Unctad Meetings -
General

TDS 213 (1)

Mr. Paul Coidan, Director
Division for Conference Affairs and
External Relations

1 June 1970

S. Dell, Director
New York Office of UNCTAD

Working Parties and Study Groups

I have no comment on your memorandum of 27 May.

M E M O R A N D U M

To: All Directors 27 May 1970

From: Paul Coidan TDO.261
Director, Division for Conference Affairs MR/cr
and External Relations

Subject: "Working parties and study groups" and "commodity consultations"

... The attached schedule contains the meetings covered by the overall provision in the 1970 calendar for "working parties and study groups" (which for conference planning purposes also includes expert groups) and "commodity consultations". It would be appreciated if you would check the information concerning the meetings with which you are concerned and let me know whether any amendment is necessary.

It is my intention to include in the document to be submitted to the Board for its review of the calendar of meetings all bodies for which firm dates have been established. The overall provision will then be amended and information on any tentative meetings supplied only if requested by delegations.

I would also appreciate it if you would let me know of any meetings under these general headings which you envisage may be held <u>in 1971</u>, quoting the appropriate decision authorizing the meeting. An indication of the period of the year during which you would wish to schedule the meeting would be of considerable help in planning the overall programme of meetings for 1971.

I should be grateful if you would let me have a reply by 10 June 1970.

<u>Sent to:</u> Mr. Berthoud
Mr. Chidzero
Mr. Chossudovsky
Mr. Delgado
Mr. Dell ✓
Mr. Groby
Mr. Krishnamurti
Mr. Malinowski
Mr. Mordvinov
Mr. Stone

<u>cc:</u> Mr. Adebanjo
Miss Berman
Mr. Brack
Mr. Cordovez
Miss Parmentier
Miss Petigura
Miss Richardson
Mr. Unsworth
Mr. Viteri

FOR SECRETARIAT
USE ONLY - NOT
FOR PUBLICATION

Working parties, study groups, expert groups and commodity consultations currently envisaged for the remainder of 1970

Body	Decision taken by	Reference	Tentative timing and duration	Estimated number of participants	Interpretation
I. Working parties and study groups					
Group on Rules of Origin	2nd Pref.	TD/B/243 para. 36	29 June - 7 July (1 week)	60 - 70 countries	EFRS +
Other W/Ps on Preferences (if established)	2nd Pref.	TD/B/243 para. 36	Up to 3-4 weeks in all	60 - 70 countries	EFRS +
Group on Trade Expansion, etc.	8th TDB	RES.53(VIII) para. 2	2 - 18 November (2½ weeks)	50 - 80 countries	EFRS +
Group on Techniques of Lending	UNCTAD II	RES.29(II) para. 6	Only 1 week in all - may not be held - 4th CIFT to decide		EFRS
or Group on Commercial Credits		para. 10			
or Group on Multilateral Interest Equalization Fund	3rd CIFT	TD/B/236 para. 36			
UNCTAD/FAO Intergovernmental Consultative Committee on Oilseeds, Oils and Fats (if established)	UNCTAD II	RES.16(II)	Subject to recommendations of Committee on Commodities (July) and CCP (November) - 1 week	30 - 35 countries	EFRS
II. Expert Groups					
Group of insurance statisticians	2nd CIFT	TD/B/118 Annex I	7 - 14 October (1½ weeks)	16 experts	EFRS
Group of insurance supervisors and other insurance experts	2nd CIFT	TD/B/118 Annex I	Only one of the two groups will meet, possibly in December 1970 (2 weeks)		EFRS
or Group on planning the development of the tourist sector	2nd CIFT	TD/B/118 Annex I			EFRS
Expert Group on Rubber	5th TDB	RES.40(V)	Second half of year (1 week)	7 experts	none

+ = provision to be made for meetings of regional groups

27.5.70/mr/cr

Body	Decision taken by	Reference	Tentative timing and duration	Estimated number of participants	Interpretation
III. Commodity consultations					
Cocoa consultations	UNCTAD II	RES.16(II)A	1 - 11 June (2 weeks)	14 countries	EFRS
Other commodity consultations (if required)	UNCTAD II	RES.16(II)	Up to 2 weeks		

27.5.70
mr/cr

RECORDS CONTROL
25 JUN 1970

CIFT

TDS 213(1)

YZ973 (UNCTAD) NY 42/40 5 2328Z =

LTF

UNATIONS

GENEVA =

2813 CHOSSUDOVSKY AAA PLEASE ADVISE WHETHER WORLD BANK HAS SUPPLIED COPIES OF ENGLISH TEXT OF TD/B/C.3/74 AND WHEN YOU EXPECT THESE TO BE DISTRIBUTED BBB PLEQSE INDICATE ALSO WHEN DISTRIBUTION WILL TAKE PLACE IN OTHER LANGUAGES =

DELL +

COL 2813 TD/B/C.3/74 +

70 JUN -5

CIFT
TDS 213(1)

YZ758 NY 183 4 2139Z=

LTF

UNATIONS

GENEVA=

2772 CHOSSUDOVSKY RE MONYITS 2209 AAA WOULD SUGGEST THAT FIRST FULL PARAGRAPH ON PAGE TWO SHOULD READ AS FOLLOWS QUOTE IN VIEW OF THE EXCEPTIONALLY LONG AND COMPLICATED AGENDA OF THE FOURTH SESSION OF CIFT, THE SECRETARY GENERAL OF UNCTAD SUGGESTS THAT GOVERNMENTS MAY WISH TO=

P2=

CONSIDER THE ADVISABILITY OF ENSURING THAT THEIR REPRESENTATIVES ARE PRESENT IN GENEVA IN TIME TO PERMIT THE VARIOUS GROUPS TO MEET FOR CONSULTATIONS CONCERNING THE BUSINESS OF THE SESSION IN ADVANCE OF ITS OPENING, NAMELY ON SEVENTEEN JULY. THE SECRETARY GENERAL IS MAKING FACILITIES AVAILABLE FOR SUCH=

P3=

CONSULTATIONS AT 10:30 A.M. AND 3:00 P.M. ON SEVENTEEN JULY: DETAILS OF MEETING ROOMS WILL BE PROVIDED ON THE USUAL NOTICE BOARDS IN THE PALAIS DES NATIONS ON THAT DATE. RESPONSIBLE OFFICIALS OF THE SECRETARIAT WILL ALSO BE AVAILABLE TO THE GROUPS FOR CONSULTATION, IF SO REQUIRED=

P4-33=

UNQUOTE BBB INTEND ARRIVING GENEVA ON SIXTEEN JULY. PLEASE CONVEY TO CHAIRMEN OF GROUPS THAT I SHALL BE AT THEIR DISPOSAL IF THEY SO WISH AT ANY TIME DURING SEVENTEEN JULY=

DELL+

COL 2772 2209 10:30 3:00 +

RECORDS CONTROL

15 JUN 1970

CIFT
TDS 213(1)

21 April 1970

Dear Mr. Demuth:

Many thanks for your letter of 15 April in reply to my letter to Fred Consolo of 8 April concerning the status of your investment insurance study. I am most grateful to you for your explanation of where the matter stands.

I shall, of course, take your advice, and leave our paper as it stands. I might mention that my letter was prompted by a suggestion from the United States Mission. I shall now inform them that on the basis of the information I have received from the World Bank, we have decided to maintain the present text of our paper for the time being.

Yours sincerely,

S. Dell, Director
New York Office of UNCTAD

Mr. Richard H. Demuth, Director
Development Services Department
International Bank for Reconstruction
and Development
1818 H Street, N. W.
Washington, D. C. 20433

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
Cable Address – INTBAFRAD

INTERNATIONAL DEVELOPMENT ASSOCIATION
Cable Address – INDEVAS

1818 H Street, N.W., Washington, D. C. 20433, U.S.A.
Area Code 202 • Telephone - EXecutive 3-6360

April 15, 1970

IDS r13(c)

Mr. S. Dell
Director
New York Office of UNCTAD
United Nations
New York
New York 10017

Dear Mr. Dell:

In Fred Consolo's absence in Geneva, I am replying to your letter of April 8, concerning the status of our investment insurance study.

Although you are correctly informed that we have taken up the matter again, I do not believe that we have yet progressed sufficiently far to warrant issuing an amended statement to the Committee on Invisibles and Financing related to Trade. What has happened is that the Committee of the Whole of the Executive Directors recently met to try to decide whether there was sufficient support for the scheme in principle to justify considering in detail the provisions of the draft of Articles of Agreement sent to governments in August 1968. At that meeting, several Executive Directors representing developed countries said that their governments considered it important that the developing countries should help to meet the Agency's financial requirements arising from both administrative expenses and payments to insured investors. Some Directors representing developing countries had on earlier occasions opposed such participation, in general terms. The Committee therefore decided that, before it turned to any Article-by-Article discussion, it should take up the basic issue posed by these two positions. At a meeting later this week, the Committee will fix a date, probably some months ahead, by which governments will be asked to express their views on the single question whether the scheme should make provision for developing country financial participation. If accommodation can be reached on this basic issue, some other basic issues can more readily be resolved; if it appears that there is no consensus on this issue, there would be little point in proceeding.

For all practical purposes then, the position is still as reported in your paper on external development finance, and my own preference would be that you leave it at that for the time being. We shall, of course, inform you of the decision of the Committee when made, whether it is to take up the draft Articles in detail or to suspend the study indefinitely.

Sincerely yours,

Richard H. Demuth

Richard H. Demuth
Director
Development Services Department

MINISTRY OF OVERSEAS DEVELOPMENT
Eland House, Stag Place, LONDON S.W.1
Telegrams: Ministrant, London, Telex
Telephone: VICtoria 2377, ext.

Our reference:
Your reference:

27 April 1970

UND.206/264/01

Mr S Dell
Director
New York Office of UNCTAD
United Nations
NEW YORK

CIFT
TDS 213(1)

Dear Sidney,

Thank you very much indeed for your letter of 15 April which, although it took so long to get here, (it arrived only this morning) is very welcome and most interesting.

I will consult colleagues here in London and let you know if there are any useful comments we can offer at this stage. Owing to my impending absences from London, it may take a week or two before I am able to write to you again. If, however, at the July meeting of the CIFT we can have a serious discussion of all the topics mentioned in your letter, it should turn out to be a most interesting meeting.

Yours sincerely
Douglas Williams

D Williams

C1FT

TDS 213(1)

ZY803 GENEVA 43/40 28 1043Z=

LTF

UNATIONS

NEWYORK=

RECORDS CONTROL

15 JUN 1970

GVA 2108 DELL FROM MOMYIET. YOUR 2471 DOCUMENTS TD/B/-
C.3/79 AND ADD.1 NOW BEING DISTRIBUTED IN ENGLISH. SIX
COPIES OF EACH WILL BE DISPATCHED TO YOU BY FRIDAY'S POUCH.
ADD.2 WILL BE SENT AS SOON AS AVAILABLE+

COLL 2108 2471 TD/B/C.3/79 ADD.1 ADD.2+

UNITED NATIONS
CABLE OPERATIONS
70 MAY 28 PM 12 47

CIFT

TØS 213(1)

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RECORDS CONTROL
15 JUN 1970

ZY531 GENEVA 29 06 1143Z

LTF

UNATIONS

NEWYORK=

GVA 1822 DELL FROM CHOSSUDOVSKY RE YOUR 2007 WE NEED
2270 PRINTED COPIES IN ENGLISH FOR FULL DISTRIBUTION OF
REPORT ON TECHNIQUES OF LENDING FOR CIFT+

COL 1822 2007 2270 ALSO CIFT++

70 MAY -6 AM 10 49

UNITED NATIONS
CABLE ...

CIFT
TDS 213(1)

YZ40 (UNCTAD) NY 98/97 4 1838Z =

LTF

UNATIONS

GENEVA =

2007 CHOSSUDOVSKY AM ADVISED BY WORK BANK THAT REPORT ON TECHNIQUES OF LENDING FOR CIFT WILL BE SUBMITTED IN ENGLISH INPRINTED FORM IN APPROXIMATELY ONE WEEK. AAA PLEASE ADVISE HOW MANY PRINTED COPIES IN ENGLISH YOU WILL NEED FOR FULL DISTRIBUTION. BBB HAVE ASKED =

P2/48/47

FOR FIVE PHOTOCOPIES OF PAGE PROOFD TO BE SENT TO YOU IN GENVA IMMEDIATELY FOR TRANSLATION PURPOSES. CCC WILL SEND YOU DRAFT COVERING NOTE BY SECRETARY-GENERAL OF UNCTAD AS SOON AS A COPY IS RECEIVED HERE SO THAT WE CAN SEE WHAT IS NEEDED =

DELL +

COL 2007 +

UNITED STATES MISSION TO THE UNITED NATIONS

799 UNITED NATIONS PLAZA
NEW YORK, N. Y. 10017

YUkon 6-2424

April 22, 1970

CIFT
TDS 213(1)

Mr. Sidney Dell, Director
New York Office of UNCTAD
United Nations
New York, New York

Dear Sidney:

Thank you for your letter of April 21 embodying your conclusion that for the time being there are no developments within the International Bank on multilateral investment insurance which are worthy of report to the Committee on Invisibles and Financing Related to Trade.

I am forwarding your views to my colleagues in Washington.

Sincerely yours,

Clarence I. Blau

Clarence I. Blau
Counsellor for Economic
and Social Affairs

Committee on Invisibles
TDS 213(1)

20 May 1970

Dear Jo:

This is simply to confirm that our distribution people in Geneva will need 2270 copies of the English text of the paper on techniques of lending. As you can imagine, it is rather urgent to get the copies to them since otherwise it will be impossible to have any serious discussion at CIFT, the deadline for meeting the six-week rule having already passed.

Yours sincerely,

S. Dell, Director
New York Office of UNCTAD

Mr. Jo Saxe
International Bank for Reconstruction
and Development
1818 H Street, N. W.
Washington, D. C. 20433

TDS 213(1)

YZ210 S NY 78/77 19 2154Z P1-51/50=

ETATPRIORITE

UNATIONS

GENEVA

2327 CHOSSUDOVSKY

AM SERIOUSLY CONCERNED AT EXTRAORDINARY DELAY IN ISSUANCE OF
TD/B/C.3/72 WHICH WAS SENT TO YOU ON FOURTEEN JANUARY. UNDERSTAND
PAPER WAS HELD UP BY CHARTS. IF THIS IS STILL THE CASE PLEASE ISSUE
FIRST FIFTYONE PAGES TOGETHER WITH ANNEXES TWO AND THREE IMMEDIATELY=
P2-27=
WITH ANNEX ONE TO FOLLOW LATER AS ADDENDUM. SINCE THIS IS A BASIC
DOCUMENT FOR CIFT WOULD GREATLY APPRECIATE YOUR URGENT ATTENTION
TO THIS MATTER=

DELL+

COL 2327 TD/B/C.3/72+

26 May 1970 DELL 927 3304

Committee on Invisibles

TDS 213(1)

UNCTAD 1508-590-301

RECORDS CONTROL
3 - JUN 1970

UNATIONS

GENEVA (SWITZERLAND)

MOMYIT YOUR 2070. PLEASE POUCH SIX COPIES TD/B/C.3/79 AND ADDENDA AS THEY BECOME AVAILABLE.

DELL

S. Dell, Director
New York Office of UNCTAD

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UNATIONS

NEWYORK=

GVA 2070 DELL FROM MOMYIT. YOUR 2433 SIX COPIES TD/B/C.-
3/70 ENGLISH BEING POUCHED TO YOU TODAY. TD/B/C.3/79 AND
ADD.1 DUE FOR DISTRIBUTION IN ENGLISH 29 MAY OTHER LANGUAGES
8 JUNE. TD/B/C.3/79/ADD.2 IN ENGLISH DUE ON 5 JUNE
AND OTHER LANGUAGES ON 26 JUNE+

'70 MAY 26 PM 2:39
UNITED NATIONS
CABLE OPERATIONS

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8 TD/B/C/C.3/79/ADD.2 5 26+

Committee on Invisibles
TDS 213 (1)

YZ41 NY 28/27 25 1900Z =

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UNATIONS

GENEVA =

2433 MO MYIT UR 2021 PLEASE POUCH SIX COPIES. PLEASE ADVISE WHEN TD/B/C.3/79 AND ADDS.1 AND 2 ARE TO BE DISTRIBUTED =

DELL +

COL 2433 2021 TD/B/C.3/79 1 2 +

Comm. on Invisibles

TDS 213(1)

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UNATIONS

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3 - JUN 1970

TO

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INITIALS

Return to Records Control Room 2071

1970 MAY 22 PM 1:02

UNITED NATIONS CABLE OPERATIONS

GVA 2022 DELL FROM MOMYIT RE YOUR 2327 TO CHOSSUDOV-

SKY ACTION HAS BEEN TAKEN AS FOLLOWS - DISTRIBUTION OF

DOCUMENT TD/B/C.3/72 (INCLUDING ANNEXES I, II

AND III) EFFECTED IN ENGLISHN FRENCH AND SPANISH+

COL 2022 2327 TD/B/C.3/72 ALSO I II III ++

(TDS 213(1))

RECORDS CONTROL
8 - JUN 1970

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FILE NO.
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INITIALS
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LTF

UNATIONS

NEWYORK=

GVA 2021 DELL FROM MOMYIT RE YOUR 2328 TO CHOSSUDOVSKY
ANNOTATED AGENDA TD/B/C.3/70 DISTRIBUTED IN ENGLISH ON
20 MAY. OTHER LANGUAGES EXPECTED SHORTLY+

COL 2021 2328 TD/B/C.3/70 20 ++

UNITED NATIONS
CABLE OPERATIONS
1970 MAY 22 PM 12 02

Committee on Invisibles

TDS 213(1)

ZY89 GENEVA 21/19 25 1522Z=

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UNATIONS

NEWYORK=

GVA 2049 DELL FROM MOMYIT. RE YOUR 2415 SIX COPIES IN ENGLISH

TD/B/C.3/72 BEING POUCHED TODAY+

COLL 2049 2415 TD/B/C.3/72+

TDS 213(1)

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UNATIONS

NEWYORK=

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ANNOTATED AGENDA TD/B/C.3/70 DISTRIBUTED IN ENGLISH ON

20 MAY. OTHER LANGUAGES EXPECTED SHORTLY+

COL 2021 2328 TD/B/C.3/70 20 ++

(TDS 213(1)

RECORDS CONTROL

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ETATPRIORITE

UNATIONS

GENEVA

2328 CHOSSUDOVSKY UNDERSTAND DECISION ON DATE OF CIFT IS NOT LIKELY TO BE TAKEN BEFORE EARLY JUNE. IN THESE CIRCUMSTANCES CONSIDER WE CANNOT CONTINUE TO HOLD UP ISSUANCE OF ANNOTATED AGENDA TD/B/C.3/70 AND WOULD THEREFORE APPRECIATE YOUR AUTHORIZING ITS IMMEDIATE DISTRIBUTION=

DELL+

COL 2328 TD/B/C.3.70+

Mr. Dell

TD/B/C.3/79 and Add.1 did not change since you last read them.

In TD/B/C.3/79/Add.2 there are several changes; the most important ones are in paragraphs 3, 4 and 8.

The attached copy is for your file.

G.D. Arsenis.

TDS 213(1)

Mr. Dell

The attached was cleared by P. Streeten. At D. Seer's suggestion, he wants to add a short sentence in para. 6 of TD/B/C.3/79 about consumption patterns and "demonstration effect".

This addition should reach us by Wednesday and I shall cable it to Mr. Chossudovsky for inclusion.

I informed Mr. Lehman about this.

May 4, 1970.

G.D. Arsenis

Mr. Arsenis

I would rather not read the whole thing again. Can you please draw my attention to any paras. which I should examine?

SD 5/5

RECORDS CONTROL

14 MAY 1970

COPY
New York files

CIFT
FDS 213 (i)

Mr. E.M. Chossudovsky,
Assistant Director,
Division for Conference Affairs
and External Relations

29 April 1970

G.D. Arsenis,
New York Liaison Office, UNCTAD

TDO 280
(4th session)

Documentation for the fourth session of the Committee on Invisibles and Financing Related to Trade

... 1. Attached please find five copies of the study on the Balance-of-Payments Effects of Private Foreign Investment. The study is to be issued as document TD/B/C.3/79 and Add.1 and Add.2.

2. This study replaces an earlier version which was submitted to you some time ago, but the reproduction of which was withheld at our request.

3. The study was finished in Geneva and the relevant stencils are being held by Miss Dorothy Thompson.

TDS 213(1)

Distr.
GENERAL

TD/B/C.3/79
27 April 1970

Original: ENGLISH

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

TRADE AND DEVELOPMENT BOARD
Committee on Invisibles and Financing
Related to Trade
Fourth session
Geneva, 20 July 1970
Item 3 of the provisional agenda

THE FLOW OF FINANCIAL RESOURCES

Balance-of-payments effects of private foreign investment

Progress report prepared* by

Paul Streeten
(Queen Elizabeth House, University of Oxford)

1. This is an interim report of a study on the balance-of-payments effects of private foreign investment which was requested by the UNCTAD secretariat. It contains two papers. The first paper entitled "Some Aspects of the Balance-of-Payments Effects of Private Overseas Investment" (TD/B/C.3/79/Add.1) deals with some broad questions of method and approach. The second paper (TD/B/C.3/79/Add.2) relates to the results obtained in field work in Jamaica and Kenya.[1] It was carried out by a team under the direction of Dr. Lionel Needleman. While a Steering Committee[2] was set up to give advice on this project, the team was given a free hand to develop their own ideas and methods and to apply them to these two

2/ The Committee consisted, apart from myself, of Lord Balogh, Professor John Dunning, Mr. Michael Lipton, Dr. Lionel Needleman and Professor Dudley Seers. Dr. Max Corden joined the Committee in April 1970.

* The study was prepared at the request of the UNCTAD secretariat and is submitted to the Committee in pursuance of paragraph 3 of resolution 33(II) of the Second Conference. The views expressed in the study do not necessarily reflect those of the UNCTAD secretariat.

1/ Two more country studies - on India and Iran - are in progress.

countries. The members of the team are economists who are associated with the Institute of Development Studies at the University of Sussex or with the Queen Elizabeth House, Oxford but it need hardly be said that these institutions must not be identified with the methods employed or the conclusions reached. Equally, the merit of the study should be credited entirely to Dr. Needleman and his team. The interim report, though confined to two countries only, provided useful experience in framing hypotheses and collecting data, which will prove valuable for future work.

2. It might be useful to put the study very briefly into a more general context, in order to bring out explicitly its scope, its limitations and its lessons.

3. Two sets of interrelated problems arise in a study of this kind, and both are crucial, not only to analysis, but also to policy. One set relates to the assumptions about the "alternative situation" (i.e. what the balance-of-payments would have been in the absence of the foreign firm); the other to government action with respect to aggregate demand and the balance-of-payments. I shall attempt to underline briefly what the report on Jamaica and Kenya (TD/B/C.3/79/Add.2) states ~~in~~ (paragraphs 173.-177.) viz. what difference to the conclusions would be made by different sets of assumptions. It might well be, indeed it has already emerged in the team's study of India, that some assumptions about the alternative situation are realistic for certain countries and certain periods, and quite different ones for other countries and other periods.

4. The scope of the investigation is confined to an analysis of marginal changes, so that only a particular, relatively small act of overseas investment is under consideration, not the policy towards overseas investment generally, or the policy towards <u>large</u> changes in overseas investment. To a large extent, this limitation is dictated by manageability. A comparative study of large or of structural changes would require considerably more time and resources and would even then have to rely heavily on guesses. The limitation adopted precludes asking questions about the manner in which host country policies come under pressure from foreign investors. Pressures to put up or raise a protective tariff on a range of products or to allow into the country cheaply

imports required in their production, pressures for tax concessions, on exchange rate policy and a whole range of other policies could be considered more appropriately in the context of <u>large</u> changes of overseas investment, since the difference made by a single investment is likely to be negligible. It is commonly argued that these pressures stem from domestic, as well as from foreign producers and should therefore not be attributed to overseas investment as such. But the relative bargaining strength and amount of information available to a government in relation to different business groups is bound to be different and it is an open question whether governments can resist these pressures with equal strength, or yield to them with equal abandon, wherever they may originate.

5. The limitation of the analysis to marginal changes also rules out the analysis of policies, advocated by some, to the effect that private overseas investment should double or treble over the next ten years, or should largely replace official aid, or should be severely curtailed, or should be combined with official aid in fairly rigid proportions. All these questions, important though they are, require different types of studies.

6. The assumption made in the study that the total value of domestic sales of the product produced by the foreign firm would be the same in the absence of that firm, the gap being completely filled by indigenous producers or by importers or by both, will tend to ~~bias~~ influence the results in favour of the foreign investment. Domestic production of the same product or a near substitute as an alternative is not perhaps a very realistic assumption. The whole rationale of direct foreign investment consists in some special advantage that the foreign investor possesses over the indigenous firm, whether it is size in the face of economies of scale or goodwill attached to a brand and reinforced by advertising or managerial skills or special know-how. Without these advantages, the indigenous firm, with its greater local knowledge, will be able to mobilize the required resources and to use them more effectively than the foreigner. In some respects it would be simplest to assume that the pattern of demand is given and that the product would have been imported in the absence of private overseas investment. If the product is sold at its world price, private

overseas investment, on this assumption, must contribute to foreign exchange earnings or savings, though this is no longer necessarily true under protection, when its sale price exceeds its world price. At the other extreme, one might assume that demand for the product is created by the foreign firm and that the product would not be bought at all, or some much simpler substitute produced locally would be bought, were it not for the private overseas investment. (Even where private foreign investment "jumps the tariff" and replaces previous imports, the intention of the tariff-imposing government may have been to reduce consumption of the product, not to encourage foreign investment.) But such an assumption leads immediately to the question as to what the purchasing power would have been used for, had it not been spent on the product in question. It would be illegitimate to assume that the whole foreign exchange expenditure is saved, compared with the case where it is imported, unless policy reduces aggregate demand by the amount necessary to bring this about. If imports of the same total value are assumed to be the alternative, the question arises whether these imports are wanted at all, or of the same value or of the same type produced in much the same way. Where branded consumer goods are concerned, especially those catering for a small, relatively high-income market, the producers will tend to shape their market through advertising and pressures of imitation. There could be cases where exclusion of the product would reduce consumers' welfare by very little, partly because the prohibition may be used as a means of income redistribution in the face of an imperfect tax system, partly because the desire to consume something because others consume it vanishes if no one can buy the product, and partly because the product may have met "excess needs". The assumption of replacement by imports therefore biases the results in favour of the investment, as the study points out (paragraph 108.). The study expresses the expectation that this bias is negligible for Kenya and Jamaica. But it would be dangerous to generalize too readily. And even in the two countries it is possible to think of examples where the elimination of an imported consumer good or its equivalent, produced domestically by private foreign investment, might make a contribution to the saving of foreign exchange.

7. The assumption that the indigenous producer would use the same technique as the foreign firm also ~~biases~~ influences the result in favour of the foreign investment.

Whatever may be true of technical substitution possibilities, it is clear that the incentives to use imported equipment, components and materials may be different in the two cases. The information on availabilities will be different, the temporal and the geographical horizons will be different, the economic incentives will be different and, what is often neglected, the sophistication and quality of the product itself will be different. Products, as well as production processes, can be excessively resource consuming and can be more adapted to the multiple high-income demands of the rich than the needs of the poor. Moreover, responsiveness to political pressure to employ more domestic resources will also differ. These differences are exceedingly difficult to quantify. The study discusses some of these issues in paragraphs 177-182 for the two countries investigated, disclaims universal validity, and examines the situation where the ratio of import costs to sales is one-third lower for domestic than for foreign firms.

8. Turning now to the second set of assumptions with respect to government policy, we may assume either that aggregate demand is kept constant by appropriate monetary and fiscal policies, or that the government is passive and permits additional demand to raise incomes and prices. For an analysis of balance-of-payments problems, it is, of course, essential to assume the exchange rate fixed. But for a deeper analysis, this may not be justified. If the exchange rate is overvalued, this makes it possible to import components and materials more cheaply. The private overseas investor (as well as the domestic investor, though with unequal strength) catering for the domestic market has an interest in preserving this state, particularly if the investment is also protected by a tariff against low-cost foreign competition. It is not necessary that these policies should be accepted as data in an analysis of private overseas investment. They constitute, admittedly, the "rules of the game". But these rules may themselves be influenced by the foreign investor. A wider investigation would have to embrace political and administrative changes which were beyond the team's resources and chosen terms of reference. Assumptions relating to policies with respect to aggregate demand, government revenue and expenditure, repercussions on domestic investment and direct action on the balance-of-payments must be explicitly introduced.

9. Assumptions about government stabilization policies present a dilemma. On the one hand, even much more experienced governments with plentiful information have not always been successful in steering a course between inflation and excess unemployment. The relatively new administrative machinery in many less developed countries cannot be assumed to be invariably successful where so many older ones have failed. On the other hand, there are also serious objections to Keynesian multiplier analysis in the ~~fact~~ face of a passive government policy. The argument against this assumption is that in economies with supply inelasticities, bottlenecks, immobilities and low responsiveness to incentives, Keynesian multiplier analysis has little relevance, but an analysis combining real income, - employment - and price-changes and the responses to these becomes too complicated to handle.

10. The study attempts to steer a course between the unmanageable and the unrealistic. Its claims are modest and workmanlike. It points to the need for further studies. It is flexibility of assumptions, based on particular cases, which, in the end, alone can illuminate this difficult subject.

11. In order to present an alternative set of assumptions, the first paper explores at a more general level various lines of reasoning. The lesson to which the paper points is that we have to proceed pragmatically, judge each situation by the evidence and collect more data and experience. It may be that, later on, more general principles will emerge from a sufficiently large number of case studies.

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THE FLOW OF FINANCIAL RESOURCES

Some aspects of the balance-of-payments effects of private foreign investment

Study* prepared by

Paul Streeten

1. The role of private foreign investment in the process of development needs re-thinking in the light of fundamental changes in the world economy. Much of our present thinking and many of our institutions are still dominated by the experience and the doctrines of the nineteenth century, and are therefore ill-adapted to the altogether new circumstances and needs of the second half of the twentieth century.

2. There are a number of features which distinguish modern private foreign investment from that in the last century. First, whereas in the nineteenth century the bulk of world foreign investment took the form of bonds and only a small proportion that of equity, today bond investment is small (although middle income countries like Israel, Mexico and Argentina have floated large bond issues in recent years) and, disregarding trade credits, the majority is in direct equity. This suggests that the rates of return and the services

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The study was prepared at the request of the UNCTAD secretariat and is submitted to the Committee in pursuance of paragraph 3 of resolution 33(II) of the Second Conference. The views expressed in the study do not necessarily reflect those of the UNCTAD secretariat.

rendered have changed. Second, equity investment in the nineteenth century carried the risks of cyclical fluctuations. In bad years no dividends would be paid out. Such fluctuations are less important today, in spite of continued fluctuations in export earnings, and there is, therefore, less justification for a reward to this kind of risk bearing. Third, in the nineteenth century the transfer of capital was accompanied by the migration of skilled people, in whom aptitudes and attitudes geared to development were incorporated. Today, traditional attitudes have to be transformed and skills have to be created. Fourth, as a result of the more rapid spread of knowledge, certain, although by no means all, types of technological knowledge are nowadays more widespread and standardized than they were in the nineteenth century. It is sometimes cheaper to hire foreign engineers and to borrow capital, particularly if it is available on concessionary terms, than to invite direct equity investment. In those areas where hired skills plus borrowing can achieve the same results more cheaply than foreign equity investment, the latter puts an excess burden on the host country. There are other industries in which technical and managerial know-how is not so readily available and where higher returns are justified. The most difficult problem frequently is to identify profitable opportunities as well as to execute and run projects that have been selected. The process of identification can be undertaken by foreign capital, which acquires in return the right to exploit the opportunities fully. But there are other arrangements which may serve the same purpose, some of which may impose a smaller burden on the host country. It would for instance, be possible to offer a management contract to a foreign investor who may also be permitted to hold a substantial minority of shares. The foreign investor would construct and manage the plant and would receive a management fee. This fee can take the form of a percentage both of profits and of foreign exchange savings realized. At the same time, the managing firm may be expected to offer credit at a fixed rate of interest to the local firm. This credit should cover either the foreign exchange costs or a certain proportion of the total investment costs of the project. The duration of the loan would be the same as the duration of the management contract.

3. Foreign private enterprise has an important part to play in assisting the progress of the developing countries. At the same time, a number of obstacles stand in the way of greater participation of foreign private investment in the development process, though new thinking, new policies and new institutions can contribute to overcoming these obstacles.

4. The obstacles are partly economic, arising from the difficulties of operating in countries with small markets and shortages of skilled manpower, foreign exchange and basic utilities, and partly political. The latter include the sometimes ambivalent attitudes of the governments of developing countries and the resulting political risks faced by private enterprise.

5. A question central to any analysis of the economic effects of foreign private investment is whether such investment can achieve a large and sustained transfer of foreign exchange resources to developing countries. If the rate of growth of foreign capital, resulting from new capital inflow and retained profits, is higher than the rate of return on accumulated foreign capital, there will be a net addition to the foreign exchange resources available for development. On the other hand, foreign private investment would tend to diminish the level of available foreign exchange resources if the outflow of profits and repatriation of capital exceeded new capital inflow.

6. It is often argued, however, that it would be misleading to view the foreign exchange contribution of foreign private investment by merely comparing new capital inflow and reinvested earnings with the profits earned on the accumulated foreign investment. According to this view, such a simple comparison fails to take into account the impact of foreign investment on export promotion and import-saving, the maximum contribution of foreign private investment to the balance-of-payments being given by all additional sales made possible by the investment project, minus the imported inputs into the project. However, this would be a true maximum only if all resources employed in the project were previously unemployed, all sales were either exports or import substitutes, and all additional income generated were saved or if the marginal propensity to import were zero or if fiscal policy kept consumption constant. Otherwise, there will be some reduction in the maximum foreign exchange earnings and savings, depending on the amount of extra imports or reduced exports.

7. A difficulty arising in the approach outlined in the previous paragraph is that such indirect effects emerge from any investment, and not merely from foreign private investment. The characteristic peculiar to the latter, as distinct from domestic investment, is that privately owned foreign exchange first flows in for the construction of the project and later flows back in the form of remitted profits.

8. If a country wishes to build, say, a cement factory, it can either invite a foreign firm to do it, or it can build it by hiring experts and managers, buying machinery and borrowing capital. It may be that the foreign investor can erect and manage a factory more efficiently or more cheaply than if it had all been done at home, or than if it had been done by borrowing capital and hiring skills. It may, of course, be that other more efficient and less costly alternatives present themselves. It is the difference in costs and returns between available alternatives that should be credited (or, in the opposite case, debited) to private foreign investment. Historically, private foreign investment may often have been the only way of getting the investment undertaken and it would then be correct to identify the total effects with the differential effects. A typical case is investment in oil. Oil exports might not have occurred had it not been for the foreign company's investment and in that event oil export earnings should be credited in their entirety to the balance-of-payments contribution of the investment.

9. From the standpoint of policy, what matters is not what historically preceded the foreign investment, but what the next best alternative would have been. Any operational assessment of the potential contribution of foreign private investment must start from an assumption about this alternative. If a country wishes to evaluate the costs and benefits to be derived from setting up a plant, it must compare the plant to be established with the following potential alternatives:

(i) raising the capital and other resources domestically and setting up an indigenous plant;

(ii) borrowing money ~~abroad~~ abroad, hiring engineers and managers and buying the know-how through a licensing arrangement;

(iii) any partial combination of (i) and (ii), including joint ventures with foreign firms, management contracts, etc.;

(iv) importing the finished product;

(v) not carrying out the investment nor importing the product, but doing without it for the time being.

10. A clear formulation of the alternatives is an essential prerequisite to the proper appraisal of the value of foreign enterprise. The important point for analysis and policy is to free oneself from ideological bias and historical precedent, and to exercise one's institutional imagination upon the various alternatives against which any operational assessment has to be made.

11. Another difficulty which arises in estimating the total effects of foreign private investment on export promotion or import saving relates to the implicit assumption made that the resources employed in the project were previously <u>unused</u>, as pointed out above, or <u>unusable</u>, and also that they represent net additions in that they do not replace resources in other sectors of the economy. Even where supply is freely available, demand may be such that previously employed resources become unemployed as a result of foreign investment. The new production may neither earn nor save foreign exchange, but may simply displace other sources of supply, which now become unemployed or under-employed. Not only must there be no limitations of <u>supply</u>: <u>demand</u> limitations must also be absent.[1]

12. The above considerations suggest that the analysis which runs in terms of capital inflow (including retained profits) and profit outflow, crude though

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1/ There is a further difficulty which relates to the assumption concerning unemployment. If any of the resources employed in the project are taken away from activities which earn or save foreign exchange, it is quite possible that the foreign exchange contribution may become negative, or at any rate smaller.

it is, has stronger logical validity and operational use than the analysis based on "indirect" effects in cases where alternative investment schemes are available. On the other hand, the analysis based on "indirect" effects is more appropriate in cases where in the absence of foreign private firms, no investment for and production of a specific commodity would have taken place. In the area of empirical studies on the effects of foreign private investment, it is essential to make explicit assumptions about the availability of alternative schemes to foreign private investment, and the analysis may have to run in terms of a framework that lies somewhere in between the two extremes of the straight capital flow analysis and the approach that credits all indirect effects on exports and net imports to foreign private investment.

13. Irrespective of the framework of analysis that is adopted, the contribution of foreign private investment in relation to other alternatives tends to be reduced to the extent of any profit outflow. It is sometimes said that additional new investment and the retention of current profits in the host country can indefinitely offset or more than offset the return flow of profits and dividends on old capital and of capital repatriation. But if the rate of return on cumulative foreign capital (after local tax and depreciation have been deducted) exceeds the rate of growth of national income - a quite realistic assumption since the former is likely to be at least 10 per cent and the latter about 5 per cent - the rate of growth of foreign capital must be higher than that of national income. This implies, assuming a constant ratio between capital and output for foreign and for domestic capital, that foreign capital ownership would grow at a faster rate than domestic capital and therefore an ever increasing proportion of the domestic capital stock would be owned by foreigners. This is particularly serious if, initially, little locally owned capital exists, as in many African countries. Even if such alienation of the capital stock were politically acceptable (and it rarely is), the process must come to an end when nearly all capital is owned by foreigners. After that, further postponement of repatriation and remittances will not be possible, unless the rate of return is brought into equality with the rate of growth of national income.

14. Remittances abroad may also, sooner or later, grow faster than export earnings, since these are not likely to grow much faster than income. For a constant investment base, remittances may be expected to be constant and therefore, with growing export earnings, may represent a shrinking proportion of such earnings. But fixed-interest bearing capital may be raised locally and the growing gearing ratio be reflected in a rising profit rate. In that case growing profits will be remitted on a constant investment stake. Growing remittances may also reflect growing investment in the past and may place a growing future burden on the balance-of-payments.

15. For these reasons, private investment may not make a sustained and substantial net contribution to the transfer of foreign exchange resources. To say this in no way implies that foreign investment may not make a contribution to economic growth. Numerous factors which accelerate growth lead to a deterioration of the balance-of-payments. It is, for example, quite possible that the worsened balance-of-payments position would occur at a higher level of foreign trade and real income than would have been attainable without the foreign investment.

16. But even during the period when a net inflow of foreign exchange is possible, because the rate of growth of foreign capital exceeds the rate of return on foreign capital, less developed countries are faced with a dilemma: either they permit or even encourage this growth of foreign capital, in which case they will be faced with growing foreign ownership of their capital stock. Or else they limit this process of alienation, in which case a part of their export earnings will be devoted to remitting profits and repatriating capital.

17. There is a fear that the reaction of developing countries to this dilemma may be expropriation (without adequate compensation) to prevent alienation, or restrictions on remittances abroad, to lighten the burden on the balance-of-payments. Any such danger of expropriation or of restrictions on profit remittances adds to the political risks of foreign investment and raises the rate of return required by foreign companies as an inducement to invest. The fact that expropriations and interference with remittances are in fact relatively infrequent does not necessarily eliminate or reduce the

subjective fear in the minds of investors. But the high rates of profit required sharpen the dilemma: alienation versus balance-of-payments burden. The host governments accuse the companies of taking out of the country more than they put in. Foreign enterprise accuses the host countries of creating political risks that raise the required rates of return. The high profits, intended as an insurance against risks, tend to bring about the very consequences that the high profits seek to compensate for. This leads to demands for even higher profits and the vicious spiral is given another twist.

18. It is clear that mutual gains could be derived from measures that would reduce these risks, lighten the balance-of-payments burden, reduce the rate of profits required by foreign companies, and dispel fear and suspicion. Private investment in uncertain conditions is not a zero-sum game and both investor and host country can gain from such mutually agreed "disarmament".

19. Neither the "crude" analysis, which runs in terms of new investment versus profit outflows, nor the "indirect" analysis, which takes into account the effects on export earnings and import savings, make any allowance for the complex political effects of the pressures of foreign private investment upon the economic policies conducted by a host country. In a world in which it is no longer the case, as it was in the nineteenth century, that a handful of countries confront numerous business enterprises but where, instead, numerous countries confront a handful of companies, the repercussions of foreign investment upon a host of policies pursued by the government of a small country may be considerably more important than the above analysis, which assumes these policies to be unaffected, would suggest. The range of policies that might be affected in this way includes policies with respect to tariffs, import licensing and other protective measures, exchange rates, monopoly legislation, tax policies and other matters.

20. It has been argued above that private foreign investment cannot be expected to make a substantial contribution over a sustained period of time to filling the foreign exchange gap. But while the additions to the volume of total available foreign exchange may not be substantial, private investment may provide capital in a particularly productive form, so that the efficiency of the

resources transferred is high. The particular contribution of private foreign investment may lie not so much in the transfer of foreign exchange as in helping to lay the foundations for further growth in the economy and in strengthening the base from which domestic savings and foreign exchange are generated. In particular, private foreign investment can bestow substantial benefits on the host country where domestic management skills and entrepreneurship are embryonic and where there is no other way of organizing large-scale manufacturing industry.

21. Its merits then lie not so much in directly contributing to filling the foreign exchange gap, or even the savings gap, as in the following:

(i) it may contribute indirectly to filling the savings and the foreign exchange gaps by contributing to tax revenue. This contribution to filling the budgetary gap is particularly important in countries where effective taxation of the domestic sector is difficult. It can, however, be eroded by tax concessions extended by less developed countries to attract foreign companies;

(ii) it may help in the transfer of technology (know-how) and skills;

(iii) it may provide management and training of local managers;

(iv) it may help in the training of workers and the creation of indigenous skills in administration, marketing and other business techniques;

(v) in appropriate forms and with appropriate safeguards, it may contribute to the growth of local entrepreneurship, by sub-contracting, by the encouragement given to the establishment of repair shops and other ancillary enterprises, etc.;

(vi) it may, by changing the market structure, contribute to more vigorous competition;

(vii) it may help in establishing contacts with overseas banks, capital markets, markets for factors and products, sales organizations and other institutions and it may open a previously closed society to world-wide influences;

(viii) it may create employment opportunities directly and indirectly;

(ix) it may raise domestic wages, or improve the terms of trade.

While all these contributions are possibilities rather than certainties, since under each heading negative as well as positive results can be listed, they point the way to methods of dealing with foreign enterprise that would help to maximize the net gains to be derived therefrom.

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THE FLOW OF FINANCIAL RESOURCES

Balance-of-payments effects of private foreign investment: Case studies of Jamaica and Kenya

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CHAPTER I

INTRODUCTION AND GENERAL FINDINGS

The study

1. In this paper we report on studies of private foreign manufacturing investment in Jamaica and Kenya that were undertaken in 1969. The first substantive chapter of this report, chapter 2, was written by Sanjaya Lall, who together with Jonathan Seagrave carried out the field work in Jamaica during the summer of 1969. The chapter discusses the background to private overseas investment in Jamaica. Chapter 3 is the corresponding account of the economic environment for foreign investment in Kenya and is the work of Robert Lacey, who together with Lionel Needleman undertook the field-work in Kenya. Chapter 4 describes the methodology of the project, while the results of the studies are given in Chapter 5. These two chapters were written by Lionel Needleman, who directed the project.

2. The aim of our researches is to examine the effects that foreign-owned firms have on the balance of payments of under-developed countries and to identify, if possible, the causal factors involved. We are concerned with evaluating the effects of marginal changes in foreign investment and do not attempt to measure the likely effects of radical structural changes in the economy. Our hope is ultimately to be able to provide under-developed countries with some criteria for choosing which sorts of foreign firms to encourage to invest within their boundaries, largely from the point of view of their effects on the balance of payments. There are a number of other effects that would have to be taken into account in any overall assessment of the choice of firms to encourage, one of the most important being the effect of foreign investment on the national income of the host country. Fortunately, however, as a by-product of our calculations of balance of payments effects, we have also been able to obtain estimates of these income effects. But we were less successful in investigating some of the more informal effects of private overseas investment on the host economy. We did attempt to explore the contribution made by foreign companies to the training of local personnel and

the extent to which the operations of these companies had encouraged the growth of local ancillary industry, as well as a number of other external effects of foreign enterprise. But we concluded that these aspects of foreign investment were too large and complex to be investigated as part of a study predominantly concerned with balance of payments effects and that these issues would have gone beyond the confines of the present study.

3. In view of the complexity of the problems to be investigated, it was thought desirable for our initial studies to deal with countries in which we had the best prospects of the simple testing of our methodology and procedures for collecting data from firms. Jamaica and Kenya had the additional advantages of having had a wide range of foreign manufacturing investment as well as publishing good trade and national accounts statistics.

4. Jamaica and Kenya cannot be taken as typical of developing countries as a whole - no two countries could be representative of so large and diverse a group of economies. It is necessary therefore to emphasize that our findings for these two countries do not enable us to generalize with confidence as to the effects of foreign private investment in other developing countries. For that we would require to study a substantial number of different country experiences and towards that end we have already begun to extend our studies and are currently examining the situation in India and Iran.

5. In our researches we have been helped by many people and organizations. Our thanks are due to our interviewers in the firms in our samples, who patiently endured our questioning and frequently went to great lengths to provide us with information that was not readily available. Our promise to them that it would not be possible to identify them or their operating results in our report prevents us from testifying to the gratitude we owe them by listing their names.

6. We were assisted and advised by many government officials in Kenya and Jamaica. Without their help we could never have obtained much of the data on which our studies were based. The austere conventions of their service once more prevent us from naming them individually.

7. Finally, all the members of the team are glad to be able to acknowledge the constant encouragement and help of the Chairman of the Steering Committee of the project, Paul Streeten.

General findings

8. In this study the operations of twenty foreign-owned manufacturing firms in Jamaica and nine similar firms in Kenya were examined in detail so as to trace the effects of their activities on the balance of payments and national income. In order to estimate the effects of foreign investment, it is necessary to compare what has actually happened with what could be expected to happen if the foreign investment had not taken place. It was assumed that in the absence of the foreign firm its domestic sales would be completely replaced by indigenous producers or by imports of finished goods or by both. The degree of local replacement assumed in the "most likely" alternative situation varied for different firms, the average percentage replaced locally being about 27 per cent of domestic sales or 20 per cent of total sales in the case of the foreign-owned firms in Jamaica and 24 per cent of domestic sales or 15 per cent of total sales for the foreign firms in Kenya. The assumption of a low degree of local replacement of the foreign firms' domestic sales reflects many factors, the major one being the scarcity of indigenous entrepreneurs in these countries. In the case of exports the assumed degree of local replacement was substantially lower for the foreign firms' exports than for their domestic sales. The explanations are that size of firm is important for successful exporting - and the local firm is likely to be smaller than the foreign firm it partly replaces - and also any local replacement firm would have to compete with the parent foreign firm in third markets.

9. The second major assumption was that in most instances the indigenous firm would use much the same techniques of production and have the same ratio of imported costs to sales as the foreign firm it replaced. We did explore the scope for using different techniques of production and replacing imported materials and components by locally produced ones, but in the light of our investigations we considered it reasonable to assume that in the industries

examined in these two countries the indigenous firms would operate in much the same way as the firms they replaced.

10. On these assumptions, almost all the firms in our samples were found to have substantial and beneficial effects on both the balance of payments and the national income of their host countries. Thus, compared with what we considered to be the most likely alternative situation, the Jamaican sample of firms on average added each year the equivalent of 13 per cent of their sales[1/] to the balance of payments and 50 per cent of their sales to the country's income, while in Kenya the corresponding figures were 2 per cent and 45 per cent, respectively. As we were dealing with going concerns, our figures related only to part of the life span of the companies. Over the whole lives of the companies, though the average effects on national income would remain about the same, the annual contribution to the balance of payments could be expected on average to be of the order of 10 per cent of sales in the case of the Jamaican companies, and about 4 per cent of sales on average for the companies in Kenya.

11. These results were based on a number of assumptions as to what would have happened in the absence of the foreign firm about which there can be no certainty. But it appeared that the average effects of our sample of foreign firms[2/] on the balance of payments, though not on the national income, of Kenya and Jamaica were fairly insensitive to large changes in the assumed degree of local replacement. There were two forces at work pulling in opposite directions. The greater the degree of potential local replacement

1/ In principle, and in many other countries, other institutional forms including joint ventures, for example, are reasonable alternatives, but in Jamaica and Kenya arrangements of this sort are very rare. For manufacturing firms as a whole in the United Kingdom, one year's sales is more or less equivalent to the value of net assets employed. If this relationship holds roughly for Jamaica and Kenya, then all the figures in the text expressed as percentages of sales may be directly, though very approximately, translated into percentages of net assets.

2/ Though not the effects of individual companies.

the less the import saving of the foreign firm, but on the other hand, the greater the output of the local firm the higher its imports of capital equipment, other things being equal. Increasing the degree of assumed local replacement does, however, substantially reduce the effects of foreign investment on the national income of the recipient countries, though the effects still remain favourable. The average results on the balance of payments were reduced by assuming that indigenous firms had a ratio of imported current costs to sales, not equal to, but one-third lower than, the foreign firms they replaced, but the overall effects remain favourable.

12. Though the average effects on national income were reduced by these changes in assumptions, the ranking of individual companies was little altered. The ranking of companies by their effects on the balance of payments was also fairly insensitive to the changes in assumptions. This stability of rankings makes the choice of foreign companies by developing countries easier, since a company that appears to have relatively favourable effects on one set of assumptions is also likely to score well on other plausible sets of assumptions.

13. It is generally accepted that political and economic stability, rising incomes and expanding markets are necessary for attracting foreign investment. All these Jamaica and Kenya have. They have moreover, fairly well-developed financial sectors, good internal transport and communications systems, attractive climates and hospitable governments, which in Jamaica's case offers tax holidays of 10 to 15 years as well as various other incentives. But these are factors that permit foreign investment rather than draw it. Economic theory is still rather vague about what induces firms to grow, either locally or internationally. It is not clear to what extent it is the prospect of higher profits in the long run or whether the dominant motive is to protect existing profits from encroaching competitors. The impression we obtained from our interviews in both Jamaica and Kenya was that the major incentive for foreign firms to invest in these countries was the threat of exclusion from the market by another firm. Jamaica, in particular, has undertaken a programme of industrialization and to encourage local manufacture, offers protection against competing imports, and in cases where one firm can meet the entire local demand,

~~an~~ is assured monopolistic position in the market. Even where a number of firms are licensed to manufacture the same product, and where imports are allowed after being charged the protective tariff, the firm that tries to sell from abroad is obviously at a disadvantage when competing with locally based firms. This applies particularly to consumer and intermediate goods that are relatively easy to manufacture, such as cosmetics, pharmaceuticals, cigarettes or containers; more complicated items like heavy machinery and sophisticated or electronic equipment clearly cannot be made at this stage of Jamaica's development and will continue to be imported.

14. In both countries, for those goods which can feasibly be manufactured or assembled domestically there is pressure on firms which have sold to Jamaica or Kenya from abroad to set up manufacturing bases within those countries or face the risk of losing the market altogether. In large part, therefore, the investments are 'defensive', although with the prospects of capturing the markets of rival exporters who had kept away, they could also be said to have 'offensive' elements. The existence of the East African common market and the prospects for the Caribbean Free Trade Area (Carifta) have enhanced the attractions of investing in Kenya and Jamaica, both by threatening the loss of a larger market to those who do not set up plants, and, through the promise of a more extensive market, permitting a more economical scale of operations. Both Kenya and Jamaica are in favoured positions relative to the other countries in their neighbourhood because both are relatively large, with good infrastructures, stable political conditions and a relatively advanced manufacturing sector.

15. Our experience thus fully endorses the view expressed in the Reddaway report[1] that investment abroad by U.K. firms was to defend their positions in host countries, and had they not invested some other non-British firm would

1/ W.B. Reddaway and others, Effects of U.K. Direct Investment Overseas, Interim and Final Reports, University of Cambridge, Department of Applied Economics, Occasional Papers 12 and 15, 1967 and 1968.

have done so. We would stress the fear of tariff imposition more than the Reddaway report did, but we confirm that in the manufacturing sector the foreign firms were concerned less to exploit the particular advantages of the host country than to protect and expand their existing business.

The choice of companies

16. It is important to stress that the results for individual firms varied greatly so that the averages quoted are not good guides to the results that might be expected from any particular firm. As was noted above, our work is still at too early a stage for us to be able with any confidence to specify criteria which the governments of developing countries could use to decide which sorts of foreign companies should be encouraged and which discouraged from investing in their countries from the point of view of their effects on income and the balance of payments. As yet we have investigated foreign investment only in Kenya and Jamaica, and these countries, though representative in many respects of a number of small, open, developing economies, do have some features, like the relative ~~insignificance~~ scarcity of local entrepreneurs, which makes it hazardous to generalize from their experience. In addition, our samples were small and included only manufacturing firms. Even within manufacturing, there were some industries that were not represented in our samples. Nevertheless, in spite of all these qualifications we can draw some tentative conclusions from the work done so far that may be of wider application.

17. One conclusion is that in devising criteria for the selection of foreign companies it is important to examine combinations of characteristics of firms rather than to look at individual characteristics like export behaviour or reliance on imported materials, or the possibilities of local replacement, on their own. Characteristics that have favourable effects when found in association with some other characteristics, may not when in other combinations. Thus, a foreign firm that imports only a small proportion of its materials from abroad could be expected to have a markedly favourable effect on the balance of payments, if it had no potential local replacement. But, if in

the absence of the foreign firm, its sales would be wholly replaced by local producers, then the proportion of imported materials used by the foreign firm becomes much less important in affecting the balance of payments. Again, a firm that exports a high proportion of its sales can have a strongly favourable affect on the balance of payments, but not if almost all of its inputs are imported.

18. We are only just beginning to develop this approach and will need to study a wide range of firms in a number of countries before we are in a position to say anything authoritative about criteria of selection. But at the present time, we can advance one or two suggestions that may be helpful, based on our Jamaican and Kenyan experience. Thus, foreign firms that have all, or at least the first two, of the following three characteristics could be expected to have large beneficial effects on both the balance of payments and the national income of small, developing countries:

i) There should be little potential local replacement of the foreign firm.

ii) The direct and indirect import content of the costs of the foreign firm should be low.

iii) A relatively large proportion of the capital expenditure of the foreign company should be on assets with a high local value added content, typically land and buildings, rather than on assets which have to be wholly imported, as most machinery and vehicles have to be in Jamaica and Kenya.

iv) Profits and service payments paid abroad should be low in relation to the exports and import saving of the firm.

19. Foreign companies that cannot be replaced by local enterprise tend either to be very large, except where the local alternative is a public corporation, or to have well-established export connexions, or to use a patented or sophisticated technology. Firms with a low import content of costs tend either to have a high labour-to-capital ratio, or more frequently in manufacturing, to base their production on local materials. Finally,

manufacturing companies that spend a high proportion of their capital expenditure on locally supplied land and buildings rather than on imported capital equipment again tend to have a high labour-to-capital ratio.

20. Firms with a low import content of costs and a low capital-to-output ratio are usually found in industries such as food processing, textiles, clothing and footwear, wood and leather products and local mineral processing, which are generally regarded as offering the greatest scope for indigenous enterprise. Nevertheless, within these broad industrial groups, there are a number of products that could not readily be made locally, often either because the local firm would not have and could not quickly get the required technical knowledge, or because sales might be concentrated in export markets which the local firm may find it difficult to break into. Our experience in Jamaica and Kenya was that foreign-owned firms that manufactured such products had larger favourable effects on income and the balance of payments than foreign firms engaged in other branches of manufacturing. But though there may be products within the industries with a high local value added which could not be produced by local enterprise at the present time, as the host economy develops, local manufacture of these products will become feasible long before the local production of, say, many capital goods that are at present imported from abroad. It might be thought that foreign-owned firms should concentrate on those products which local entrepreneurs could not be expected to manufacture within the foreseeable future. But the primary issue is - what goods should be produced within the host country and what should be imported? Only at the secondary stage, when the scope for domestic production has been defined, does the question arise as to whether the goods produced domestically should be manufactured by local enterprise or by foreign-owned business. Those goods which indigenous entrepreneurs will be unable to produce for an indefinite period will often, though not always, be the goods which ought not to be produced in the host country by foreign-owned firms either, but should continue to be imported.

21. In Kenya and Jamaica, we found very few instances of foreign firms acting against the interests of the host country. In some countries, foreign

firms have been known to rely heavily on local borrowing to finance investment, so that in extreme cases where the ratio of local debt to foreign equity is very high and most of the capital goods used are imported there can be a net outflow of foreign exchange from the very start of the enterprise. Abuse of local borrowing facilities can, however, be prevented and was in Kenya by the Government limiting local bank overdrafts to a proportion of the overseas stake in the foreign-owned companies. Foreign firms are occasionally criticized for preferring to use imported materials rather than local ones to the detriment of the host country's balance of payments. We encountered a number of firms that appeared at first sight to be importing materials unnecessarily, but in each case, on deeper examination we found that the local materials were not adequate substitutes, being either of an inferior quality to, or more expensive than, the imported materials, or having a supply that was not large enough or reliable enough to meet the foreign firm's needs.

22. Unless there is a substantial transfer of foreign equity to local shareholders, the proportion of the host country's industry owned by foreigners is likely to grow over time. The pressure to transfer is particularly strong where the foreign-owned firm is thought or known to be making handsome profits. We did find some instances of such transfers in our sample of firms. But reducing the proportion of foreign ownership of foreign industry in this way can have adverse effects on the balance of payments of the developing country. The local purchase of equity in the foreign-owned firm involves the replacement of foreign finance by local funds. The immediate effect is to produce a repatriation of foreign capital, which has a large adverse effect on the balance of payments. The longer term effect is to reduce the outflow of profits going abroad. These effects on the balance of payments are somewhat analogous to what would happen if the developing country were to invest abroad in the industry of a ~~western~~ developed country. But that may well be the alternative use of the local funds if they were not invested in the foreign-owned company. Compared with that situation, which is quite a likely alternative in many developing countries, the effects of local participation on the balance of payments will be negligible. If, however, the purchase of shares in the foreign-owned firm is at the expense of investing in purely local enterprises,

then the adverse effects on the balance of payments and national income could be substantial. Any unfavourable balance of payments effects of local participation would be lessened if the foreign parent firm when its stake in its overseas subsidiary were reduced, reinvested the funds released within the same country. But this rarely happens in the small developing countries we have examined - for foreign parent companies have more than one subsidiary in each country.

Implications for policy

23. Our work has not yet reached the stage where we can lay down detailed principles for choosing between foreign investment projects but our experience in Jamaica and Kenya does suggest a number of policy issues that might be considered by governments in developing countries.

24. The first issue is whether there is not a case for reducing in future the inducements at present offered to foreign enterprises to persuade them to locate a subsidiary within the host company. In discussing their reasons for setting up a factory in Kenya or Jamaica, few of the firms in our sample considered the inducements offered by the host government to be of major importance. Most emphasized that their primary motive for investing in these countries was to protect an export market against the possibility of another foreign firm establishing itself with tariff protection in the host country. The foreign firms were, of course, glad to accept any inducements offered, but from our interviews with them it was apparent that in most cases the size of the tax concession and height of the protective tariff, where one existed, were both greater than was necessary to decide them to set up a plant.

25. Large inducements might have been required if the profit prospects had been unfavourable, but this was not the case in either Kenya or Jamaica. In Kenya, the average rate of profit on net assets employed was of the order of 20 per cent, while the Jamaican sample, which included a number of new firms still experiencing teething troubles and a few spectacularly unsuccessful firms, had an average rate of profit on net assets employed of about 10 per cent. High profits did not usually lead to adverse effects on the balance of payments since in most firms a substantial proportion of earnings were retained and reinvested in the company.

26. The companies that were well run and without too much surplus capacity earned very handsome profits indeed, in many cases much more than they could have reasonably expected to have got from similar activities in industrialised countries. This leads on to our second policy recommendation, that if developing countries wish to attract foreign firms to their shores, it might be more effective and cheaper to spend money in publicising the profitable opportunities for appropriate foreign enterprises within their economies rather than to offer largely superfluous financial incentives. As a first step, host governments could approach many of the firms that export to them. But there is perhaps greater scope for trying to attract some firms that have had no previous contact with developing countries, but have always manufactured and sold their products within industrialised countries. Many firms with high and rising labour costs in industrialised countries, if they were informed, might wish to take advantage of the cheap and abundant labour supplies in developing countries by transferring their operations to such countries, to the benefit of all concerned. We found a few firms of this sort in Jamaica operating under a scheme whereby foreign firms can obtain certain tax concessions from setting up in Jamaica if they undertake to export the whole of their production.

27. It is important to stress the need to attract only "appropriate" foreign enterprises to developing countries. Host governments may need to be more discriminating than some of them have been in the past. The minimum profitable size of establishment for the production of some goods is greater than the total market demand of many small developing countries. Firms producing such goods that are induced to set up plants within a developing country can only hope to operate at anywhere near full capacity if they export a substantial proportion of their output. But it may not be possible to break into nearby export markets and if this is the case, then the firm may have to produce at high cost, and even though protected by high tariffs, may still make losses. It would have been better, very often, for both the host economy and the firm itself, if it had not been established in the developing country in the first place, but had continued to supply the demand for its goods in the developing country by exporting to it. Our third recommendation, then, is the need for

governments in developing countries to exercise discrimination and restraint in attempting to attract foreign investment.

28. Our fourth, and final, point relates to governmental control and vetting of foreign enterprise. Most foreign businesses are so complex and affect the host economy at so many places that it is pointless for governments of developing countries to attempt a detailed supervision of all the activities of the foreign firm. If the host government attempts to do so, the main consequence will be to hinder the foreign enterprise from operating efficiently rather than to prevent it from acting against the host country's interests. The government's objectives would be more satisfactorily achieved by concentrating control on a few strategic areas and streamlining the handling of more minor matters so that they can be dealt with on a routine basis. Different countries will have different views as to which aspects of the activities of foreign-owned firms are of major strategic importance, but most governments of developing countries would probably wish, among other matters, to be concerned with (a) company prices and the level of protection to ensure that prices within the host country are not unreasonably higher than world prices; (b) major decisions on expansion, location and changes in goods produced; (c) inter-company transactions, and (d) the extent of local borrowing, local sales of equity and the repatriation of capital.

CHAPTER II

The Background to Private Foreign Investment in Jamaica

I. Introduction

29 ~~11~~. Jamaica is the largest island in the Commonwealth Caribbean, comprising an area of 4.4 thousand square miles and containing about 2 million people. It achieved independence in August 1962 and in 1963 launched a 'Five-Year Independence Plan' as its first step in a long term development programme. This was an instance of indicative rather than direct planning, the major effort being left to the private sector. It more than achieved its target of a 5% real growth per annum in GNP and the indications at present suggest that the country's creditable economic performance will be continued for some years to come.

30 ~~12~~. Jamaica is a prosperous country relative to underdeveloped countries in general; in 1968 its per capita income of £206 (U.S. $ 494) was somewhat higher than the average per capita income for Caribbean and Central America and considerably higher than that for the underdeveloped world as a whole. Though Jamaica is small and, like most other less developed countries, suffers from an inequitable income distribution, a lagging agricultural sector, a high rate of population growth and considerable unemployment, it also enjoys many advantages which make its prospects rather brighter than those of most other poor and small countries. Thus, Jamaica possesses some of the largest bauxite deposits in the world, a highly successful tourist industry, proximity to very rich markets, a well-developed educational system, a competent and stable government and an advanced institutional framework.

31 ~~13~~. It is not within the scope of this study to discuss the economy of Jamaica in any detail. We have, however, thought it useful to give some idea of its structure, the place of manufacturing within the economy, the importance of foreign investment, and the state of the balance of payments.

II. The Structure of Jamaica's Economy

32 ~~14~~. The Jamaican economy has traditionally been dominated by two agricultural products, sugar and bananas. Until some 15 years ago, agriculture provided

both the largest sectoral contribution to GDP and the bulk of the island's exports. With the growth of other sectors, the share of agriculture has declined steadily, and its contribution to GDP at factor cost has fallen from 31% in 1950 to 12% in 1960 and to 10% in 1968, while its share of exports has declined from 80% in 1950 to 34% in 1968. In part this has been caused by the slow growth of agricultural production itself and the peculiarities of the sugar market, but it also reflects the rapid growth of other sectors such as manufacturing, mining, tourism and government services.

33 ~~15~~. Manufacturing is now the largest single sector in terms of its contribution to GDP. Since 1963, however, it has barely kept pace with the growth of total product, and for the past four years its share has been stable at about 15%. The next largest sector, distribution, has steadily declined in its share of GDP, while construction has started on a slow recovery from the bottom of a ten-year cycle. Table II.1 shows the distribution of GDP at factor cost in Jamaica from 1959-68.

34 ~~16~~. Mining and refining have increased their share of GDP only slightly; surprisingly enough (or perhaps not so surprisingly) the only steady and noticeable increase has been recorded by public administration.

35 ~~17~~. GDP at current prices has grown by 87.4% from 1959 to 1968; gross national product (GNP) at current prices has grown by 88.2% over the same period. At constant prices GNP has grown at a compound rate of 3.2% per annum over the past ten years, the increase per capita being 1.2% per annum during this period. The growth of the economy has not been steady: the rate of increase was fastest in 1963-65, with a considerable slowing up in 1965-66 and a gradual increase since.

36 ~~18~~. The contribution of the various sectors to capital formation follows a rather different pattern from their contributions to GDP (see Table II.2) and it is of interest to compare their importance by this measure.

37 ~~19~~. The most striking point about Table II.2 is that it gives a very different picture of the manufacturing and mining sectors from Table II.1. Thus, the relative contribution of manufacturing to capital formation has declined from 18% in 1961 to 12% in 1967, while that of mining has shot up in a rather erratic fashion from 3% to 28% over the same period. Agriculture has fallen in importance in both tables, while the other sectors show slightly divergent

TABLE II.1.

Jamaica: Percentage Distribution of GDP at Factor Cost

	1959	1961	1963	1965	1967	1968
Agriculture, Forestry, Fishing	13.3	12.0	13.4	11.6	11.4	10.2
Mining and Refining	8.2	9.6	8.9	9.7	9.6	9.8
Manufacturing	13.8	14.2	15.4	15.0	14.9	15.1
Construction	12.1	11.2	10.2	10.7	10.8	12.4
Electricity, Gas, Water	1.0	1.2	1.2	1.4	1.4	1.4
Transport and Communication	7.7	8.0	7.4	7.4	7.4	7.4
Distribution	17.7	16.5	15.0	14.4	13.9	13.7
Financial Institutions	4.0	4.4	3.7	4.4	4.6	4.5
Dwellings	3.1	3.2	3.3	3.5	3.3	3.1
Public Administration	6.0	6.5	7.3	7.5	8.9	9.1
Miscellaneous	13.1	13.2	14.2	14.4	13.8	13.2
Total	100	100	100	100	100	100
Total GDP in J£m (Current Prices)	198.3	230.8	255.8	297.1	340.9	371.7

Source: National Income and Product (Preliminary Estimates, 1968), Department of Statistics, Government of Jamaica.

TABLE II.2

Jamaica: Percentage ~~Contribution~~ Distribution of ~~Selected Sectors to~~ Fixed Capital Formation by Selected Sectors

	1959	1961	1963	1965	1966	1967 (estimate)
Manufacturing	17.0	18.3	11.1	12.4	11.9	11.9
Agriculture	12.2	11.3	9.2	9.4	8.9	6.3
Mining and Refining	3.4	2.7	23.0	9.1	14.4	28.0
Electricity, Gas, Water	3.9	4.6	1.8	1.7	2.3	6.0
Transport and Communication	12.6	12.0	11.0	13.6	11.9	7.6
Construction and Installation	4.5	4.5	4.6	7.4	7.0	6.0
Other	46.4	46.6	39.3	46.4	43.6	34.2
Total	100	100	100	100	100	100
Total Fixed Capital Formation (J£ million at current prices)	45.4	48.9	45.8	62.1	73.0	86.4

Source: National Income and Product (Preliminary estimates 1968)

Department of Statistics, Government of Jamaica.

trends in terms of the two measures.

38 ~~20~~. The two most dynamic sectors in the economy as far as investment is concerned are the bauxite-alumina complex and tourism. The large jumps in investment in bauxite-alumina in 1963 and in 1966-67 result from the setting up of rather 'lumpy' facilities for alumina refining; this investment was mostly financed by inflows from abroad and is responsible for the acceleration in private capital inflows during 1966-68 (see Table II .5). The indications at present are that inflows by the bauxite companies have been maintained in 1968 and 1969, though the results in terms of output are not immediately apparent because of the lengthy gestation period of the investment.

39 ~~21~~. The extent of capital formation in tourism is not shown separately in the table on sectoral contributions. The following table (Table II.3) gives figures for capital formation by type of capital good, and shows the great importance of construction and building, which includes the bulk of tourist investment, in the total. Investment in non-residential building in particular has grown by about 127% during 1963-67, and construction as a whole has accounted for 65% of the increase in capital formation in this period.

40 ~~22~~. It is of interest to note that expenditure on industrial machinery and equipment virtually stagnated during 1959-67, its share of total capital formation falling from 18.1% in 1959 to 12.2% in 1965, though recovering slightly to 12.8% in 1967. Purchases of 'other' machinery and equipment, chiefly for the bauxite-alumina complex, have on the other hand increased by about £10 million over the period, though their share of the total has only risen from 21.8% to 22.8%.

41 ~~23~~. As mentioned above, the bulk of the investment in the bauxite-alumina sector has been financed by inflows from abroad (mainly the U.S. and Canada). The bauxite companies are all entirely foreign owned, and raise almost no capital in Jamaica. A substantial portion of the investment in tourism is also financed by inflows from abroad, and, while exact figures for this are not available, at a rough estimate the foreign stake in hotel ownership is between 50 and 65% of the total. Foreign capital is also flowing into holiday housing, which has become extremely

TABLE II.3.

Jamaica: Fixed Capital Formation by Type of Capital Good

(in J£ million, current prices)

	1959	1961	1963	1965	1967 (prov)
I Land Development and Buildings	22.9	23.9	20.7	30.5	46.6
of which, Non-residential buildings	10.4	10.9	9.3	12.4	21.1
II Machinery and Equipment	19.1	20.8	21.6	25.5	33.5
of which, Industrial	8.2	9.0	8.1	7.6	11.0
Agricultural	1.0	1.0	1.0	3.6	2.9
Other (largely alumina 1 refining)	9.9	10.7	12.5	14.3	19.6
III Other	3.4	4.3	3.4	6.0	6.0
TOTAL	45.4	48.9	45.8	62.1	86.1

Source: National Income and Product (Preliminary estimates 1968), Department of Statistics, Government of Jamaica.

popular among Americans on the north coast of the island.

42 ~~24~~ The industry group which used to attract the largest infows of foreign capital, sugar plantations and refineries, has ceased to draw significant amounts of money, either from Jamaica or from abroad. With bad weather, rising costs and consequent growing uncompetitiveness in world markets, Coupled with persistent bad weather Jamaican sugar producers have suffered large ~~falls~~ declines in profits, with net investment in this sector being very low or negative in recent years. There is a possibility, however, that in the near future the producers will be allowed to mechanise production more rapidly than has been ~~permitted~~ possible in the past: if so, fairly large inflows may take place to finance it.

43 ~~25~~ There has been a steady if not spectacular inflow of foreign investment into manufacturing in the past decade. As with tourism, no figures are available about the exact proportion of manufacturing industry owned or controlled by foreign firms, and it is difficult even to hazard a guess for so diverse a sector. Most of the intermediate goods industries are foreign owned with the exception of cement, and foreign investment plays an important role in the newer consumer goods industries. As is to be expected, most of the technologically advanced industries are wholly owned or controlled by foreign firms, while Jamaicans predominate in the smaller and more traditional industries. The manufacturing sector is discussed in greater detail below.

44 ~~26~~ As a consequence of the massive inflows of capital into mining, tourism and manufacturing, Jamaica has been able to sustain what is for an under- ×
developed country a remarkably high ratio of investment to national product (see Table II.4).

45 ~~27~~ The really large investments in relation to GNP took place in 1967-68, though high investment-income ratios were also recorded in some earlier years. The part played by private foreign investment is illustrated in Table II.5 which shows that in 1967 over 45% of gross domestic investment was financed by identified private capital inflows.

46 ~~28~~ The percentage of identified private inflows in total investment fell sharply in 1968, but this may have been due to the fact that unidentified inflows in that year were very large and with better identification most of these flows may be classified as private capital inflows. If the entire

TABLE II.4

Jamaica: Gross Domestic Investment and Gross National Product (at current prices)

	1960	1961	1962	1963	1964	1965	1966	1967	1968
GNP (in £ million)	227.3	242.7	253.5	270.1	294.5	318.7	339.2	362.4	395.7
GDI (in £ million)	51.9	53.0	52.0	49.8	60.4	64.5	75.8	88.3	115.8
GDI as % of GNP	23	22	21	19	21	20	22	24	29

TABLE II.5

Jamaica: Identified Private Capital Inflows and Net Investment Income 1962-68

	1962	1963	1964	1965	1966	1967	1968
Identified Private Capital (£m)	5.7	9.5	1.6	5.1	23.1	40.1	31.1
IPC as % of GNP	2.3	3.5	0.5	1.6	6.8	11.1	7.9
IPC as % of Gross Domestic Investment	11.0	19.1	2.6	7.9	30.5	45.4	26.9
Net Investment Income (£m) paid abroad (a)	-12.6	-13.2	-14.3	-15.3	-16.8	-18.0	-19.7

(a) Includes interest on public debt, insurance company transfers, remitted profits and undistributed profits of foreign companies.

Source: Economic Survey, Jamaica, 1967 and 1968. The Central Planning Unit, Government of Jamaica.

unidentified inflow of £19.4 million were private capital, the total for the latter for 1968 would become £50.5 million, and it would account for 44% of total domestic investment.

47 ~~29~~ Finally, a brief mention must be made of employment. Agriculture employs the largest number of people of all the sectors ~~(about 63 thousand in 1967)~~; wages and earnings are, with the exception of full-time plantation workers, very much lower than in other sectors. Manufacturing comes next with 43 thousand, followed by about 15 thousand in tourism. The service industries and construction are large employers, but the bauxite-alumina complex offers very little employment relative to its size and importance (about 5 thousand). Wages and salaries for all grades of labour in this complex are far higher than in other sectors of the economy. Manufacturing wages are approximately equal to the average for the economy, but within the manufacturing sector, industries such as beverages, petroleum and printing pay relatively high wages, while textiles, footwear and rubber products pay relatively low wages.

48 ~~30~~ Jamaica faces a serious and growing unemployment problem, particularly in urban areas. About 15-25% of the labour force is unemployed, and with a high rate of population growth and restrictions on emigration of unskilled labour the situation is getting steadily worse. Coupled with this is a brain drain of proportions large enough to cause serious shortages of skilled people, particularly in manufacturing and the service industries.

III. The Manufacturing Sector in Jamaica

49 ~~31~~ The manufacturing sector has grown ~~spasmodically~~ erratically over the past decade at the average rate of 5.7% per annum at constant prices. Its development has followed the standard pattern of a decline in the importance of food processing and the more traditional industries such as furniture and footwear, accompanied by a rise in the importance of 'modern' industries with complex technologies like chemicals, cement and metal products. Food products (including sugar, rum and other beverages) are still very large, and account for about 40% of total manufacturing output; the 'modern' industries contribute less than 30% (see Table II.6).

50 ~~32~~ Manufacturing has not yet reached an advanced stage in Jamaica, and is

TABLE II.6

The Structure of Manufacturing Industry in Jamaica

(percentages)

	1959	1961	1963	1965	1967	1968
Food (excluding sugar)	23.2	20.0	19.9	21.2	21.4	20.1
Sugar and rum	18.1	20.8	21.3	14.6	10.7	10.7
Alcoholic and other beverages	6.7	7.8	8.0	8.4	8.5	8.2
Tobacco and products	3.7	4.0	5.5	5.0	5.0	4.3
Textiles and products	6.4	6.5	7.2	7.8	7.1	6.9
Footwear	2.0	1.9	1.6	1.6	1.9	1.8
Wood and products	3.0	2.7	2.4	2.5	2.5	2.5
Furniture	5.0	4.8	4.2	4.1	4.0	4.1
Printing, publishing etc.	5.7	6.1	6.1	6.6	8.0	7.7
Leather and products	0.6	0.5	0.5	0.5	0.5	0.5
Chemicals	4.6	4.6	4.4	5.1	6.4	6.8
Cement and clay	7.5	7.0	6.2	7.7	7.6	8.6
Metal products	11.3	11.3	10.5	12.6	13.8	13.2
Miscellaneous	2.3	2.0	2.2	2.3	2.8	4.7
TOTAL	100	100	100	100	100	100
Total value added in Manufacturing Output (£ million at current prices)	27.3	32.7	39.4	44.6	50.8	56.2

growing by substituting domestic production for the simpler kinds of imported goods. ~~At this stage import substitution usually involves the assembly, blending or simply packaging of imported components, with value added in Jamaica constituting a relatively small proportion of the value of sales. Production units in the modern sector are, with some exceptions, small by international standards and thus have relatively high unit costs. To protect these firms against imports, tariffs are required in a large number of industries; in a few cases competing imports are completely banned.~~ Nevertheless, the average level of protection in Jamaica is low in comparison with most developing countries, and with the exception of the banned imports, a wide variety of consumer goods is freely available in the country. The government has always attempted to maintain an 'open' economy, and, with a favourable overall balance of payments position, has not found this too difficult to achieve.

51 ~~33~~ The formation of the Caribbean Free Trade Area (CARIFTA) offers excellent prospects for Jamaican manufacturing industry. Jamaica has the largest manufacturing sector in the Area, and with a common tariff barrier against imports from non-Caribbean producers it can be reasonably sure of capturing for itself an expanding share of the market. Producers of paints, pharmaceuticals, petroleum products, clothing and other goods have already established themselves as important exporters to other Caribbean islands (see section on balance of payments below).

IV. Industrial Incentives

52 ~~34~~ A distinctive feature of industrial policy in Jamaica is the old-established and comparatively liberal industrial incentive legislation. There have been three main laws: The Pioneer Industry (Encouragement) Law (1949), now replaced by the Industrial Incentives Law (1954); and the Export Industry Encouragement Law (1956).(1)

53 ~~35~~ Under the Industrial Incentives Law, a company producing particular products is permitted duty-free import of capital goods, and exemption from income tax for either all income for ten years from start-up or partial exemption on a sliding scale for six years commencing three years after start-up.(2) Under

(1) Similar provisions under separate laws cover textiles and petroleum refining.

(2) The exemption periods have recently been extended. However, the periods quoted in the text were the operative ones for the years covered by our study.

the Export Industry Encouragement Law, which requires firms to export the whole of their output, similar income tax concessions are granted, but in addition, all imported raw materials used or consumed in production are exempted from duty.

54 Further encouragement to industry is provided through the provision of factory buildings and facilities on the industrial estates of the Jamaican Industrial Development Corporation, which is also responsible for promoting new investment.

55 These benefits are available equally to local and foreign-owned firms. Not all firms are granted these concessions: approved status depends on assessment by the J.I.D.C. of the contribution of the enterprise to employment, exports, manufacture of new products and so on. Up to 1967, 181 firms had been granted approved status: of these some 30 were under the Export Law and the remainder were under either the Pioneer Industry (Encouragement) Law or the Industrial Incentives Law. Of our final sample of twenty firms, some seventeen had enjoyed incentive status on at least some of their output for part of the time, though a number of the older firms had run through their concessions by 1968. The majority of major new enterprises have in fact been operating under one of these laws, and they thereby account for a large share of output and employment in the manufacturing sector. In 1964/5, the latest year for which J.I.D.C. data were available, sales of incentive companies were £11.6m; investment totalled £10.0m, and employment was 8,229 of which some half was in Export Law companies.

56 The incentive legislation has been criticised as over-generous and unnecessary to attract fresh investment. We did not investigate this issue in detail, but we did gain the general impression that tax incentives had not been the deciding factor in investment decisions. However, they were clearly an important element in the creation of a generally favourable investment climate.

V. <u>The Balance of Payments</u>

57 Jamaica is heavily dependent on foreign trade: in the past decade exports and imports of goods and services have averaged 40% and 46% of GNP, respectively. With its efforts at industrialisation, the expansion of alumina refining facilities and the maintenance of a 'free' economy coupled with a shortage in

the domestic supply of foodstuffs, Jamaica has in the past three years become increasingly reliant on imports, and, despite rising exports, has incurred large deficits on the current account. Table II.7 shows the state of the balance of payments for 1961-68. Imports have been larger than exports for every single year in this period, with the gap growing larger from 1963 onwards. In 1963, however, the difference between exports and imports was small enough to be more than compensated for by net transfer payments, yielding the only current account surplus in this series. The growing deficits on current account have, nevertheless, often been more than matched by private capital inflows, and of the eight years 1961-68, five have seen an overall surplus in the balance of payments. Official capital inflows have been small, equivalent to about one-sixth of private capital inflows over the period 1961-68. In 1968, however, official inflows rose sharply, and, according to information available on aid commitments, will be maintained at the new level. Even so, private inflows will continue to be the largest item in the capital account for the foreseeable future.

58 ~~40~~ Jamaica has maintained parity with the United Kingdom in the external value of its currency. In November 1967 the Jamaican Pound was devalued to exactly the same extent as Sterling. In September 1969 the currency was changed to a decimal system and the new unit of account became the Jamaican Dollar, worth 10 shillings under the previous system.

59 ~~41~~ Table II.8 below gives figures for the main categories of exports from Jamaica during 1964-68. Bauxite and alumina are by far the largest exports of the island, accounting for nearly half the total value of merchandise exports in recent years. Agricultural products come next, with manufactured goods far behind, contributing about 9% of the total in 1964 and 12% in 1968.

60 ~~42~~ Of manufactured exports 75% is accounted for by the following products: clothing; minerals, fuels and lubricants; essential oils; toilet, polishing and cleaning preparations. Total exports of manufactured goods grew at an average rate of 17.5% per annum in this period, with chemical elements and compounds, pharmaceuticals, cement and metal manufactures being the fastest growing items.

61 ~~43~~ Tourism is the largest foreign exchange earner for Jamaica after bauxite-alumina, though, being an 'invisible export', it is not included in the above

TABLE II.7

Jamaica: Balance of Payments

(in £ million at current prices)

	1961	1962	1963	1964	1965	1966	1967	1968
Exports of Goods and Services	98.6	101.8	111.9	119.5	129.1	138.2	143.2	161.3
Imports of Goods and Services	106.9	111.1	115.1	140.3	144.9	159.0	173.1	208.3
Net Transfer Payments	4.8	6.3	6.5	5.5	4.9	3.6	3.2	3.2
Net Current Account	-3.4	-3.0	3.3	-15.3	-11.0	-17.2	-26.8	-43.9
Government External Borrowing	-1.6	0.8	2.2	4.1	3.0	3.7	2.5	6.3
Identified Private Capital	4.1	5.7	9.5	1.6	5.1	23.1	40.1	31.1
Unidentified Flows	-4.1	2.0	-1.4	2.1	-1.5	-2.9	-8.9	19.4
Overall Balance	-5.1	5.5	13.6	-7.5	-4.3	7.2	6.9	12.9

Sources: National Income and Product and Economic Survey.

Note: Minor discrepancies are due to rounding of figures.

TABLE II.8

Jamaica: Merchandise Exports 1964-68 (£ million, current prices)

	1964	1965	1966	1967	1968
Bauxite and Alumina	33.8	35.3	37.7	39.9	44.4
Sugar, Rum and Molasses	21.8	17.7	18.6	17.6	19.2
Bananas	6.0	6.1	6.3	6.6	7.0
Other food products[1]	4.8	5.1	5.3	4.6	4.9
Manufactured goods, of which:	6.7	7.9	9.0	8.5	10.8
Clothing	2.5	2.1	2.5	3.9	3.4
Minerals, Fuels, Lubricants	1.0	2.7	3.1	2.2	3.0
Others	3.2	3.1	3.4	3.4	4.4
Other products	2.5	2.9	3.2	3.2	5.1
Total	75.6	75.0	80.1	80.4	91.4

1. Includes citrus, cocoa, pimento, ginger and their products, but excludes essential oils.

Source: Economic Survey.

table. Tourists spent approximately £14 million in 1960, £16 million in 1964, and £37 million in 1968. The largest increases occurred after 1965, when the government started taking action to promote the industry abroad and to increase and improve accommodation in the main tourist areas in Jamaica. The contribution of tourism to GNP rose from 5% in 1962 to over 9% in 1968, and the increase will almost certainly be maintained into the early 1970's.

CHAPTER III

The Background to Private Overseas Investment in Kenya

1. The Structure of the Kenyan Economy

62 ~~44~~. Kenya, the most industrially advanced of the three nations of the East African Community, has a population of about 10.5 million. The total land area is 219.8 thousand square miles. The population is most heavily concentrated in Central Province and Nairobi District (about 350 to the square mile), and in Nyanza Province (about 300 to the square mile), both areas of high rainfall. Vast tracts of land, especially in the northern part of the country, are thinly populated by nomadic warrior tribes. In addition to being the most industrially advanced country of the East African Community, Kenya is also the wealthiest in per capita terms. In 1968, income per head was £43.7 compared with £24.9 for Tanzania and £32.4 for Uganda.

63 ~~45~~. The structure of the economy is changing very slowly. Agriculture, including estimated production outside the monetary economy, accounts for about 40 per cent of Gross Domestic Product, and employs almost 60 per cent of the working labour force. The following table shows the contribution to G.D.P. by sector:

Table III.1

Gross Domestic Product: Kenya,
percentages of total G.D.P. at factor cost 1963-68

	1963	1964	1965	1966	1967	1968 (a)
Agriculture (b)	43.5	43.3	39.4	41.8	40.7	39.6
Mining and Quarrying	0.5	0.4	0.4	0.4	0.5	0.5
Manufacturing, Building, Construction	9.6	10.2	11.3	10.9	11.1	11.4
Electricity and Water	3.6	3.5	3.6	3.8	4.6	4.7
Transport, Storage and Communications	7.4	7.7	8.3	8.4	8.2	8.3
Private Services	24.1	21.9	23.2	22.1	21.8	21.5
General Government	11.6	13.0	13.2	12.6	13.1	14.1
Total	100.0	100.0	100.0	100.0	100.0	100.0
£ million, current prices	304.04	331.35	330.49	385.03	406.69	430.73

Table II.1 (cont.)

(a) Provisional

(b) Includes non-monetary sector

Source: Government of Kenya, Economic Survey, 1969.

64 ~~#6~~ Table III.1 indicates that there is no one sector whose share of G.D.P. has notably changed. There has been a relatively high overall growth rate, but the share of agriculture, in both the "traditional" and "modern" sectors has been maintained.

65 ~~#7~~ The rate of growth of G.D.P. which Kenya has achieved since independence in December, 1963, has been substantial. This, together with the Government's continued friendliness towards foreign investment, has prevented any major flight of foreign capital from the country. Nevertheless, in spite of recent rapid growth and large inflows of foreign resources, Kenya is still in the same predicament as most other poor countries, with increasing population pressure on land , high urban unemployment and an inequitable distribution of income, in respect of both race and region, both between and within the rural and urban sectors.

66 ~~#8~~ A Development Plan was published in 1964, and a revised version, with raised targets, followed after two years. The private sector is of considerable importance in the economy, however, and this means that planning is of the indicative kind. A large part of the implementation remains outside the Government's direct control. Nevertheless, the Government has taken some part in the stimulation and guidance of economic activity, though this has been through more indirect channels, such as licensing and parastatal organisations, than through wholly state-owned enterprises. In terms of achievement of plan targets, the 1966-70 Development Plan has been successful. Over the period 1964 to 1968, the overall annual average rate of growth of G.D.P. was 6.8 per cent at current prices, and 6.3 per cent at constant (1964) prices. This is the precise rate projected in the Plan, though it would be unwise to rule out entirely the possibility of coincidence. The following table

gives a sectoral breakdown of the annual average rate of growth in real terms since 1964.

Table III.2

The Growth of Gross Domestic Product of Kenya, 1964 to 1968

	Gross Domestic Product at 1964 prices, K£ million		Average annual percentage rate of growth
	1964	1968 (provisional)	
			%
1. Agriculture, including non-monetary sector	143.59	170.68	4.42
2. Manufacturing	33.74	42.11	5.70
3. Mining, Building and construction, Electricity and Water	13.15	17.39	7.24
4. Transport, Storage and Communications	25.14	38.66	11.37
5. Private Sector Services	72.76	93.75	6.54
6. General Government	43.00	59.48	8.45
Total Gross Domestic Product	331.35	422.07	6.24

Source: Based on Government of Kenya, Economic Survey, 1969, Table 1.1, pp. 4-5.

67 ~~49~~ Agriculture has grown at a slower rate than total G.D.P.; manufacturing, building and electricity together at a slightly higher rate; and services at a notably higher rate.

68 ~~50~~ The categories in Table III.2 conceal differences within each industry group, and between each year in the period. Agricultural production rose by about 20 per cent in 1965-66 alone, though estimates of production outside the monetary economy are necessarily tentative. In the same year there was a sharp increase in building activity: a symptom of returning confidence after a year of independence. The growth in government services of 8.45 per cent overall, represents the attempt of a new state to establish itself. The rate of growth in other sectors seems

to have been more steady. The manufacturing sector has grown at a fairly even rate, though there was a drop in 1966-67. That year also saw a large increase in capital formation and capital inflows (see below) which were beginning to bear fruit in 1968. Growth in the transport and communications sector has been impressive, and there was a sharp increase in 1967 and 1968, the latter year seeing the opening of the Kindaruma Dam on the Tana River.

69 ~~51~~. Turning to investment, it can be seen from the following table that the shares of the major sectors in capital formation have undergone notable changes since 1964.

Table III.3.

Capital Formation in Kenya
percentage distribution by sector 1964-1968

	1964	1965	1966	1967	1968 [a]
1. Agriculture [b]	29.5	29.0	27.7	21.5	22.2
2. Manufacturing	15.4	16.2	15.5	17.1	15.5
3. Mining, Building and Construction	3.0	4.5	2.7	5.0	5.3
4. Electricity and Water	2.9	4.7	4.0	7.1	3.7
5. Transport, Storage and Communications	24.0	17.6	21.8	19.1	18.9
6. General Government	9.7	15.1	14.5	15.7	17.3
7. Other	15.5	13.0	13.8	14.5	17.1
Total	100.0	100.0	100.0	100.0	100.0
£K million, current prices	45.14	46.54	61.21	87.30	91.00

(a) Provisional
(b) Including non monetary sector

Source: Based on/ Government of Kenya, Economic Survey, 1969, Table 1.10, p. 17.

70 ~~52~~. Most striking is the sharp decline in agriculture's share of total capital formation. That of the transport sector also fell, though by a smaller amount, but the share of all other sectors rose in comparison with 1964. The sharp rise recorded for electricity in 1967 was due to the

Tana River development referred to above. Private capital formation has grown rapidly, but that of the public sector has outstripped it. As a consequence while private capital formation constituted 75.4 per cent of all fixed investment in 1964, by 1968 the private share had fallen to 62.6 per cent.

~~63~~ 71 The overall ratio of capital formation to Gross Domestic Product has grown in recent years to a very high level for an underdeveloped country (see Table III.4). Many advanced industrial countries spend less on investment than the 21.1 per cent of Gross Domestic Product spent by Kenya in 1968.

Table III.4

Capital Formation as a Percentage of Output in certain sectors, 1964-1968

	1964	1965	1966	1967	1968 (provisional)
Agriculture (including non-monetary sector)	9.4	10.4	10.6	11.3	11.8
Manufacturing	20.6	20.2	22.7	33.0	28.8
Electricity and Water	27.3	43.1	46.1	97.6	48.6
Transport, Storage and Communications	43.1	29.7	42.0	49.8	47.9
Whole Economy	13.6	14.1	15.9	21.5	21.1

Based on/

Source:/ Government of Kenya, Economic Survey, 1969, Tables 1.1 (~~Pages~~ pp. 4-5) and 1.10, p. 17.

72 ~~64~~ In all sectors, other than agriculture, there has been a high and increasing ratio of capital expenditure to output. In manufacturing, this trend seems likely to continue, despite the fact that excess capacity exists in many industries within the manufacturing sector. The reason for this is that industries which are new to Kenya are constantly being created. Recent examples are toothpaste and electrical goods. In addition many firms are prepared to set up subsidiaries to work, if need be, at less than full capacity, in order to protect their market from competitors, already in production in Kenya, who may have the advantage of high tariff protection. This is especially important where brand names and advertising

are significant in the market.

2. The Manufacturing Sector

~~58~~ 73 Table III.5 below gives some indication of the structure and recent growth of manufacturing in Kenya.

Table III.5

The growth of manufacturing industries in Kenya, 1964-68

	Index of Production, 1964 = 100					Proportion of gross product in 1966 (a)
	1964	1965	1966	1967	1968 (provisional)	
1. Food	100	99.5	102.8	110.2	113.0	13.0
2. Beverages and Tobacco	100	97.1	101.4	99.8	108.7	14.4
3. Textiles	100	111.1	135.4	149.4	205.1	4.2
4. Footwear and Clothing	100	118.9	132.6	125.2	146.5	4.3
5. Wood, Paper and Printing	100	125.6	140.6	149.4	138.3	11.2
6. Leather	100	96.7	110.0	100.0	116.7	0.8
7. Rubber	100	104.0	132.0	134.0	172.0	
8. Chemicals	100	100.6	112.4	109.2	118.4	14.8
9. Petroleum Products	100	118.8	119.3	128.5	126.3	
10. Non metallic Minerals	100	109.8	112.2	117.7	134.8	6.6
11. Metal Products	100	101.6	94.6	98.6	111.8	5.2
12. Non Electrical Machinery	100	122.9	167.1	180.0	170.0	7.6
13. Electrical Machinery	100	103.7	107.9	102.3	117.4	
14. Transport Equipment	100	103.2	108.5	119.8	128.6	15.8
15. Other	100	108.9	123.3	82.2	86.7	2.1
Total Manufacturing	100	105.4	111.9	116.2	124.8	100.0

(a) Gross Product = Value of sales plus resales plus change in stocks minus industrial costs.

Source: Government of Kenya, Economic Survey, 1969, Table 5.1. Page 83.

The chemical industry together with production of petroleum products has attracted substantial foreign investment during this last decade. Food, beverages and tobacco continue to be of considerable importance and have increased their output by about 10 per cent over the five years. The proportion of total output accounted for by these industries is, however, slowly falling and that of chemicals, metal products and machinery increasing. This process can be expected to continue.

~~56~~ 74 The scope for import-substitution is still great. A considerable number of foreign firms have set up subsidiaries in Kenya to produce goods that were formerly imported, particularly goods with fairly low capital-output ratios, for example, printing, toothpaste, batteries, cigarettes, window frames and plastic and metal containers. But much of the activity of these firms and of manufacturing in general consists of the processing of mainly imported raw materials and intermediate goods using almost entirely imported machinery and equipment. On the basis of the results for our sample of firms in manufacturing, the import content of manufacturing sales is of the order of 50 per cent or so. Most manufactured goods are produced mainly for local consumption, though there is considerable trade with Tanzania and Uganda.

57. The manufacturing sector is still small relative to other sectors in the economy, particularly if size is measured by employment rather than output (see Table III.6, below). Employment in manufacturing

Table III.6

Reported employment by sector in Kenya, 1958-67

thousands

	1958	1961	1963 (a)	1965	1967
1. Agriculture	249.5	252.0	217.5	213.4	196.3
2. Mining and Quarrying	6.4	3.8	3.2	2.3	2.4
3. Manufacturing	55.6	42.6	43.6	52.7	57.5
4. Building, Construction, Electricity and Water	23.4	20.4	11.6	11.3	25.2
5. Private Services	100.6	104.0	109.6	136.1	137.9
6. Public Sector	157.7	167.0	159.5	188.2	208.6
Total	593.2	589.8	545,0	604.0	627.9

(a) Between 1963 and 1964 there is a break in the series caused by fuller coverage of private industry and commerce. Source: Government of Kenya, Statistical Abstract, 1968, Table 184, p. 164.

has hardly increased during the last decade or so and for some years in the early 1960s was substantially lower than it had been in the 1950s. Since about 1964, however, employment has begun to rise slowly. The relative stagnation of manufacturing employment is partly explained by the increasing importance of foreign firms within manufacturing and the fact that such firms, using more capital-intensive methods have a higher output per man than do the indigenous producers.

58. Population growth and the actual decline of agricultural employment has produced a drift of labour to the towns but as labour requirements of manufacturing and sources have grown so slowly serious urban unemployment problems have resulted. In Nairobi, it is estimated that about 30 per cent of men available for work are unemployed.

3. The Balance of Payments

~~59~~ 75 Kenya is heavily dependent on foreign trade. In 1967, imports of goods and services were 37.3 per cent of Gross National Product, and exports 33.1 per cent.

Table III.7

Balance of Payments of Kenya 1963-68   £K million

	1963	1964	1965	1966	1967	1968
Current Account Debits, of which:	125.4	136.0	141.9	167.4	171.4	180.7
Visible Imports	82.3	87.3	97.4	113.5	116.5	121.1
Invisible Imports	43.1	48.7	44.5	53.9	54.9	59.6
Current Account Credits, of which:	124.3	146.5	142.2	160.8	152.0	165.6
Visible Exports	68.7	77.9	78.0	86.8	79.0	83.5
Invisible Exports	55.6	68.6	64.2	74.0	73.0	82.1
Current Account Balance, of which:	-1.1	10.5	0.3	-6.6	-19.4	-15.1
Visible Balance	-13.6	-9.4	-19.4	-26.7	-37.5	-38.5
Invisible Balance	12.5	20.5	19.7	20.1	18.1	22.5
Long Term Capital						
A: Private						
(i) Liabilities [a]	9.8	10.8	8.8	2.1	4.1	9.0
(ii) Assets [b]	14.1	17.0	7.3	1.1	+4.8	+1.5
Net Credit						
B: Government						
(i) Liabilities	9.4	3.0	9.6	12.5	8.7	7.2
(ii) Assets	0.6	5.5	3.0	+1.1	+8.5	+2.2
Net Credit	8.8	-2.5	6.6	13.6	17.2	9.4
Long Term Balance	4.5	-8.7	8.1	14.6	26.1	19.9
Short Term Balance	2.3	2.6	-2.4	-12.5	1.0	-9.7
Overall Balance	5.7	4.4	6.0	-4.5	7.7	-4.9

(a) This is the net increase in foreign long-term liabilities represented by equity capital, loan and debentive capital, and, retained profits after tax.

(b) This is the net increase in foreign long-term assets held by residents, represented by fixed assets, securities, local equity investment in foreign companies, long-term loans by residents to foreign companies, changes in the value of long-term assets held by resident companies (whether foreign or locally-owned) abroad; and dividends and interest due by foreign companies to residents but not yet paid.

Source: ~~Rn~~: Government of Kenya, Economic Survey, 1967, 1968, 1969 and Statistics Abstract, 1968

~~60~~ 76 The trade balance has been in consistent, and recently increasing deficit. This deficit has been financed by a favourable invisible balance and by long-term capital inflows, both official and private. The rising import bill reflects the continued dependence of the economy on foreign consumer goods, raw materials and intermediate goods. Growth in manufacturing investments tend to reduce dependence on imports of consumer goods, but not on raw materials and many intermediate goods. This is especially so as Kenya has been endowed with little mineral wealth.

77 ~~61~~. As far as exports are concerned, agriculture and tourism are still far ahead of manufacturing as foreign exchange earners, though petroleum products have been the third most important export for the past four years. The most important manufactured export, other than petroleum products, is cement. In 1968, exports of cement totalled £K1.2 million, including sales in Tanzania and Uganda. Of total exports tea and coffee have been the highest foreign exchange earners. Both these products are currently under international quota agreements, though the Tea Agreement is due to operate for twelve months only.

78 ~~62~~. The position with regard to Kenya's trade with the other East African nations is rather different. Here, Kenya is in balance of trade surplus, with manufactured goods providing the bulk of the exports. There is a strong preference among foreign manufacturers for locating their main production centre in Kenya to serve the whole East African market. There is evidence, however, that the Tanzania and Uganda markets are important to many producers. Unless firmer location criteria for new industrial projects are evolved by the authorities of the three countries, there is a danger of fragmentation, and, therefore, the loss of many of the Community's potential economic benefits.

79 ~~63~~. Among Kenya's invisible earnings, tourism is of considerable importance, accounting for about 20 per cent of invisible exports. In addition, Kenya supplies many services to Tanzania and Uganda, while Kenya-incorporated companies receive investment income from their subsidiaries elsewhere in East Africa.

Kenya has in recent years maintained a high level of foreign exchange revenue holdings. In December, 1967 there were £K31.6 million; in December 1968, £K43.2 million; and in March 1969 £K52.2 million. In 1968, reserves represented about 24 per cent of visible and invisible imports. Such a level of reserves can only be described as remarkable for an underdeveloped country.

4. The Extent and Importance of Foreign Investment in Kenya

80 Foreign investment has been of considerable significance in financing development in Kenya. Not only in manufacturing, but in the primary and tertiary sectors also, foreign enterprises have led the expansion of the economy. In agriculture, many plantations are partly foreign-owned, and a considerable portion of the arable and pastoral farming was carried on by European settlers. Since independence, the Government has followed a policy of transferring ownership of agricultural land previously held by Europeans to Africans, but foreign capital remains important in the plantation sector. In the services sector, many of the large trading houses are foreign owned, as are all save one of the commercial banks. The exception is the Government owned National Bank of Kenya Ltd. which was established in 1968. A large part of the activities of the transport and communications sector is accounted for by the three Corporations answerable to the East African Community - Railways and Harbours, Airways and Posts and Telecommunications. However, electricity and other transport services both involve large amounts of foreign capital, though there is a scheme for eventual local ownership of the East Africa Power and Lighting Company.

81 In terms of the balance of payments also, it can be seen that long-term foreign capital, both private and official, has been of importance in helping to finance the current account deficit. The item that we wish to concentrate on is the private "liabilities" item which represents the net increase in foreign long-term liabilities,

or the net inflow of foreign long-term capital, in each year. The decrease in assets held abroad in recent years has largely been due to the reduction in assets held by Kenya based companies in Tanzania, following upon the Arusha Declaration.

82 ~~66~~. In recent years, much of the net inflow has been accounted for by retained earnings by foreign companies. Reinvested earnings in 1966 were £K2.8 million, while the total net inflow for the year was only £K2.1 million. Again, in 1967, retained earnings, at £K4.4 million, were greater than the total net inflow. However, provisional estimates for 1968 indicate that while retained earnings were about £K5 million, total net inflow was £K9 million, so that now new money is being injected into the economy over and above that provided by retained profits.

83 ~~67~~. Comparing, however, net inflow with investment income, over a number of years, the result is unfavourable to the balance of payments. This is so because retained earnings must also be entered as a debit on the investment income side. The following table shows the position since 1957

Table III. 8.

Net inflows of private long term capital and net outflows of investment income, 1957-68

£K thousands

	Net Inflow of capital 1)	Net Outflow of Income 2)	Total Net Inflow
1957	1,119	5,360	-4,241
1958	650	5,450	-4,800
1959	375	7,016	-6,641
1960	5,462	7,283	-1,821
1961	-5,133	5,341	-10,474
1962	-2,696	4,845	- 7,541
1963	9,800	9,843	- 43
1964	10,800	8,665	2,135
1965	8,800	8,731	69
1966	2,100	8,750	-6,650
1967	4,100	9,170	-5,070
1968 (provisional)	9,000	9,590	- 590

1) Net increase in long term liabilities

2) Net outflow of dividends, interest and retained earnings after tax.

Source: East African Community Statistical Department and Central Bank of Kenya.

84 ~~68~~. The fall in net liabilities in 1961 and 1962 reflects some uncertainty in the immediate pre-independence phase. In 1962, new inflows of equity capital were only £K160,000, but rose in 1963 to £K2,158,000. In 1963 and 1964, there

were several large inflows in the electricity sector. The low figure for net inflow in 1966 was partly explained by another sharp drop in equity inflows (to £K77,000) and partly due to heavy repayments of loan and equity capital (about £K5.3 million). However, 1967 showed a sharp increase in gross inflows from £K7.4 million in 1966 to £K11.1 million. Repayments and redemptions were also substantially higher (about £K7 million). In 1968, the estimated gross inflow rose again to about £K13.9 million.

85 ~~69~~. The importance of retained earnings has already been pointed out. If retained earnings are eliminated from both "sides of the account", the position is as follows:

Table III. 9.

Net inflows of private long term capital and net outflows of investment income less retained earnings, 1963-68

£K thousands

	Net Inflows of capital 1)	Net Outflow of Income 2)	Total Net Inflow
1963	6,286	6,329	-43
1964	7,254	5,119	2,135
1965	5,782	5,713	69
1966	-700	5,950	-6,650
1967	-300	4,770	-5,070
1968 (provisional)	4,000	4,590	-590

1) and 2) As in Table III 8, less retained earnings

Source: East African Community Statistical Department

86 ~~70.~~ Retained earnings increased their importance in the total inflow, though as an absolute amount they have more or less remained at the same level until 1967 when they rose from £K2.8 million to £K4.4 million. There is a tendency for established foreign enterprises to finance expansion from retained earnings sometimes supplemented by a loan, while new inflows of equity capital and a large proportion of new loan capital is associated with the setting up of new enterprises.

87 ~~71.~~ Unfortunately up to date estimates do not exist for the sectoral breakdown of foreign private capital commitments. However, by examining figures for 1965 and taking into account trends in new investment since then, it seems that about 45 per cent of total foreign long-term liabilities are in manufacturing, about 25 per cent in trading and finance, and about 12 per cent in construction and electricity. About 50 per cent of the total equity investment in Kenyan incorporated companies, and a considerably higher percentage of the long-term loan capital, is held by non-residents. Often, however, the degree of foreign influence is not reflected in breakdown of the equity holding according to resident status. In many instances, the foreign shareholder is a company, while the local shareholding is by individuals.

88 ~~72.~~ For 1966-1968, figures for the gross inflow of foreign capital are available, and some indication of the significance of the foreign capital inflow can be obtained by comparing it with other key variables in the economy.

Table III. 10

Gross long term private capital inflow

in relation to other economic variables, 1966-68

	1966	1967	1968 (provisional)
Gross Inflow (£Kmillion)	7.4	11.1	13.2
As percentage of current account deficit	180.0	57.2	87.4
As percentage of current account deficit plus gross payments	79.6	42.0	68.4
As percentage of total capital formation at current prices	12.1	12.7	14.5
As percentage of private capital formation at current prices	17.7	19.9	23.2
As percentage of private capital formation at current prices less dwellings and breeding stock	22.9	23.5	29.5

Sources: Central Bank of Kenya; East African Community Statistical Department; Government of Kenya, Statistical Abstract 1968 and Economic Survey, 1969

89 ~~73~~. First, from the point of view of the balance of payments, it can be seen that private long-term inflows have been highly significant in maintaining the overall balance in the face of current account deficits. The percentage is

still high even when gross repayments are added to the current deficit. The percentages related to capital formation give some indication of the contribution made by private inflows to financing capital expenditure. In addition, it is estimated that at least 45 per cent of the new inflows are in the manufacturing sector. Taking 45 per cent as the actual percentage, then the contributions to capital expenditure in manufacturing by private long-term inflows were about 35 per cent in 1966, 33 per cent in 1967 and 42 per cent. in 1968.

90 Another way of illustrating the significance of foreign private capital is by examining the number of firms in each industry group, and comparing those which have some foreign ownership, and those which are entirely owned by residents. It is difficult, for this purpose, to arrive at a satisfactory definition of a foreign enterprise. In Table III 11. below, a foreign enterprise is defined as one in which a non-resident institution, usually a foreign company engaged in similar activity to the Kenya company, owns a portion of the equity capital. Often these shareholdings are accompanied by technical and financial advice and sometimes by long-term loans.