suggest that even without any change in credit the loans may change the willingness of people to use available cash reserves and bank deposits to buy goods. Thus, the shift in the demand curves may be the result simply of this changed willingness to buy. As payments are not made until the goods are received, which is often months after the order is given, there is plenty of time for the monetary transfer to take place.

3. Iversen like most earlier writers seems to assume some kind of »equilibrium« on the capital market to start with but without explaining what this equilibrium means. Naturally, it is possible that the international capital movement disturbs this »equilibrium«. If so, it is important to know what kind of inflationary and deflationary processes are set up. Furthermore, it is necessary to describe such processes in all the cases, where there is no »equilibrium« to start with. In other words, the interrelation of the international capital movements and the capital markets in the countries concerned must be explained. Otherwise, the mechanism has not been described.

If one adopts more consistently the method of a »process analysis«, then it becomes obvious that one has to deal also with cases where the capital movement starts under conditions of inflationary or deflationary processes. The order of events and, thus, the whole mechanism is different in different cases of this sort. In a depression prices will react differently and probably more slowly than in a boom. Their reactions can be explained only in terms of the changes of the capital markets. Besides, the whole capital movement may be the outcome of such a process in a way which one cannot explain by a comparison of Walrasian mutual interdependence equilibrium systems. The »basic« changes in these systems which can give rise to capital movements do not exhaust the possibilities (see pp. 94 and 127). E. g., changes in the credit policy of banks or in the expectations of business men cannot be ignored.

In my opinion, Iversen could have made a very important contribution, if he had followed up Axel Nielsen's suggestions of connecting the international capital movements more with the domestic capital markets, utilizing also parts of Hammarskjöld's analysis in »Konjunkturspridningen«. It would also have been use-

ful if he had taken up certain suggestions by Keynes concerning the price influences that may come from the unbalancing of the capital markets through international borrowing and lending. In one place (p. 300) the author seems to promise such a discussion, only to forget it later on.

4. It is surprising that even the books on capital movements, which have been written during the depression, pay so little attention to the importance of »unused resources«. E. g. in the treatment of the mechanism, attention is concentrated on the price changes and little is said about the variations in the quantities of factors of production employed and of goods produced. The increase in income and buying power from home market industries in a borrowing country will often come more from increased employment and production than from price changes. Secondly, any discussion of the effects of capital movements, which does not pay much attention to the changes in employment, leaves out something essential.

5. One of the worst difficulties for the theory of capital movements as dealt with by the classics and by the Harvard school is the treatment of »outside countries«. In my opinion, it would be worth while to explore further the alternative approach which has been suggested and used by Mr. Folke Hilgerdt. A very considerable part of capital movements have always gone from industrialised countries to nations which export chiefly food stuffs and raw materials. Hence, changes in the capital flows must have something to do with changes in the relative prices of more or less manufactured commodities. To approach the problem from this side of different products or different areas of production — each including several nations — has the advantage of permitting an easier comparison of facts and reasoning. It also tends to bring considerations of business cycles more naturally into the analysis from the beginning. I cannot but feel that much remains to be done through an attack on the problem from this angle.

6. An obstacle in the way of a simple explanation of both international capital movements and international trade in general comes from the special difficulties connected with the factor of production capital and its price. Most writers in this field — Nurkse is an exception[1]) — deal with capital as with any

[1]) Ragnar Nurkse, Internationale Kapitalbewegungen, Wien 1935.

other factor of production, and pay very little attention to its special characteristics. Let me raise a question: When a country is deprived of many of the advantages of international trade and the productiveness of its industry therefore declines, will the fall in the reward to the factors of production mean not only lower wages and rents but also lower interest rates? (Iversen takes it for granted that this will be so, otherwise a statement on page 139 is false). It seems to me quite possible that the decline in rents obtained from various capital goods will lead to a fall in capital values and not to any reduction in the rate of interest. That the total of interest income in terms of goods will decline is another matter. Indeed, it is hard to see why the outcome could not be a higher interest rate. The ability and willingness to provide new savings may decline more than does the curve of marginal profitability of new investments.

Another difficulty connected with capital concerns the measurement of its quantity. Static concepts like number of days of embodied labour are not of much use in an investigastion into processes of change like those caused by international transfers of capital. Is it perhaps possible to do without any measurement of the total quantity of capital in each country? One could conceivably regard all capital goods in the same way as natural resources without reducing them to a common denominator. The question of the rents accruing to these capital goods and resources is, of course, entirely different from the height of the rate of interest which expresses the scarcity of capital in the sense in which it is relevant, e. g. when new investments are to be made. The rate of interest has only a very indirect connection with the supply of capital goods, not more than with the supply of natural resources. Its height is not determined so simply as the Walras-Cassel reasoning indicates. These equations have no time dimension and refer to an equilibrium. Actually, the rate of interest may vary considerably even if the quantities of the different productive factors, as conventionally measured, are constant. Political uncertainty in some countries can make for pessimistic expectations. Hence, interest rates there, after deduction of »risk rents«, may be lower than in some other countries, where political conditions are stable but the quantity of capital goods — however measured — much greater per individual.