

Holthus, Manfred

Article — Digitized Version

## Aspects of foreign investment policies

Intereconomics

*Suggested Citation:* Holthus, Manfred (1973) : Aspects of foreign investment policies, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 08, Iss. 12, pp. 367-369, <https://doi.org/10.1007/BF02929679>

This Version is available at:

<https://hdl.handle.net/10419/138937>

### Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

### Terms of use:

*Documents in EconStor may be saved and copied for your personal and scholarly purposes.*

*You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.*

*If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.*

developing countries and were trying to adapt their methods to those aspirations. As a recent United Nations study has put it, "Host developing countries are, moreover, suspicious of the multinational corporations' style of doing things. Their financial power and easy access to the top hierarchy of government and

business may be used, openly or covertly, to influence the domestic political process to their liking. Such alien influence is especially resented by local élite groups, such as intellectuals, government cadres, labour and business leaders, who see themselves as contenders for power and guardians of the values and

heritage of the country. The multinational corporations, through their tacit alliance with certain social groups, may even be regarded as obstacles to appropriate social and political development."<sup>6</sup>

<sup>6</sup> In this connexion see "Multinational Corporations in World Development", document ST/ECA/190, United Nations, New York, 1973, page 57.

## Aspects of Foreign Investment Policies

by Manfred Holthus, Hamburg

**E**xperiences made in the "First Decade of Development Aid" clearly show that the provision of capital has so far not proved to be an effective remedy. Apart from the fact that the envisaged amount of capital flow was not achieved, the industrialisation effect was obviously also smaller than had originally been expected. A drop of the LDCs' share in world exports followed more or less automatically. Foreign exchange proceeds were not realised and balance-of-payments deficits became more severe.

It has become clear that the prevailing situation keeps an extension of development aid within narrow bounds. From this aspect, private direct investments are gaining increasing importance. Their special advantages for the recipient countries are due to their contribution to cover capital requirements, discharge of the balance-of-payments, transferring know-how and technology, creating jobs, contribution towards diversification of the production and export structure.

However, apart from these favourable effects of direct in-

vestments there are negative ones, too, viz.:

☐ The foreign enterprises might be an economic and political factor of power and exercise an undesired influence on the policy of the country concerned.

☐ The possibility exists that the investors make too high profits, which they transfer abroad and thereby cause a negative balance-of-payments effect and, moreover, practise a sort of exploitation.

### The LDCs' Dilemma

It follows therefrom that the LDCs in consideration of their development policy must offer incentives to as many foreign investors as possible for starting or extending production, on the one hand, and should eliminate, or at least minimise, possible negative effects of such investments, on the other hand.

Although these objectives are clear and plausible, it is difficult to materialise them. For measures which offer the required investment incentives, frequently favour the undesired practices and behaviour of enterprises. Conversely, measures which are to

eliminate negative effects of direct investments, possibly prevent foreign enterprises altogether from making investments in the country concerned.

The policy of most of the LDCs is highlighted by this dilemma. Some aspects of this policy are worth to be analysed in detail with a view to their efficiency. The measures most frequently applied to avoid possible negative effects of direct investments are regulations limiting the share of foreign capital at 49 p.c., at most. One accepts knowingly that the propensity of foreign enterprises to invest in this country will probably diminish, but one feels that this disadvantage is made up for by the fact that part of the capital proceeds will remain in the country and that the new corporation will be subject to domestic control.

It cannot be assumed in general that advantages and disadvantages are always well balanced. The market concerned must be very attractive, indeed, and hold out excellent prospects and high profitability rates for investments so as to avoid that the propensity to invest ceases completely. This implies that the

country must have reached already a certain stage of development.

### Problems for Investors

It is an error to assume that the foreign partner is unwilling to accept a 49 p.c. participation for the only reason that he fears the control. It is rather a matter of very concrete economic problems. The starting phases of an investment are very much longer in LDCs than they are in industrial regions. The period during which losses have to be borne and investments for extensions and replacements have to be made at the same time, is correspondingly long. The domestic partner, however, is often not in a position to provide the required capital. Since his share of capital must not drop below 51 p.c., necessary investments have to be postponed or omitted. This may jeopardise the success of the investment altogether. Furthermore it may happen that the dimension of the first production unit is too small due to the limited funds of the domestic partner. If, on the other hand, the investment is carried through by the foreign enterprise alone, the right dimension of the first unit and the financing of the initial phase is secured.

As long as capital accumulation is the bottleneck of the LDCs, it is not necessarily advisable to limit the foreign capital share at 49 p.c. This holds good even if the domestic partner is a public authority since its investment possibilities are fully absorbed by infrastructure investments.

### Limitation of Share

The limitation of share is dubious for another reason, too; for it must be doubted whether the control function of the domestic capital share comes to bear. To begin with, it must be stated that all countries, which have introduced such limitation of share, have always made exceptions

when they considered the relevant investment to be absolutely necessary, but the foreign investor was not prepared to carry it through unless he had a 100 p.c. share. But exactly such cases of an investor's proven power potential would call for control. Moreover, this results in a legal uncertainty which must not be underestimated.

Secondly, it must be questioned who the domestic partner is, whether the government with its institutions or a private enterprise is concerned. If the domestic partner is a private enterprise as well, it should be borne in mind that private interests are not necessarily identical with public requirements. Hence, the major part of possible conflicts is not inevitably precluded. If the domestic partner is a public authority, the question is, whether the desired control effect cannot better be achieved in another way.

What is it actually that is to be controlled, and what is the aim of such control? Essentially it is a matter of restricting economic and political power as well as preventing any possible exploitation. From the exceptions made it becomes evident that at least the restriction of economic power is not always enforceable by limitation of the share. Experience has shown that, in principle, this is feasible only if the LDC is vested with a correspondingly strong compensating power or, in other words, if the interest of the foreign investor is extremely great.

Such compensating power might exist in the field of raw materials, but it is often weakened by competition of the LDCs among themselves. Only a common policy of the supply countries can remedy the situation, as was evident from the example set by the oil countries. A limitation of capital share, however, is not an effective cure. But the LDCs concluding cartelised

supply agreements must be aware of the fact that, in doing so, they provide a continuous effective incentive to the ICs' technological progress in developing substitute products.

Within the manufacturing industries such compensating power can arise only if a self-supporting process of development with promising profitability rates is already under way. The example of Japan has shown that within the manufacturing industries share limitations can then be enforced over a long period without impairing the foreign enterprises' propensity to invest.

### Prevention of Exploitation

Things are somewhat different in respect of preventing exploitation. If the government or one of its institutions is the domestic partner, it will surely be possible to prevent that domestic labour is employed at unsocial conditions and unjustified high profits are realised thereby. But for this purpose the government does not require a high capital share. The same effect could be achieved by other regulations, such as laws on termination of appointment, on child welfare, on the constitution of enterprises, to mention only a few. However, through its capital participation the government can exercise a certain additional control over the formation of prices of the produced goods. But to a certain extent only; for the formation of prices depends a great deal on the cost situation which sometimes is largely determined by intercompany price standards. The domestic partner, however, can on no account exercise through his capital share an influence on the formation of these prices.

What is said so far does not, and should not, mean that direct investments are possible and sensible only if the investor holds a 100 p.c. share. In many

instances he will look out for a suitable domestic partner in order to participate in his special knowledge of local conditions and his contacts. The point has merely been to prove that, apart from some few exceptions, general legal limitations of foreign capital share considerably diminish the flow of foreign private capital and, for another thing, cannot exercise the control expected from these measures.

### **Investment Selection by Sectors**

Another step to balance favourable and unfavourable effects of foreign direct investments is the selection by sectors. For this purpose the industrial spheres are classified in two different categories, and whilst direct investments are admissible in branches of the one category, they are prohibited in industries of the other category. This measure is sometimes combined with regulations on foreign share limitation.

Provided that this method is consistently applied and the protected branches are adequately selected, it is probably the best form of intervention to safeguard national interests. It is a prerequisite, however, that the number of branches is not too great in respect of which, for strategic, political, or economic reasons, foreign influence is to be precluded at any rate, and which are thus forming the negative list. Since, as a rule, spheres of activity such as transport, production of energy or raw materials are concerned, whose development is of decisive importance for other sectors of the economy, it must be ensured that the required capital can be raised in the country or procured by borrowings abroad.

It is thus avoided that the LDCs' limited own funds are split between many small projects. Moreover, the most important spheres are fully controlled and remain free of con-

flicts with foreign firms or even governments. In all other spheres, foreign capital is either right from the outset allowed to flow into the country unimpeded, or the individual branches are gradually released in accordance with national development plans.

### **Balance-of-Payments Objectives**

A third complex of measures has arisen mainly from the economic necessity to yield foreign currency. To this end direct investments are conditioned on the obligation to export the total production, or at least a high percentage, of say 80 p. c. This regulation is sometimes still restricted to certain regions, the so-called export zones. Here the investors are given specifically directed incentives by eased import regulations.

As far as foreign enterprises can be attracted to the country in spite of these regulations, the balance-of-payments objectives are, of course, achieved in an ideal manner. It cannot be doubted, however, that the propensity to invest diminishes to the extent to which peremptory export shares rise. The higher the part of production is that is to be exported, the more difficult becomes production planning since it is usually more difficult to forecast the situation of export markets than that of domestic markets, unless the parent company's country of domicile is concerned.

Furthermore, it should not be overlooked that such measures possibly result in an one-sidedness of production and thus of the export structure, whereby the success may be jeopardised in the long run.

The most important objection to such export obligations, however, results from the interrelation of international economic systems as well as from the fact that the decision to invest in

foreign countries in spite of existing stringent export obligations, depends primarily on the availability of skilled labour. Considering the relatively low wage level, the investor has temporarily a comparative advantage; the advantage is temporary in that the investor's competitors will soon follow suit and try to find equivalent local conditions in another country. Then, at the latest, competition again will start by rationalisation methods. Consequently, by making exports peremptory, the LDCs import the tendency towards technological unemployment, a tendency which, anyway, is becoming one of the problems in development policy.

### **Import Substitution and Diversification**

Very important, and nearly generally applied is the method to provoke direct investments by raising import barriers while liberalising capital imports at the same time. The success of this measure cannot be denied. It has, however, to be borne in mind that a certain automatical selection is connected therewith. Only those foreign companies will make direct investments, which have hitherto made substantial exports to this country. For the LDCs these investments, therefore, have the effect of a substitute for imports.

The described measure thus is the tool of a development strategy, which is to bring about the process of industrialisation mainly by substitution of imports. Experience has shown that this policy soon encountered its limits. It cannot be overlooked that industrialisation was pushed forward and the production structure was diversified thereby. At the same time it has to be noted, however, that the effects on employment could not keep up with the growth of population and the balance-of-payments difficulties were not considerably reduced.