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Policy Options for the UK

by Professor Max D. Steuer, Legon, Accra *

In 1973 the Department of Trade and Industry has published a commissioned study of the effects on Britain of the inward flow of foreign direct investment. The present article summarizes some of the conclusions of this report, but is not meant to be a review of it, as it is written by its principal author.

One must feel some sense of irony when the United Kingdom begins to worry about incoming direct foreign investment. The English have the longest and broadest tradition of capital exporting of all kinds, including direct foreign investment. And while their basic policy continues to be one of welcome to the inward flow of direct investment, in recent years both Labour and Conservative Governments, the trade unions, business interests and the general public, at least as reflected in the mass media, have been expressing concern about international capital movements and the rise of the multinational firm. In 1968, a major study was undertaken by W.B. Reddaway and his colleagues of the economic effects on Britain of the outward flow of capital from the United Kingdom.¹ And now, five years later, the Department of Trade and Industry has published a commissioned study of the effects on Britain of the inward flow of foreign direct investment.²

Concern over Foreign Multinationals

At the present time it is fair to say that concern over foreign multinational companies operating in the United Kingdom is not as great as similar host country concern in France, Japan, and many low income countries. But it is obvious that some concern is there and we may begin by asking why. Human inconsistency is part of the explanation. It is one thing for us to invest abroad, and another thing for others to invest here. The very rapid post war rise in investment is another factor, along with the dominance of investment from the United States, it being about 85 p.c. of the new investment in the sixties. The oligopolistic nature of multinational firms and the tendency for direct investment to concentrate in science based industries are additional factors. The changed nature of direct investment must also be included,

with subsidiaries tending now to be links in a worldwide integrated production and distribution complex rather than self-contained units that happen to be owned abroad. And also the multinational firm changes the power relations between employers and trade unions. These are the main background factors inducing worry that inward direct investment may involve harmful economic and political effects for host countries, including the United Kingdom.

A list of possible sources of harmful effects is not the same thing as establishing that they exist, let alone measuring their importance and comparing the costs to the potential gains to the United Kingdom. The purpose of the recent British study is to examine these possible effects more scientifically, with an eye to appropriate policy action with regard to direct investment. This article summarizes some of the conclusions of the study and the bases for them.³ These conclusions are best seen in the context of the policy choices open to the United Kingdom.

A basic question for Britain is whether to press for concerted and coordinated action with regard to multinational firms involving cooperation among many governments, or to rely primarily on unilateral policies to control foreign investment. The Steuer Report favours the latter, at least for the present, because of its judgement as to the difficulty of achieving such cooperation, and because international cooperation could well result in greater loss of sovereignty for Britain in itself than that due to multinational firms. In addition, the purely national policy options seem adequate to the task. (This conclusion should not be extended to the less developed countries where competition among them to attract foreign investment often results in subsidizing the foreigner through tax holidays, tariff protection, and infra-structure pro-

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¹ W. B. Reddaway et al., *Effects of United Kingdom Direct Overseas Investment: Final Report*, Cambridge University Press, 1968.

² M. D. Steuer et al. *The Impact of Foreign Direct Investment on the United Kingdom*, H.M.S.O., 1973.

³ This article clearly is not in the way of a review of the British study, as it is written by the principal author of that Report. The other authors of the Report are Peter A bell, John Gennard, Morris Perlman, Raymond Rees, Barry Scott and Ken Wallis.

vision to such an extent as to wipe out the receiving country gains.)

The strongest national option open to the United Kingdom is a total ban on foreign direct investment. New investment can be prohibited, and existing investment nationalized or ordered to wind up and withdraw. There are two general grounds for doing this, anti-capitalism as such and the desire to minimize the impact of foreign, and particularly American, life styles and political influence in one's country. Neither of these grounds seem applicable in the British case. Nationalization of a single link in an internationally integrated production complex is likely to be expensive and to add little or nothing to domestic income.

Selective Prohibition

One can, of course, operate a selective ban and this in two senses, either prohibiting investment in certain British industries, or excluding particular foreign firms while allowing others. The authors of the Steuer Report were unable to find any rational grounds for operating either type of selective ban. (They did not address themselves to military considerations.) They are more sympathetic to establishing an overall upper limit on the proportion of foreign investment, possibly achieving this through special taxes on incoming capital, while recognizing an inevitable arbitrary element in the choice of that upper limit. The grounds for such a policy, they argue, would not be economic, but rather possible political considerations which could manifest themselves at significantly higher levels than the current level of foreign capital, and are not present at that level. The authors emphasize the sometimes neglected point that the relevant choice is not between having a particular enterprise being domestically instead of foreign owned, but rather between having the foreign owned enterprise operating here or operating elsewhere.

Regulation of Foreign Firms

Next in the hierarchy of policy options comes regulation of the foreign owned firms. Mandatory domestic equity participation is a form of regulation, and one that the Steuer Report does not favour. It is a costly and highly uncertain policy, as well as an inefficient means of influencing the behaviour of foreign owned subsidiaries. Direct regulation is more certain in results and cheaper to apply. On purely economic grounds, there is no reason to believe that equity participation in subsidiaries is more profitable than participation in the entire organization. And if participation is to be selective, civil servants do not have an

enviable record in choosing profitable ventures. The essence of participation is that it reduces the volume of foreign capital, an end, if desired, to be better achieved by other means.

A common area for regulation in many countries, including the United Kingdom, is allowable debt borrowing in the host country. A full consideration of this option involves macro-monetary issues, including the international monetary system. These issues go beyond the brief of the authors of the Steuer Report. Staying within their topic, they see no compelling reason to change the current policy of limiting debt borrowing to normal short term working capital.

Effects on Technology

Consideration of the effects of foreign capital on British technology plays a big part in this Report, and here the authors strongly oppose both the general Servan-Schreiber position of the dangers of technological dependence⁴ and the particular British policies currently in force. The basic British aim has been to try, through regulation and the imposing of conditions on the foreign investor, to achieve a position where foreign industrial complexes engage in research in the United Kingdom rather than concentrating this activity in the parent country. The Report finds no good reasons for this policy either on economic or other grounds. As the supply of scientists and technologists is limited in the short and medium run at least, and as foreign firms doing research in Britain employ almost exclusively British nationals, insisting that multinationals engage in research in Britain simply reduces the number of scientists and technologists in United Kingdom owned domestic industry, assuming full employment of this type of labour which is a broadly accurate assumption. At the very least the policy of encouraging or forcing foreign research in Britain is inconsistent with the brain drain fears also present in that country. It makes no difference whether a British scientist goes to work for Ford in America or for Ford in England. In either case his output becomes the property of the foreign multinational. If we oppose it in one form, it makes little sense to encourage it in another form.

Location of Foreign Investment

Both current regulations with regards to the location of new industry and the unregulated behaviour of the foreigner setting up a new establishment tend to result in much foreign investment

⁴ J. J. Servan-Schreiber, *Plan, 1967*, published in England as *The American Challenge*, Hamish Hamilton, 1968. It is interesting to note that much of his argument is illustrated by a presumed superiority of the Americans in the field of commercial supersonic aircraft, and the presumed profitability of this alleged advantage.

being located outside of the main domestic conurbations. While this type of investment in the relatively high unemployment regions is likely to have especially beneficial effects on domestic income, the authors of the Steuer Report were keen to see if it carried with it undesirable social and political effects in contrast to the situation where the foreign subsidiary was located in the midst of many large domestic firms. A case study based in Scotland revealed little or no such effects. An important factor in explaining this conclusion is the reluctance of foreign subsidiaries to concentrate in a particular development region and so become collectively the principal employers. Their demand for skilled labour, combined with reluctance to do much training, precludes such concentration.

The Steuer Report does recommend that more legislative attention be given to making it easier for unions to organize workers in foreign owned subsidiaries. While it is true that many domestic firms are also anti-union, they at least had to deal with potential unions when they were small newcomers. The foreign subsidiary starts from a position of strength, backed up as it is by the parent organization, and so calls for special regulation on this score.

Balance of Payments Effects

An error, both crude and common, in attempting to determine the welfare effects of foreign direct investment is to subtract repatriated profits from the initial inflow, seeing the balance as a significant indicator. This Report strongly urges instead measuring the time profile of domestic income, contrasting the situation with and without the foreign investment, and assuming optimum policies to achieve balance of payments equilibrium in both cases. This approach, which is certainly economically sound, tends to make the balance of payments effects looked at in isolation a completely unimportant and uninteresting question. While insisting on this position, the authors have complied with the British Government's specific request that they attempt to measure the direct investment effects on the British balance of payments. These effects will not be equal and opposite in sign to the effects on the source countries because of exporting to and importing from third countries consequent upon the direct investment.

To answer the balance of payments question, which as explained the authors argue to be not a very meaningful one, the authors employ a formal model taking account of such factors as the efficiency of the foreign subsidiary, its exporting behaviour, the import substitution effect (products are produced locally which formerly were imported), after tax profit repatriation, and the general

macro-economic effects due to the changed income level brought about by direct investment. Many of the empirical magnitudes are not known, and the Report employs an extensive simulation approach assuming a wide range of plausible magnitudes. The general conclusion is that incoming foreign investment is beneficial to the United Kingdom balance of payments, the extent depending fairly critically on the policies the Government employs to maintain internal balance. Roughly speaking, foreign investment contributes annually to the British balance of payments an amount on the order of 10 p.c. of the stock of foreign capital in the country.

Additional Aspects of the Steuer Report

In a brief summary of the lengthy Report it is worth mentioning some of the ground covered that does not immediately bear on the policy options for dealing with direct investment. Taking the years 1963 and 1968, the Report finds that the foreign subsidiaries are less strikeprone than their domestic counterparts. This is a surprising result in many ways, given the extra complications these subsidiaries have in industrial relations and the tendency for American firms in America to have more strikes than the British.

The Steuer Report examines the kind and degree of control exercised by parent organizations over subsidiary activity. The authors find some tendency for control to tighten over the period examined as subsidiary activity is more closely integrated into the multinational operations. For example, the size of investment that the subsidiary company can undertake without approval from the parent company tends to fall over time even as an absolute figure. The most interesting result in this area of parent company control is the contrast between the control exercised by the network company with subsidiaries in many countries and the simple parent/subsidiary case. This is new and relatively hard evidence of the changing nature of the direct investment phenomena.

While confirming other studies which highlight the essentially obligopolistic nature of much direct investment, this Report finds that for Britain foreign investment probably adds to the competitiveness of many industries. Obviously a similar result would not be found in countries which did not have large domestic firms operating in any case. Even apart from this consideration, the authors see fewer adverse effects due to monopoly than were felt to be found in, for example, the Watkins Report on foreign investment in Canada.⁵

⁵ Foreign Ownership and the Structure of Canadian Industry, Report of the Task Force on the Structure of Canadian Industry, Privy Council Office, Ottawa, January 1968.