Europe has been a center of international finance for several centuries, as the Italians, the Dutch, and the British followed in each other’s footsteps. Britain assumed the mantle of chief purveyor immediately after the Napoleonic war, but after a disastrous flurry with lending to Latin America in the 1820s, concentrated for the next three decades on Europe and North America, and did not lend significant sums to what is now the Third World until after the creation of the Indian Empire in 1857. Thereafter Britain was joined by France and Germany, and at the end of the century by the United States, which had previously been one of the largest borrowers. The development of the Third World did not begin until the last third of the nineteenth century when this flow of finance began to finance the railways, ports, and other infrastructure without which commerce could not move.

Although foreign capital was important to the Third World, the Third World in the nineteenth century was not all that important to foreign capitalists. In 1913 only about one-third of outstanding investment was in the Third World (excluding Argentina). The bulk of the investment was in Europe, North America, and the other temperate countries of recent settlement. Foreign investment and imperialism do not coincide.
It is particularly important to note that foreign investment was not based on the rich countries lending to the poor countries. Per capita income was higher in the United States or Australia or Argentina, which were borrowers, than it was in the United Kingdom, France, or Germany, which were lenders. If income per head were the chief determinant of self-sufficiency in finance, we could not answer the question posed by opponents of foreign aid: namely, if Britain and France were saving enough to be lending in the middle of the nineteenth century, when they were not much richer than Ceylon or Brazil is today, why cannot the developing countries now save for themselves all the capital they need?

In the nineteenth century the distinction between the European lenders and the rich borrowers turned on differences in rates of urbanization. Those whose urban populations were growing by less than 3 percent per annum (France 1.0, England 1.8, and Germany 2.5) loaned, and those whose urban populations were growing by more than 3 percent per annum (Australia 3.5, United States 3.7, Canada 3.9, Argentina 5.3) borrowed.

Urbanization is a decisive factor because it is so expensive. The difference between the costs of urban development and rural development does not turn on the difference of capital required for factories and that required for farms. Each of these in a small part of total investment, and the difference per head is not always in favor of industry. The difference turns on infrastructure. Urban housing is much more expensive than rural hous-
ing. The proportion of urban children for whom schooling is provided is always much higher, at the stage where less than 60 percent of children are in school. The town has to mobilize its own hospital service, piped water supplies, bus transportation. In all these respects the towns require more per head in terms of quantity than rural areas, but even if quantities per head were the same, urban facilities would cost more in money terms than rural facilities. Rural people do more for themselves with their own labor in such matters as building houses, or working communally on village roads or irrigation facilities. When they hire construction workers they pay less, both because of a generally lower price level and because they are not faced with powerful construction unions. Rural people also do not hire architects.

The cause of these high rates of urbanization has been population growth—in Europe in the nineteenth century and in the developing countries in the second half of the twentieth century. Rural people have to move when population starts to grow, because this menaces the family farm. The family farm can be passed on intact if about two and one-half children per family survive to age of reproduction, of the eight or so born into the average rural family. As the number of survivors increases, the farm is threatened with dismemberment unless some sons move out. If there is plenty of land, as in West Africa, they can move out to make new farms or to seek employment on other new or expanding farms. If there is little new, cul-
tivable land, they look to the towns. They will not go to the towns unless employment is known to be expanding there. If there is no work in the towns, or on other farms, the sons stay on the family’s farm, which is then cut up into smaller and smaller pieces in the way with which we are so familiar in Southern Asia and the Middle East.

Therefore, in countries where all the land that can be cultivated without great expense is already occupied, the natural increase in the rural population seeks employment in the towns, once economic development has begun. The quantitative significance of this migration depends on two factors, the rate of natural increase of the population and the already existing ratio of urban to total population. At the end of the nineteenth century, Germany’s population was growing at about 1.2 percent per annum. The urban population was 48 percent of the whole. To absorb the whole increase, the urban population had to grow at a rate of 1.2 divided by 48, i.e. by 2.5 percent per annum, which is exactly what it was doing. By this time emigration from Germany had virtually ceased. In Latin America, the population increases at about 3 percent per annum, and the urban population is already about 50 percent, so to absorb the whole natural increase the towns would have to grow at 6 percent per annum. This also is just about what the Latin American towns are averaging; the rural population remains constant while all the natural increase is accumulating in the towns. Asia and Africa cannot reach this condition be-
cause, though their population growth rates are about the same as the Latin American or even lower, say 2½ percent, their current urbanization level is lower still, say about 20 percent, so if the towns were to take all the natural increase they would have to grow at 12½ percent a year, which is virtually impossible.

The evidence suggests that in a complex industrial system whose interdependent parts must grow in some sort of balance if profitability is to be retained, employment in manufacturing and mining cannot grow faster than about 4 percent per annum. Japan has the fastest growth rate, and its industrial employment grew in the 1960s only at 3.8 percent a year. The figure for the United States in its heyday before the First World War was 3.5 percent a year. The U.S.S.R. reached 4.6 percent per annum in the 1930s but was then producing mainly armaments and factories to make armaments, which is a relatively simple system; in the 1960s, industrial employment in the U.S.S.R. grew only at 2.5 percent a year. It looks as if a complex industrial system cannot expand employment at more than 4 percent a year.

The problem is not so acute in Africa, where there is still plenty of land, as it is in South Asia, where there is not. Given its population growth rates, South Asia needs both more cultivable land and also more employment in agriculture per acre. These are its two highest priorities. This is not just a matter of providing work, over and above what non-agricultural activity can reasonably be ex-
pected to provide. It is also a matter of providing food for an exploding population. But even with all that can be done to make more employment in agriculture, rapid urbanization remains inevitable.

Urbanization would not be inevitable if industry could be spread around the countryside instead of concentrating in towns. This has been a deliberate objective of Mao’s China. There are, however, two limits to what is possible. One is that people will migrate to the towns if they are allowed to do so; hence a system of permits to reside in the town, ruthlessly enforced, is an integral part of such a policy. And, second, industry is itself gregarious; most industrialists prefer to establish themselves in existing industrial centers, which already have not only the requisite physical infrastructure but also the network of institutions that binds industrial establishments together. One can work hard at establishing rural industries, but except in police states, success is bound to be limited.

The financial dependence of the developing countries on the developed is not due to their poverty, since even the richest countries have been borrowers. Neither does it derive from their unwillingness to save. Net domestic saving of the developing countries averaged about 10 percent a year in the 1960s, which is not very different from the ratios of Britain or France in the 1860s, when they were already lenders and not borrowers.

The developing countries’ dependence for finance derives ultimately from their high rates of population growth, and intermediately from their
high rates of growth of urbanization—around 5 percent per annum and more—to which this population growth gives rise. Population growth has already started to diminish (urbanization seems to be the basic constraint on population growth), but the dependency on borrowing will probably continue until the rate of natural increase drops to about one percent per year. Thus, it is likely to be with us at least until the end of this century.

It should be noted that dependence on international borrowing and dependence on foreign entrepreneurship are not the same thing. Britain was still borrowing from the Dutch in the eighteenth century, though not using Dutch entrepreneurship. The importance of direct private investment in the international flow is always greatly exaggerated, both by those who oppose it and by those who believe that it should be the principal channel for foreign transfers. The current scope for direct foreign investment is rather small. Plantations, public utilities, and mines were the usual sectors for private foreign investment up to 1929. The investment in plantation companies, which was associated with the movement of Indian and Chinese labor across the world, ended after the First World War as that movement ceased, and the investment of foreign capital in agriculture is now almost zero. Investment in public utilities is also at an end. Part of the reason for this is that it has become the conventional wisdom that public utilities should be in the public sector, so the private utilities are being bought out one after another. In addition, inflation
kills public utilities because their costs rise faster than their prices, which are usually subject to elaborate public control. No knowledgeable person would put private money into Third World public utilities today. In the 1950s and 1960s the unprecedented growth of world industrial production created a large demand for minerals, including oil, and this sector became a magnet for foreign private investment. However, its very profitability has killed it. One after another, the governments are buying out the mineral enterprises, usually at substantially less than their market value, so this sector will no longer attract much private foreign investment. The other profitable sector was the financial sector, including banking and insurance. This sector took money out of the developing countries, rather than putting money in, so the developing countries have been clamping down here as well.

As these traditional sectors for private foreign investment fade out, the new sector is manufacturing industry. It is at present a reluctant contributor; it is the only sector in which Third World governments are actively encouraging foreign investment, and they are finding fewer takers than they would like. Here the emphasis is not on finance but on technology and management. The share of manufacturing in gross investment is rather small, and, if it were only a question of money, most developing countries could finance their manufacturing sectors without foreign involvement. The foreigner contributes two things, a market connec-
tion and managerial expertise. He may also contribute technology, but in the standard light-industry factory the technology is well known, and one can purchase a new cement factory or a new textile factory virtually off the rack. Advanced technology is relevant only in a few highly sophisticated industries such as computers, motor cars, or petrochemicals, and these are of immediate interest only to large, already industrially sophisticated countries such as Brazil, Mexico, or India. Current discussion of international investment as if it were mainly a problem of handling multinational corporations is quite out of perspective.

The developing countries will depend on foreign borrowing long after they have ceased to depend on foreign enterprise.* One should note that the Communist countries are now among the biggest debtors, alleged to be owing the Western world some $32 billion. It is the fast pace of urbanization that makes a country short of capital rather than a dependence on managerial expertise.

* I have said nothing about the need of oil-importing LDCs to borrow money to finance their balance of payments deficits because this is a separate problem, so large and urgent in itself that an immediate solution has to be found, in the shape of medium-term loans from oil-producing countries to LDCs, through one channel or another. In this paper I confine myself to the relationships that developed over the century up to 1973 since these are likely to continue for some time.