

Deepak Lal, *Appraising Foreign Investment in Developing Countries*, Heinemann, 1975, £6.00.

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This work is 'aimed at providing decision-makers in developing countries with the necessary tools to determine the net social benefit to them from the operation . . . of particular acts of private overseas investment (POI)'. The tools put forward are the Little-Mirrlees (LM) method of social cost-benefit analysis.

The viewpoint of the author, a leading contributor to the development and application of the LM methodology, is that POI should be seen as one of several alternative sources of finance, technology and expertise; he aims to provide a method of quantifying the social costs and benefits of POI so that developing countries can enter the bargaining process with foreign companies armed with adequate data on the effects of POI. The study is divided into five parts of varying length and depth of analysis. Part I provides a brief and selective review of 'the dimensions,

determinants and effects' of POIs in developing countries. Published data on the size and direction of POI flows are given; there is a brief review of the literature on the determinants of POI, and an introductory section on its effects. Part II contains the theoretical core of the work. The author shows how the LM methodology can be applied to POI projects. Most of the analysis is a straightforward adaptation of the known methodology, but there is some original work of the author's on the derivation of income distribution weights. Also, the theory of effective protection is incorporated explicitly into the analysis. Part III is a study of POI in India, including brief introductory sections on Indian government policy towards POI, historical data on POI in India, discussion on the alleged effects of POI, and four case studies of chemical plants. Part IV includes three sectoral case studies from Kenya: of food processing, tourism and cables. Finally, Part V is a very brief discussion of the fears of many host countries concerning the effects of POI, categorised by the author as 'non-economic' arguments against it.

The work represents the first systematic attempt to apply the recent developments in the field of social cost-benefit analysis to POI projects. However, as a set of guidelines it has a number of limitations.

First, Part II, the theoretical section, gives insufficient attention to the problems of applying the LM methodology in practice. The emphasis of the LM approach is on the importance of quantification as a guide to micro-level decision-taking; 'strategies' which stress unquantifiable externalities and linkage effects are disparaged. However, it is important to remember that the national parameters necessary in order to apply sophisticated project evaluation techniques in a meaningful way are extremely difficult to estimate realistically. The problems involved cover both data collection and conceptual issues, and the discussion on national parameters would have been strengthened if the limitations of the values used had been brought out more clearly. Externalities are another area in which realistic quantification is difficult. It can be argued that in many instances external effects will be a very important aspect of POI projects; where a relatively weak indigenous industrial bourgeoisie exists the entry of multinational firms may have a severe inhibitory effect on its future development. The author is aware of this danger but states that he is concerned with an economy in which aggregate investment is limited by the availability of savings, rather than the inducement

to invest. His problem of the allocation of a given level of resources is not necessarily the most significant, however.

The LM methodology uses world prices as a measure of social value for all 'traded goods'. There is a basic ambiguity regarding world prices for many commodities, so that there is not necessarily a given set of prices at which an economy can trade. Prices of capital equipment, key inputs into industrial projects, will vary with suppliers and terms of supply offered. The phenomenon of transfer pricing means that prices charged by multinationals can vary with different host country tax policies. Again, these practical problems receive too brief examination.

Second, the presentation of the case studies is unsatisfactory for teaching purposes. The POI projects examined are not placed adequately in the context of their particular industries: one would like to know more about the Indian chemical industry or Kenya tourism and how these have been affected by POI. There are also only brief discussions concerning some of the objections which have been raised against POI in these countries. Important issues such as the limitations of technical collaboration agreements and the alleged capital intensity bias of POI are raised, but not illuminated by the case studies. Furthermore, the manner in which the case studies are presented is not as useful as it might have been. Tables of benefit and cost flows are given for the Indian projects, but not for the Kenyan studies. The latter appear to be merely a recording of results and the reader cannot use these studies to illustrate particular points. The Indian projects, while given in more detail, are not adequately explained. In some it is by no means clear how the alternative benefit flows differ from each other. In view of the work's intention, which is to provide a set of guidelines, these limitations to the case studies are significant.

The danger of the approach used, that of treating POI as discrete, separable acts of investment, is that many of the broader issues, of which the author is clearly aware, are ignored because they are impossible to quantify or even identify at the level of the individual project. Project analysis is a useful complement to wider planning strategies, and POI projects must be evaluated in terms of policies for particular industries, and the alternative sources of finance, technology and expertise. There is sufficient evidence of the dangers of reliance on POI, only some of it cited by the author, for the view that the interests of host countries and globally oriented multinationals can often diverge.