FOREIGN CAPITAL AS AN INSTRUMENT OF NATIONAL ECONOMIC POLICY

A STUDY BASED ON THE EXPERIENCE OF
EAST EUROPEAN COUNTRIES BETWEEN THE WORLD WARS

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by

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PREFACE

The task of rehabilitating the underprivileged countries requires that all resources, foreign capital included, be harnessed for the benefit of mankind. Today, financial transactions accross national borders take place at an unprecedented scale, and greater international mobility of capital is often recommended as a means for the attainment of economic stability and development. However, the promise that such mobility will augment the borrowers' capital stock often remains unfulfilled. Thus the essential purpose of international lending – to promote the well-being of the debtor countries by improving their productive capacity – could be subverted.

Since the elimination of economic deprivation is the dominant problem of our time, the crucial test of the effectiveness of external borrowing and lending should be whether these transactions help to increase the capital stock and the productivity of impoverished regions. In view of these objectives, I have endeavored in this study to determine (a) the impact of foreign capital on over-all investment, incomes, and employment; (b) the nature of the interdependence between a country's internal and external balance as they relate to international capital movements; and (c) the appropriateness of national policies purporting to promote economic stability and development with the aid of foreign capital.

This study of a closed chapter in the history of six East European countries was undertaken with the intention of shedding some light on a question with which our century will remain preoccupied: what role can be assigned to international capital movements to promote economic stability and development. Obviously, the advancement of East European economies required a rapid rate of investment. But while their ability to generate capital internally was limited, foreign sources of capital were arid and not dependable. In fact, the already existing debts became an additional burden during the commercial and financial crisis of the early 1930's.

The evidence suggests that not only in the industrial but also in the less developed economies, the objective of maintaining price stability and an equilibrium in the balances of payments conflicts with an urgent need to absorb underemployed resources into production. Passive submission to the vicissitudes of the world-wide business cycle by countries like Poland proved burdensome and unjustified especially since short- and long-term foreign credit was inadequate and unreliable. In contrast, positive monetary and fiscal policies pursued by Estonia, Latvia, and, later, Hungary successfully stimulated investment and tended to maintain full employment of resources.

With regard to the efficiency of resource allocation, a conclusion is reached that investments attributable to foreign capital should be supplemented by intensive domestic investment programs in order to achieve a more balanced pattern of capital allocation.

Unfortunately, even well-intentioned unilateral policies could be subverted by a chaotic international environment. Thus, unreceptiveness to imports and other irresponsible policies in the creditor countries contributed to the balance-of-payments crises in the debtor countries, especially in view of the ever-increasing outpayments of debt services. Indeed, international co-operation might be a most reasonable undertaking of governments which claim to be guardians of their citizens' welfare.

I sincerely hope this monograph will be of value not only to those concerned with the history of East European countries but also to those interested in the broader problem of international capital transfers in our times. International financial problems acquire special significance when viewed from the standpoint of the interests of small "insignificant" countries. Similar to the predicament of most underdeveloped countries today, Eastern Europe between the World Wars found itself on the fringes of the financial and commercial world. Nevertheless, foreign capital assumed a key role in the functioning of these economies since its significance was magnified by the scarcity of real and monetary capital. Given the similarity of conditions in the less developed countries and Eastern Europe, it is clear that current policy thinking can gain by analyzing the inter-war experience and assessing the policies of that time. Unwillingness to seek the lessons of history may cause recurring disappointments for both the debtor and the creditor nations.

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