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Changes in the Investment Climate in Developing Nations

Jack Baranson

CHANGES IN THE INVESTMENT CLIMATE IN DEVELOPING NATIONS

*Jack Baranson**

I. PATTERNS OF FOREIGN PRIVATE INVESTMENT

Beginning in the mid-19th century, foreign enterprises invested in banking, transport and utilities, but most of these investments have since been taken over by national interests. During the 1950's and 1960's, the great surge of import-substitution investments occurred, followed by investments in offshore manufacturing. From the developing countries' viewpoint, the attractions of foreign enterprises were that they brought capital, technology, and, in the case of export industries, access to world markets.

A. *Import-substitution under Protection*

Foreign firms moved into the market opportunities opened by import-substitution programs. These foreign firms were often in a highly favorable position to establish manufacturing operations because of their financial resources, management systems, and command of industrial technology. Inadequate domestic savings relative to expanded growth targets further generated demand for foreign capital as investment equity, particularly since less developed countries (LDC's) were unable to borrow sufficient financial resources on favorable terms.

Under the partial monopolies created by absolute protection of import-substitution programs, profit-taking was often substantial. Ironically, the largest incentives were given to highly protected luxury goods. In markets of limited size, production costs of end products, in terms of costs of foreign exchange savings, were high. The smaller the market, the sooner the range of "easy" import-substitution was exhausted. To maintain growth rates in the industrial sector, development authorities moved into an ever-widening product range.[1]

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* Managing director of Developing World Industry and Technology, Inc. (DEWIT Corporation), Washington, D.C. B.A., 1951, University of Wisconsin; M.A., 1956, Johns Hopkins School of Advanced International Studies; Ph.D., 1966, Indiana University.

1. Baranson, *Will There be an Auto Industry in the LDC's Future?*, 3 COLUM. J. WORLD BUS. 49 (1968).

B. *Export Processing Zones*

More than a dozen developing countries have established special regimes to attract foreign firms to take advantage of low-wage labor to manufacture for export. Among the earliest to develop programs in this field were Hong Kong, Singapore, Taiwan, Korea, and Mexico. In each of these cases, special incentives were provided in the form of industrial facilities, exemption from trade controls, fiscal and tax benefits, and assistance in recruiting and training labor. Singapore and Taiwan held wages down and even indirectly subsidized labor costs by providing fringe benefits in housing, transportation, education, and welfare, without taxing the foreign employers. Special industrial estates and export processing zones were established to reinforce and promote these efforts.[2]

C. *Raw Materials Extraction Enclaves*

In the 1950's and 1960's, foreign firms continued to expand investments in sources of raw materials. Oil and minerals headed this list of raw materials, but agricultural commodities and forest products were among the other natural materials sought from LDC's. The lack of capital and organizational means to establish their own distribution outlets in world markets made the LDC's heavily dependent upon foreign enterprise.

II. CHANGES IN THE 1960'S

As import-substitution and export expansion evolved, certain structural changes occurred that permitted developing countries to reduce their reliance on private foreign investment. Structural shifts in the supply and demand for certain raw materials have reinforced the developing countries' bargaining position vis-à-vis other foreign sources. Barter trade and international lending agencies also have helped reduce dependence upon private foreign capital. Moreover, the trends toward state socialism and the examples of Japan and socialist countries have reinforced this "weaning" process.

A. *Limits of Import-substitution*

By the mid-1960's the more advanced developing countries in

2. Baranson, *Clearing the Way for Exports*, 8 FIN. & DEV. pt. 1 at 7 (1971).

Latin America and Asia (countries such as Brazil, Mexico, India and Pakistan) had reached the limits of "easy" import-substitution. Further expansion has encountered the constraining factors of uneconomic production in markets of limited income and demand, and technical and managerial difficulties in the further proliferation of industries to supply materials and other industrial goods.[3]

B. *Limits of Export Expansion*

Several constraints to the further expansion of export industries began to be felt in the mid-to-late 1960's. Singapore began to run out of labor and land by 1969-70. The Singapore Government shifted its policies from unrestricted acceptance of foreign investment to a more discriminating screening of proposed projects. Aimed at increasing foreign exchange earnings per worker, the new criteria stipulated high-skill, high-technology industries; programs to upgrade the training of engineers and technicians were simultaneously introduced. In technical training at the university level, the new emphasis was placed on design engineering rather than on the former curriculum aimed at supplying engineers trained to operate imported technology. Foreign corporations also have been asked to share in the technical training programs by sending trainees abroad and releasing to the Singapore economy one trained national for every two they train.

In the export processing zones of Taiwan, Chinese factory workers often outproduce United States labor by 50 per cent or more, at approximately one-tenth the cost. Until now, this windfall has accrued almost entirely to the foreign multinational enterprise. There are now, however, rising LDC aspirations to share more equitably in this bonanza.

C. *The Shift in World Demand for Raw Materials*

Industrially advanced countries have been consuming minerals and energy resources at a phenomenal rate. For commodities such as oil and copper, demands have increased more rapidly than the development of new supply sources. Oil-rich countries have been

3. Baranson, *The Real Costs of Inefficient Industrialization,* in MEMORIAS DEL TERCER SEMINARIO LATINO AMERICANO DE QUIMICA 167 (Universidad Nacional Autonoma de Mexico, Facultad de Quimica ed. 1970).

eminently successful in forming cartels to raise world prices and their share of earnings. An expanding number of countries have expropriated mineral and energy sources, resulting in the progressive erosion of foreign investment and earnings bases in developing countries.

D. *Tightening Wedge on Foreign Investment*

In manufacturing industries, there also has been a tightening of controls and progressive erosion of foreign investments. From Eastern Europe, the Soviet Union, and, most recently, the People's Republic of China, developing countries have drawn examples of acquiring technology and know-how without foreign investment. State control of industrial enterprise, coupled with borrowing from other socialist countries to supplement domestic savings, has provided the basis for excluding private foreign investment.

Japan has served as another major industrialization model for acquiring foreign technology without foreign investment. Japan, however, had a unique set of circumstances that provided the basis for its model. The Japanese were able to mobilize their domestic resources sufficiently, so that with modest international borrowing, they could do without foreign capital. They also had the manpower and organizational skills to do for themselves what developing countries have heavily relied on multinational enterprises and international agencies to do for them. The Ministry of International Trade and Industry (MITI) and corporate trading companies have helped Japanese companies penetrate foreign markets and acquire technology without foreign investment.

Foreign enterprises have been criticized by developing countries on three grounds. First, is their extensive use of trademark and other proprietary industrial rights to earn substantial profits in captive protected markets and to secure a competitive advantage over technically weaker domestic enterprises. Secondly, rightly or wrongly, developing countries have grown increasingly resentful of the umbilical cords that tie management and technology to industrial affiliates, necessitating dependence on parent sources. These industrial affiliates are often fed obsolete technology, and even where technological parity is maintained, the needs for local design and engineering capabilities, particularly in vital domestic capital industries, are obviated. This structured dependence robs the developing country of the opportunity, and necessity, to develop technological self-reliance, which is the basis for industrial competitiveness in the modern world.

E. *Drive Toward State Socialism*

Ideologically and substantively, many developing countries have moved toward state ownership and management of "key" enterprises, which have included basic industries such as steel and petrochemicals; certain capital goods industries, such as automotive and farm tractor manufacture; and consumer goods industries, such as vegetable oils and bicycles. The supporting rhetoric has varied from price structuring arguments to the removal of excess profits or the maximizing of foreign exchange earnings. In some countries, domestic private enterprise has fared no better than foreign interests—Ceylon and Pakistan are cases in point.

III. PROSPECTS OF THE 1970'S

The changes of the 1960's point to two important trends in the 1970's—the continuing erosion of the foreign investment base and an expanding drive toward technological self-reliance. These tendencies have important implications for future operational modes of multinational corporations and for further adjustments in the world economy. First, developing countries will continue their efforts to eliminate foreign ownership and control of their industries and their preference for licensing arrangements and management services will continue to erode the foreign investment base. Secondly, developing countries will not be satisfied with the transfer of manufacturing techniques and related management systems. They will want to acquire design and engineering capabilities as part of the licensing arrangement in order to achieve technological self-sufficiency, at least in selected industrial fields.[4]

These trends have important implications for the future role of foreign enterprise in the economic development of newly industrializing nations. In place of the heavy reliance on equity investment as an earnings base, foreign industrial enterprises will have to repackage goods and services and price them accordingly. Just as multinational corporations in an earlier period shifted from marketing to manufacturing, so they will have to train new cadres of transfer agents and develop new operational modes to accommodate the emerging LDC demand for transferring design and engi-

4. Baranson, *Multinational Corporations and Technology Transfer to Developing Nations,* 1 PORTFOLIO—INTERNATIONAL ECONOMIC PERSPECTIVES (1974).

neering capabilities.[5]

For the United States, as for Europe and Japan, these trends mean further adjustments in the international division of labor, as developing nations acquire for themselves the standard range of industrial technology. If the United States is to maintain its technological lead, as a supplier of technology and management packages, from which an increasing share of its international earnings may come, maintenance of investments in research and development will be a critical factor.

5. Baranson, *The Changing Role of Multinational Corporations in the Technological Advancement of Less Developed Countries,* 23 ATLANTA ECON. REV. 17 (1972).