II PRIVATE FOREIGN INVESTMENT: IS IT USEFUL?[1]

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It is a premise of much writing on economic policy that private foreign investment is necessary for development. This is often seen to be so self-evident as to require little explicit justification.

That this view is so widely accepted is, on reflection, surprising. There is little evidence that the leading industrialised countries developed largely as the result of an impetus provided by foreign investment. Those cases of successful development in which private capital flows have played a major role (e.g. Canada, Australia, South Africa and, in more recent years, Puerto Rico) typically involved the transfer of private capital as part of a wider set of cultural and political interrelationships not at all similar to the situation now facing the developing countries. It is interesting to

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1 An extended version of this article, with specific reference to East African conditions appears in Private Enterprise and the East African Company, ed. P.A. Thomas, Tanzania Publishing House, Dar-es-Salaam. A well argued article by Frances Stewart "Private Investment: A Hostile View" just published in Venture touches on important income distribution, structural and political effects not treated here, but well deserving consideration. Giovanni Arrighi provides a brilliant critical analysis of the role of the multi-national corporation in Africa in his forthcoming volume of essays.

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note that two of the most conspicuous success stories of development in this century, Japan and the Soviet Union, both developed under conditions in which the role of direct private foreign investment was severely limited.

If private foreign investment were generally beneficial, it might be supposed that the advantages flowing from it would have been particularly great in the colonial situation, when conditions were peculiarly appropriate for private capital movements. The unbalanced character and limited extent of colonial development in most l.d.c.s gives reason for caution in casting private foreign investment in a leading role in the future.

It has been a weakness of much development thinking that many of the most difficult development tasks have been assigned to foreign capital, with great expectations of both aid and private investment.

The case for emphasising private foreign investment may be examined by considering the three _a priori_ arguments which may be advanced in favour of such a policy. These are:

(a) that private foreign investment is desirable as an addition to the net resources available for development;

(b) that such capital flows are likely to be of significant size, as capital is likely to flow from rich countries (where it is plentiful) to poor countries (where it is scarce); and

(c) that dependence on foreign enterprise is unavoidable because the lack of entrepreneurial talent and technical know-how in the less developed world

eliminates the possibility of effective domestic-based development.

The contribution of additional net resources

It seems self-evident that more foreign exchange and capital are required if higher rates of development are to be achieved. However, private investment creates an ownership claim on the nation's resources which remains as part of the subsequent economic structure. In addition to any political or social considerations which might limit the role appropriate to foreign investment, the creation of a large segment of foreign-owned capital brings with it problems of a purely economic character. Profit is necessary to provide an incentive for the foreign investor. From the point of view of the recipient economy, foreign investment provides access to foreign exchange in the present, in payment for which a flow of investment income will be transferred to the foreign investor in the future. As development is a notoriously lengthy process to be achieved over decades, if not generations, the impact of foreign investment has therefore to be considered over the long period. And one of the objectives of economic policy must be to avoid the extreme balance of payments problems which have eliminated economic flexibility and reduced the political independence of a number of poor countries in recent years.

For a country which has to develop over the long haul, the initial task is not so much to achieve the highest growth over any given short period, but rather to create the conditions for sustained growth. It is necessary to concentrate on the effect of an investment project on future foreign exchange availability. The net change in the situation resulting from a project will be determined by a combination of three effects:

(1) the profits accruing to foreign nationals (which will be a charge on the current account of future balance of payments);

(2) the net import substitution (or export promotion) resulting directly from the project (which will hopefully have a favourable effect on the trade element in future balance of payments); and

(3) the indirect impact of the project on the balance of payments

At the extreme, over-enthusiasm for foreign investment combined with inadequate industrialisation policies result in the combination of the first and second effects being negative. If, for example, a project involves no more than the final stages of assembly, and incorporates a large proportion of imported components, and if the output of the project is heavily protected, profits may be higher than the import reduction resulting from the project. And the rate of profit expected by foreign investors is high enough for such an outcome to be quite possible.

Even if the net effects of (1) and (2) are positive, the addition of the indirect effect of the increase in imports resulting from the increase in local incomes derived from the project may lead to deterioration of the balance of payments situation. Now, it may be justly argued that such indirect effects are not attributed to the project and would have resulted from an increase in income whatever its source, although a large foreign sector may often go along with consumer import bias. Certainly, following a period of foreign investment, it is not unusual for the balance of payments situation to deteriorate with a continuing high

ratio of imports to total economic activity and a growing element of foreign claims on local income. The result is that if great amounts of foreign capital are imported, subsequent development plans incorporate even higher foreign investment goals. An ever increasing proportion of the economy becomes foreigh-owned. The investment acts like a drug which provides a stimulus, but which can only continue to take effect if the dosage is steadily increased.

It is still possible to argue that the economy nevertheless is likely to grow faster than would be the case in the absence of the foreign investment. Surely the economy must be better off than if the investment did not take place at all ?

This may be true to an extent; however, it must be recognised that many foreign investments are not marginal contributions in the sense that if foreign finance were not available, those projects would not be implemented. Rather, as a result of foreign finance some of the domestic finance which might have been available for such projects is diverted to other investment opportunities - the foreign investment is enabling the finance of some other project from local sources which would otherwise not have been implemented and which may make less of a balance of payments contribution. Also, it is likely that dependence on foreign finance will reduce the domestic savings effort - for example, by reducing pressure on the economic authorities to exert discipline in mobilisation of domestic resources and restraint on imports. Typically, public investment concentrates on the development of overhead facilities, the provision of which creates the conditions in which profitable foreign investment can take place. In the absence of foreign investment, the domestic savings effort may be greater, the rate of profit

on locally financed investments higher, and the balance of payments situation at a given income level sufficiently much better to allow a higher rate of growth over the longer period.

The case for a foreign investment will be strong if it can be demonstrated that in the particular case the required injection is temporary in nature, and that the project would not be implemented in the absence of foreign finance. The adoption of an overall strategy of heavy dependence on foreign private investment is fraught with a number of long-term dangers which are rarely fully recognised.

The likely flow of investment funds

It is not necessarily the case that capital is relatively scarce in the poorer countries, that is relative to commercially attractive investment opportunities. Poor countries often find themselves in a "low level equilibrium trap", where the economy stagnates and there is a lack of investment opportunities because of the general poverty, but where the poverty can only be alleviated through expanded investment. In such a situation, private investment decisions will be inadequate to promote growth. Even within the rich countries regional disparities have often not been eliminated through the movement of private capital - there are numerous examples of countries within which private investment decisions have tended persistently to widen regional disparities. Certainly in recent years private foreign investment has not been a net contributor to the resources available to the less-developed world, when flows of investment income to the more developed world are subtracted from new investments.

One readily available form of private finance is short-term credits made available for the promotion of machinery sales or

construction contracts. Such credits are often guaranteed by export credit guarantee arrangements in the exporting country. Short-term credit is clearly a valuable source of finance if kept in its place. Repayments come due soon and must be met over a short period. Excessive use of such credits leads to balance of payments inflexibility, as was the case in Ghana, where an excessive resort to such financial arrangements left the financial situation particularly vulnerable to fluctuations in export earnings. The danger of excessive reliance on such finance is increased by the fact that this is an area in which some of the sharper international business practices are to be found, in the cut-throat world of competing export promotion among the rich countries.

Reliance on expatriate know-how

The third line of argument mentioned above is altogether more convincing. Even if dependence on foreign investment has its dangers as a long-term strategy and the prospects for such investments are poor, there seems to be no alternative because of the lack of local technical and administrative know-how. Foreign investment brings with it technical knowledge and effective organisation. This is more important than finance. The underdeveloped condition not only involves a poverty of physical resources but also inadequate institutions for development. It is in this direction that the case for foreign investment is most compelling.

Lack of knowledge is not just a matter of shortage of "skilled man-power", as defined by manpower planners, which may be readily eased by ensuring the education of sufficient numbers of the relevant technicians. The successful corporate enterprise, whether publically or privately owned, involves something more than

the collection of assets found in the enterprise. The corporate form represents not only a legal ownership relationship, but is, more important, a social institution far from fully described by a mere enumeration of the individual parts.

The role of the multi-national corporation is of sufficient potential importance to be compared with the great chartered companies that played such an important role in extending European hegemony over so much of the rest of the world in the seventeenth through nineteenth centuries. If such corporations are emerging today as the dominant influence on transatlantic economic relations any discussion of foreign investment in the less developed world must also take account of them.

These companies are, of course, willing to invest throughout the world. Indeed, in a systematic and rational fashion they seek out investment opportunities to extend themselves into the remotest parts of the globe. They colonise with products. They create new tastes, establish new needs, exploit new sources of raw materials. That this can contribute to a certain form of economic growth is undeniable; whether it can become the basis for long-term development is more debatable. The problems involve not only questions of economic arithmetic posed above, but also the implications of such styles of investment for the emerging structure of the less developed world. The problem can be summarised by asking whether such investment activities can lay the foundation for an indigenous growth process sustainable over a sufficiently long period to lead to development, or whether enclaves of alien economic activity are created which will form the basis for future stagnation.

The techniques, the product designs, the social organisation of the enterprise will all

be cosmopolitan, responding to the needs of the multi-national corporation, predominantly based in the developed world, sensitive to the conditions existing in high income countries.

In particular, foreign investment projects will be largely concentrated in import substitution industries. Typically, a high rate of profit will be ensured by protective arrangements. In many cases value added will be a low proportion of final value of the output of the project, inputs at an advanced stage of manufacture being imported. The investor thus lays claim to a protected market not only for the net output of the project but also for the inputs produced by the firm overseas.

This form of investment will not to any considerable extent produce manufactured exports nor will it create industries with considerable linkage effects but low levels of profitability.

"Follower nations" which have succeeded in catching up, have done so through ingenious combinations of technological borrowing and institutional innovation, with the creation of forms of business organisation appropriate to the period and the local circumstances. There is a need to create an environment in which there is a high degree of mobilisation of resources for development. This requires, in a broad usage of the term, high levels of entrepreneurship. The senior management of the large multi-national corporation are often mobile, shifting from country to country. Designs and major investment decisions emanate from head office. Indeed, this is the advantage such a corporation has to offer - access to an international pool of talents and ideas. It can certainly establish plants and produce new products. Does it, however, create the conditions in which there will be high levels of local entrepreneurial activity? Does it breed a generation of indigenous business organisers?

Often, among Western commentators, the encouragement of foreign investment is seen as the necessary prerequisite for a capitalist pattern of development. Even if such a path to development were desirable in principle, or possible in practice, the creation of an indigenous capitalism may require the protection of incipient indigenous capitalists. The encouragement of foreign investment is likely to exhaust the most straightforward industrial development opportunities. With the most readily established industrial activities pre-empted, it will become increasingly difficult for the less-developed countries to create an industrial base capable of competing with the industrial power of the developed world. Short term growth may be achieved at the expense of longer term development.

The success of the policy of dependence on foreign investment, at least in the short term, must rest upon the generation of a belief among potential foreign investors in the orthodoxy and stability of the environment. Such confidence will be precarious, easily unsettled not only by changes in objective conditions but also by the subjective responses of the foreign investing community to the larger political environment. The danger is that the sensibilities of foreign investors are to be satisfied by political decisions inconsistent with the political stability they claim to desire. Broadly, the more conservative the political and social environment, the more the situation is viewed as "sound" by the foreign investor. Conversely, when governments pursue that minimum of nationalist and radical policies necessary to ensure their own survival, there is a decline in foreign commitment. Such factors constitute a special disadvantage of a strategy heavily dependent upon foreign investment in societies in which, for the foreseeable future, a wide range of political experiment is not only desirable but also inevitable.