AID AND PRIVATE INVESTMENT

by

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I

The current conference has been looking at aid flows from two points of view, that of the recipients and that of the donors. In this paper, we want to keep this double perspective in discussing the relationship between aid and private investment. In the first part of the paper we outline the importance of aid programmes to the private sector of the donor countries. In the second part, we analyse the problems, as seen by the recipient, of direct private foreign investment, which is a method of transferring resourses.

Aid and private capital in the donor country.

The thesis of the first part of this paper is that the development of an increasingly integrated international economy, most notably in the form of international firms, has created a demand by these firms for the provision in the underdeveloped countries of the necessary conditions for profitable corporate activity. These conditions are neither being supplied by the private sector, nor by the governments of the underdeveloped countries. Rather they are increasingly being supplied by the governments of the particular foreign investor, or by international institutions funded and directed by developed country governments. The economic role of the state within national economies is in effect being internationalised in response to the internationalisation of private capital. We want to argue that an important portion of aid flows should be seen in these terms:

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that in this way the form, the terms and the direction of aid flows may be substantially understood.

We can distinguish two functions which the state has come to perform in national economies: first, it provides infrastructure, the means of communications, energy, water, housing, education, health, and political security; second, it manages the macro economy, intervening on both supply and demand in the real and monetary sectors, as well as supervising the nation's international economic relations. Recently, the emphasis in macro-management has shifted away from the control of short-term fluctuations to that of encouraging medium if not long-term growth. This has led to a concern with the supply side of the economy, with factor management (incomes policy, retraining, SET, investment incentives, state-financed research) and sectoral intervention (industrial re-organisation, the little Needies, the nationalisation of steel). Furthermore, in this double role of provider of infrastructure and macromanager, the state has come to perform a third function, that of a large, stable market through its necessary purchasing. These points hold, though in varying degrees, for all the advanced capitalist economies. Galbraith puts it thus: "the government fixes prices and wages, regulates demand, supplies the decisive factor of production which is trained manpower, underwrites the technology and the markets for products of technical sophistication."

In the underdeveloped countries during the colonial period, the role of the colonial government was less extensive. The international firms which did operate, mainly in primary production and extraction, tended to provide their own infrastructure outside the enclaves, or it might be financed by international portfolio investment. Self-provision was the tendency not only in roads, railways, houses, hospitals and schools, but also in terms of security. The East India Co. had its own army. Rhodesian police still wear the initials BSAC dating from the period of Company rule. Parts of the Congo as late as 1964 were being policed solely

by company security forces. Even in South Africa RTZ has to provide its own compound police to aid the national force in defending company employees property in the town.

Macro-management was less of a problem. The monetary domestic sectors of the economies were small, and the monetary system based on overseas branches of metropolitan banks had a consistent deflationary bent.

In the post-colonial periods, and in Latin America and Southern Europe, conditions were somewhat different. First an independent government, however closely bound to the former metropolitan power, still had the latitude to disrupt a foreign company's operations in a way quite distinct from actions by a colonial administration. In this situation, the minimisation of risk capital by foreign direct investors became a central concern, and the divestitute of the responsibility for infrastructural provision an obvious way to economise. For, to a firm, the infrastructure is not directly productive: it can be controlled by others without prejudice to the firm: as an investment it has long maturity, and offers rates of return which are relatively inferior to those enjoyed by most extractive firms. Certainly if the extractive operation and the infrastructure neccessary for the operation are indivisible complements then it may still be profitable for the firm to invest - the oil companies provide many examples. But in most underdeveloped countries the public provision of infrastructure is not only favoured by most companies who would have otherwise undertaken them for the sake of their specific operations, but also by companies who would have otherwise not found it worthwhile to invest.

Other factors are involved as well: while hospitals, and houses may be tied to the job, labour can less easily be. Thus a firm's investment in training may be nullified by the worker's switching of jobs, even migration: this has been a complaint of foreign investors in the underdeveloped West of Ireland for example.

Often, too, though there may be political reasons for providing infrastructure as a sign of contributing to a country's general development, there are cases where political factors point the other way: security and policing is the clearest instance.

These specific considerations of an international firm have tended to coincide with the wishes of underdeveloped country governments for general infrastructure for development, as well as with the political-economic concerns of the international firm's domestic government in the post-war period of national rivalries in what were previously highly protected and isolated economies.

This is the background to a modest but significant portion of aid flows, those aimed at providing infrastructure for already specified projects. If instead of analysing aid flows through public accounts, one approaches them through specific foreign direct investments, one finds hardly a case where a foreign investor who has found an otherwise economically worthwhile project in an underdeveloped country, has failed to arrange for a public aid flow to assist with the infrastructure. It is true of the Sashi development in Botswana, (World Bank funds for diamonds and copper by Anglo and RST respectively) of the Volta scheme in Ghana, of bauxite development in Guinea, of copper in Mauretania, and so on. It is difficult to derive global figures for this form of aid from the public aid accounts. Much though not all would come under the heading of project aid, though clearly projects have been of many other different types to those we are discussing. Nevertheless, in the US at least, parts of the business community look at aid in this specifically infrastructural way. As the US Chamber of Commerce put it in 1967, "Government-to-government programmes are needed initially to build the infrastructure for participation by United States and foreign private sectors in developing foreign economies." (67 : 436).

One of the functions of infrastructural aid has been to minimise the capital at risk to the international firm. The most usual form for this flow is government to government loans: but considerable amounts of aid have been given in the form of direct loans to or equity partipation in the operation itself. The Export-Import Bank in the US, which over the period 1945-63 disbursed $9.1b of funds, was instrumental in outflows of US private capital abroad of roughly $2.8b, a significant proportion of which went to underdeveloped countries. The CDC in Britain, and the Kreditanstalt fur Wiederaufbau in Germany perform similar functions, both in terms of loans and equity shareholding. The LAMCO iron ore project in Liberia is an interesting example of all three of the above-mentioned institutions providing loans to this joint venture. It is interesting that one of the criticisms made by the US business community of the World Bank was its requirement of a government guarantee for any loan not made directly to a member government. The International Finance Corporation was set up as a World Bank subsidiary in part to meet these criticisms, and currently follows a policy of taking up equity shares.

In relation to specific cash provision, British and US aid programmes have made a point of providing domestic currency as well as foreign exchange. The Cooley loans arising from the Food Programme PL 480 are perhaps the clearest example. These local currency counterpart funds are provided almost entirely to US owned or affiliated firms, and in the period June 1958 - December 1963 an estimated total of $186m. was committed by A.I.D. in this form linked with roughly twice the amount of private US capital ($366.8m).

In 1966, the total commitment had risen to $42.6m. Taking the use of funds in Turkey as an example, $3½m were lent to Ideal Standard Sanayi for plumbing supplies, and $1.9m. went to Comag Continental Magnezite Ltd. to finance mining facilities and magnezite ore.

for necessary imports to already established overseas companies, Britain's so-called Kipping aid is an instance, though loans under this scheme are limited.

Perhaps the most important form of risk minimisation provided by aid programmes to foreign investment has been in the form of insurance and political-legal guarantees. The insurance schemes exemplified by the AID Investment Guarantee Programme have been supplementary not competitive to private insurance schemes. The AID IGP was an extension of previous schemes, most importantly extending eligibility to wholly-owned chartered subsidiaries of US corporation - an extension which had been long pressed for by US international firms. The specific risk part of the programme had a coverage in 1966 of \$3.9b with a further \$1.2b. estimated for 1967. The guarantees covered inconvertability of earnings, expropriation, war, revolution and insurrection. The programme had a ceiling of \$7b in 1966 which AID were trying to raise to \$9b. The ceiling for the extended risk programme (covering 75% of a project's investment risks) in the same year was \$375m, though in fact the coverage between 1961-66 was only \$54.5m. This programme is assuming ever-increasing importance. It is noteable that whereas there is a similar scheme operating in Germany, there is little comparable in Britain.

The provision of politic-legal guarantees has been equally effective if less direct. The US now has foreign investment agreements with 73 countries, and as a general rule no US aid can be given to countries who have not entered into such an agreement. The Hickenlooper amendment, suspending aid to countries who transgress the foreign investment codes are well-known particularly because of the recent case of Esso in Peru. The amendment has been implemented in Ceylon, but for the most part, in Hickenlooper's words in 1966, "its great value is its nonuse rather than in its use: that is, its value is in its presence, and the fact that it can be used deters a great many countries from doing what they otherwise might do or not do."

This is an important point. Although the actual flow involved in the guarantees is small, they are central to the acceptability in the US of the whole aid programme. For aid flows, for whatever purpose, can be used as an important preserver of the necessary legal environment for international firms in underdeveloped areas, just as they can be used to create an economic climate suitable for foreign enterprise (the World Bank's activities in India in 1956-7 onwards are an interesting example of this).

We have discusses three aspects of the provision of the necessary conditions for private investment through aid programmes: the financing of specific infrastructure; the supply of funds; and the programme for investment guarantees and agreements. We should add to this, without elaboration at this point, the creation of a financial infrastructure through development banks, credit unions and co-operatives: the macro-management notable in the World Bank and IMF histories, as well as in the Franc Zone (Theresa Hayter's book on the latter, and forthcoming work on the former are most valuable in this respect): as well as certain parts of the military assistance budgets directed at internal order which, as we have noted above is, a most necessary condition from the point of view of business abroad.

What we have called the internationalisation of national state economic functions has importance not only for international firms investing in underdeveloped countries, but also for firms who benefit directly from aid, for whom aid constitutes a demand. One of the most interesting of these groups are the contracting industry who construct many of the infrastructural projects financed by government-to-government loans. In 1968 the top 400 construction contractors in the U.S. had a turnover of $28.6b., $3.5b. of which was abroad. The total industry, including construction services, engineering and consultants, and taking in associated, ancillary by-product industries, employs one out of seven people in the US, and accounts for some 15% of US GNP. By 1964, AID financed projects

going to the construction and engineering industry in the US totalled $4b, this in spite of the lack of an 'employee US constructors' clause in the Foreign Assistance Acts.

The Shipping industry, who do benefit under 'Ship American' provisions, had earned $80m from transporting AID goods abroad by 1964. The Housing industry benefit from an AID financed Housing Guarantee programme, which in 1966 stood at $125m. General management and consulting contracts, some of which may overlap with the construction industry, totalled $41m. in December 1966 with AID alone. If we also include (i) military manufacturers, who had a total world sales of $5.4b in 1967, and whose finance accounted for some 36% of the Export-Import Bank loans, (ii) the grain industry, 1/3 of whose total sales were financed under the PL 480 aid in 1965, as well as (iii) the general markets created by the rest of tied aid, or supported by export credits, then quite apart from the international firms who have direct investments abroad, there is a strong section of the US economy which gains considerably from the aid programme. Black's estimate for tied aid in AID's commitment is 85%, and Gand quotes 90% in 1967, providing a market of $1.1b . for US goods p.a., and over half a million jobs.

In one sense this aspect of aid expenditure parallels that of a national state's expenditure in providing a market. But the provision of suppliers' credits for example is much more a form of international hire purchase. When coupled with the extensive insurance schemes we have discussed above it appears that the national governments of developed countries are developing the functions of international financial intermediaries: functions usually provided by the private sector in industrialised countries.

To sum up the first part of our paper, we have suggested that a significant proportion of aid flows can be helpfully understood in relation to the growth of international firms, re-inforced by not-necessarily-international supplier firms. This is not to say (a) that a significant proportion of aid is not directly linked in this way, or (b) that the under developed country governments do not also see the types of aid flows we have discussed as in their interests qua governments. Rather if we look at aid flows in terms of a relationship between three units, the donor country, a donor-based company, and a recipient country, it is rare to find flows which transgress the specific or general interests of the important sections of the donor's private sector. Indeed many of the features of the aid flows, particularly those from the US, Germany, Italy and Japan, have been initiated by the private sector: the extension of investment guarantees, the move towards tieing, the pattern of grants of suppliers credits, or the interesting cases where aid is granted to compensate a donor's expropriated firms (see BSAC and UK aid to Zambia, or the compensation to UK settlers in Keyna).

Above all aid has been essentially complementary rather than substitutive to the donor's private sector's interests, and its administration guided to keep it as such.

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