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HOW DEVELOPING COUNTRIES DISCOURAGE GREATER U.S. TRADE AND INVESTMENT

A report prepared for the President's Task Force on International Private Enterprise

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EXECUTIVE SUMMARY

The greatest constraint to more U.S. trade with and investment in developing countries(LDCs) are world economic conditions. The global recession, high U.S interest rates and an overvalued dollar relative to world currencies dominate other factors. It is recommended that the President request another economic summit at which he would take the lead in developing a concerted program with other industrial countries to deal with these problems.

U.S. business involvement in LDCs is impressive. Worldwide, U.S. exports exceed those of any other country by more than $50 billion, and more than 40% of U.S. exports goes to LDCs. This percentage is higher than for any other industrial country except Japan. The U.S. has historically been responsible for about 50% of all foreign investments in LDCs, and for better or worse, this share appears to be holding up.

However, these business activities with LDCs are being conducted by an extremely small segment of U.S. firms. Less than 1% of all firms export more than 80% of the total, and an even smaller percentage export to LDCs. The same pattern holds for investment. The reasons for this limited involvement are primarily economic. LDC markets are simply too small for most U.S. firms to warrant the time and costs required to establish effective business relationships.

Emerging U.S. trading companies may play a useful brokerage role between U.S. firms and LDCs, and the U.S. government should do more to promote these activities. It is recommended that AID use trading companies in its project identification and design work. Through their involvement, more U.S. firms might be drawn into business relationships with LDCs; in addition, trading companies might find ways to leverage AID monies by identifying commercially sound projects and uncovering counter-trade opportunities.

An examination of LDCs' economic policies and discussions with Americans who have LDC business dealings indicate there are other factors that impede greater U.S. business involvement. Government controls are far more restrictive than American businessmen would like. The major restrictions are limitations on imports, price controls, local ownership and labor requirments, exchange restrictions, performance requirements, nationalized industries, and countertrade requirements.

Some of these regulations are imposed to deal with excess demand situations. Other controls are imposed to prevent real or imagined exploitation by foreign firms. There is also the desire to protect infant industries. The results of the above are usually to impair longer term growth prospects and discourage foreign business involvement.

<u>It is recommended that codification efforts to reduce tariff and non-tariff barriers to free market operations be continued. It is further recommended that the institutional settings for these codification discussions be reviewed and revamped such that more constructive dialogues between developed countries and LDCs can be conducted. AID should play a facilitating role by having its staff engage in policy dialogues with their counterparts in LDCs.</u>

Currently, U.S. policies and taxpayer monies are used to promote direct investment in LDCs. Questions have been raised concerning these government supports. At the very least, the government should make an equivalent promotional effort to support the sale of U.S. services to LDCs. <u>It is recommended that OPIC initiate a program to insure U.S. service contracts. In addition, it is recommended that AID take steps to promote services needed by LDCs through a restructuring of its technical assistance program. It is also recommended that the countertrade activities of other countries and U.S. firms be studied to determine whether new U.S. policy actions are required.</u>

The orientation of the AID staff needs to be changed somewhat. <u>It is recommended that AID recruit economists with international business and finance backgrounds. In addition, AID should recruit business school graduates who have specialized in international business and finance. Finally, AID should hire persons with technical training to interpret which of the emerging technologies have greatest applicability in LDCs. In addition to recruiting, AID should undertake serious training efforts to re-orient its existing staff.</u> Effective training can do the most to change AID's direction inasmuch as the potential for hiring new AID personnel is limited.

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1.0 INTRODUCTION

It is probable that the world-wide recession, high U.S. interest rates, and an over-valued dollar are the primary impediments to greater U.S. trade with and investment in developing countries(LDCs). Further, U.S. trade and investments in LDCs would be higher if the U.S. government adopted more "promotional"(and costly) international trade and investment policies.

This report will not deal with either of these matters directly. Instead, it will focus on how LDC "environments" and the policies adopted by their governments constitute disincentives to greater U.S. trade and investment. In the first two sections of the report, the major disincentives are described and documented. Following this, some "reasonable cost" suggestions[1] will be offered to reduce the disincentive effects.

2.0 BACKGROUND

Before getting to the main purposes of this report, it is worth pointing out that U.S. trade and investment performance, both world-wide and with LDCs, has been and remains impressive.[2] The United States remains the leading world exporter, followed by West Germany and then Japan. The table shows that as a result of the oil price increases that took place in the 'seventies, the U.S. market share fell to 12.7%, an 8.7% drop. During this

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1. There are two types of unreasonable costs to be avoided: firstly, actions that would significantly increase the U.S. government budget deficit; second, actions that would cause a significant misallocation of resources in the medium and longer term.

2. Details on U.S. foreign trade and investment performance are presented in the Appendix to this report.

period, Japan was able to increase its market share, but the rest of the industrial world suffered a dramatic reduction in market share. Both before and after the oil price increases, the United States has exported a greater share of its exports to LDCs than have other industrial nations. West Germany, sells a considerably smaller share of its exports to LDCs; in contrast, Japan sells a somewhat greater portion to LDCs. A comparison between 1971 and 1981 data[3] indicate that an increasing share of U.S. exports goes to LDCs.

Consider next investment performance. The U.S. owns about one-half of all the capital investments that have been made by industrialized nations. The United Kingdom remains the second-largest owner of capital stock, and Japan is now challenging West Germany for the third position. It appears that the United States is maintaining its fifty percent share of private foreign investments in LDCs. It also appears that Japan is moving aggressively in the investment field, and France somewhat less so.

Let us consider now the conclusions that can be drawn from this brief empirical review of the trade and investment activities of developed nations. It was to be expected that the dominant economic position the United States found itself in at the end of World War Two would deteriorate somewhat as the warring nations of Europe and Japan were reconstructed. Further deterioration was to be expected as the emerging nations of Latin America and Asia became increasingly competitive. Despite this and despite expensive efforts by governments of other industrial nations to promote foreign trade and investment(and with developing nations in particular), there has been little deterioration in the dominant position of the United States. The continued strong U.S. trade and investment performance raises questions concerning the need for new government programs to promote trade and investment. With this as background, we turn now to the developing country environment and how it discourages greater U.S. trade and investment.

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3. 1981 is the latest year for which the comparable data used in this report are available.

3.0 PERCEIVED AND ACTUAL INFORMATION INADEQUACIES

A businessman wants to know a lot about an environment before deciding to commit resources for trade and/or investment in that environment. Regarding developing country environments, four problems of an informational nature present themselves.

Firstly, there are problems stemming from a simple lack of information. The majority of American businessmen have only produced and sold in the large domestic market. Specifically, only 10% of American firms engage in any exporting, and of those that do, less than 1% account for 80% of U.S. exports.[4] Among American small businesses that do export, the major reason has been unsolicited sales orders.[5] In short, it appears that American business can be divided between large multinational corporations who have made the initial investment to learn how to invest and market internationally and the remainder(the large majority) that focuses almost exclusively on the domestic market. The little information this latter group gets on LDCs comes from the mass media which limits its coverage to exceptional events such as revolution or other forms of violent uprisings. For this group, the very thought of going to Africa is foreboding; and the idea of producing or selling in Africa is even more threatening.

Secondly, there is the problem of not being able to specify what information is needed to make a trade or investment decision. For example, for one who has conducted business entirely in countries that do not have foreign exchange restrictions, it is difficult to imagine what information one needs to have on a country with exchange restrictions to make a sound business decision.

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4. William E. Hurt, "Export Trading Companies: Forging A New Sales Tool", Business America, May 3, 1982, pp. 3-5. For further documentation on the lack of knowledge problem, see the results of the survey of the Fowler-McCracken Commission on government-business cooperation in the development world reported on in Attachment A to Private Enterprise Development: Preconditions, Experience, Policy and the Future, a paper prepared for the President's Task Force on International Private Enterprise, 1983.

5. Warren J. Bilkey and George Tesar, "The Export Behavior of Smaller-Sized Wisconsin Manufacturing Firms", Journal of International Business, Spring 1977.

Thirdly, even if a businessman is sure of the information he needs, there is the problem of knowing how to obtain it at reasonable cost. Actually, a large amount of relevant information on LDCs is available at low cost in the United States.[6]

Political and economic information on LDCs is available from a wide array of private and public sources. In the public sector, the U.S. Department of Commerce provides valuable economic information on LDCs in its Overseas Business Reports series. The State Department puts out information on current political developments in LDCs. Various publications of the World Bank, such as its World Tables and its External Debt Tables provide relevant, country-specific economic information.

In the private sector as well, there are numerous sources of relevant, accessible information. Several years back, the U.S. Comptroller of the Currency expressed fears concerning the extent of American bank lending to certain developing nations. This fear spawned a new service industry of international risk assessors.[7] It is now possible to obtain all types of qualitative and quantitative country-specific material on all possible risk dimensions.[8] Various organizations, such as The Economist and Business International, provide written materials on political and economic developments; they also do customized reports for clients.

On more technical issues, such as tax laws, exchange restrictions, and procedures to establish businesses in LDCs, several of the major accounting firms[9] provide detailed written services that are frequently up-dated. Certain media houses, such as BNA, also provide detailed information of

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6. Information for the remainder of this section came from interviews with international lawyers and accountants.

7. As one example of the market for these services, the Bank of America spends more than $1 million annually on its country risk rating service: John O. Wilson, "Measuring Country Risk In A Global Context", Business Economics, January 1979, pp. 23-27.

8. For example, see Stephen J. Kobrin, "When Does Political Instability Result in Increased Business Risk?", Columbia Journal of World Business, Fall 1978, pp. 113-122; R.J. Rummel and David A. Heenan, "How Multinationals Analyze Political Risk", Harvard Business Review, January-February 1978.

9. E.g., Price Waterhouse, Deloitte Haskins and Sells, and Arthur Anderson.

individual LDCs. The Washington embassies of many LDCs also provide useful information on tax and other regulatory matters.

The fact that the information is available does not mean it is easy to access. Indeed, law firms and accounting firms compete to serve as brokers of this information to American businessmen. And of course, the brokerage fees are high.

The final information problem concerns the fact that certain critical types of information are simply not available without visiting the LDC. Here, an anecdotal story is illustrative. A law firm was asked to answer various tax and regulatory questions for an American firm that was contemplating establishing a business in an LDC. The law firm wrote a thirty-page report based upon the sources mentioned above. In the transmittal letter, the law firm indicated that some exceptions to what they had indicated did exist. The law firm told the client orally that if you want to do business in the LDC, you go out and negotiate the best possible deal you can with the Minister of Finance.

The general point here is that in many LDCs, business deals are negotiated on an _ad hoc_ basis. Written materials and the opinions of experienced observers can provide useful indicative information, but meetings with LDC government officials will be required to determine what are frequently the most important conditions for a business operation.

The conclusion is that obtaining the information needed to make a sound business decision regarding trading with or investing in a developing country involves considerable up-front costs. Multinationals experienced in international dealings are more likely to know where to look and be willing to pay for critical information than are smaller and perhaps more technically innovative U.S. firms.

4.0 FREE MARKET CONSTRAINTS

In this section of the paper, attention is given to free market forces that work against greater U.S. trade and investment in LDCs.

4.1 Small Size of LDC Markets

For both traders and investors, there are fixed costs of entering any new market. Consequently, it is more attractive, *ceteris paribus*, to focus on larger markets. For an international trader, a country's imports are a rough proxy for his trading potential. The first column of Table 1 shows that taken in aggregate, the imports of LDCs are a small fraction of world imports.

Table 1. Percent Distribution of World Imports and U.S. Exports by Country Group*, 1981 (in percent)

Country Group	Group Imports	U.S. Exports
Industrial(incl. U.S.)	64.0	56.7
Africa	3.6	1.8
Asia	10.2	9.7
Western Hemisphere	6.4	16.7
Other	15.8	15.1

Source: IMF, Direction of Trade, 1983 Yearbook.

*Country groups include countries with exports that exceed $1 billion annually. Countries with smaller exports are grouped under the Other heading.

Asian LDC imports are only 10% of the total whereas the imports of Africa and the Western Hemisphere taken together only amount to 10%. Table 1 also shows where U.S. exports go. Overall, a greater share of U.S. exports go to LDCs than their market share of world imports would warrant. Specifically, the LDC share of world imports is 20.2%(taking African, Asian and Western Hemisphere LDCs together) whereas 28.2% of U.S. exports go to these country groupings. The U.S. exports less to African countries than their import share would suggest, but the U.S. exports far more to the geographically closer Western Hemisphere nations than their import share would warrant. The problem of exporting to LDCs is more difficult than these aggregate numbers would suggest. There are 38 LDCs with more than $1 billion in imports. To do business in each of these countries, there are significant start-up costs involved. In contrast, there are only 19 Industrial countries with far greater imports per country.

In these circumstances, it is only reasonable to expect the American trader to target first on the countries of the industrial world; their markets are considerably larger, and there are fewer nations involved.

As with traders, there are high initial costs for investors setting up to do business in a new country. Those high initial costs will not be as significant if the potential market is large. A rough measure of the potential market for the investor is the country's gross domestic product(GDP). If $10 billion is taken as a minimum market size to interest the international investor, the information presented in Table 2 is of interest.

Table 2.-Gross Domestic Product and Number of Countries, by Country Group*, 1981

Country Group	Aggregate GDP (in billions of dollars)	Number of Countries	Average GDP per Country
Industrial	4,663	20	233
Africa	274	7	39
Asia	735	11	67
Western Hemisphere	773	8	97

Source: World Bank: World Development Report, 1983.
*Including countries with GDPs exceeding $10 billion.

Once again, the industrial nations are overwhelmingly dominant. Their GDP far exceeds those of the developing nations; in addition, their average size is far greater than that of developing nations. In these circumstances, it is no surprise that the bulk of foreign investment has gone to the industrialized nations. As mentioned earlier, the U.S. accounts for roughly 50% of all investments in LDCs. This is all the more impressive inasmuch as the U.S. GDP is only 38% of aggregate GDPs of the industrial countries.

4.2 Limited Demand for U.S. Intermediate and Consumption Goods

Despite the popularity of certain American goods in LDCs(e.g., planes, jeans and music), the nature and magnitude of consumer outlays in LDCs differs markedly from what it is in the industrial world. When per capita income is less than $1000, consumer outlays will be made first and foremost for subsistence. Inexpensive food, clothing and housing will get top priority and items that are considered common in the U.S. (e.g., dishwasher and portable phones) will be seen as unnecessary luxury goods. This means the market for a wide array of U.S. consumer goods does not exist in LDCs.

Regarding the demand for intermediate goods, a large pool of unskilled laborers exists in most developing countries. As a consequence, more labor-intensive production techniques than are applied in industrialized nations appear warranted.[10] Admittedly, America has exported a considerable amount of plant and equipment to developing nations, but this has been done in the absence of more appropriate technology which is likely to be developed over the next decade.[11]

Of course, as LDCs develop, their consumption and intermediate good demand patterns will more closely approximate those of the U.S.; but for now, those differences constitute a barrier to greater U.S. trade and investment.

4.3 Competition

Historically, the U.S. has been at a competitive disadvantage in LDCs that were formerly colonies of the French, Dutch and English. In these nations, the colonial powers established

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10. For an elaboration of this point, see Dennis Livingston and Romesh Diwan, Alternative Development Strategies and Appropriate Technology, Pergamon Press, New York, 1979; see also Charles P. Kindleberger, Economic Development, Chapter 8, McGraw-Hill, New York, 1965.

11. See Krishna Kumar, "Third World Multinational Corporations: A Growing Force In International Relations", International Studies Quarterly, September 1982, pp. 387-424; see also Tamir Agmon and Charles P. Kindleberger, Multinationals From Small Countries, M.I.T. Press, 1977.

12. See Robert B. Stobaugh, "Competition Encountered By U.S. Companies That Manufacture Abroad", Journal of International Business, Fall-Winter 1976, pp. 33-43; see also John M. Stopford, "Changing Perspectives on Investment by British Manufacturing Multinationals", Journal of International Business, Fall-Winter 1976 pp. 15-27.

trading companies that today continue to do extensive business.[12] The Swiss have also several large trading companies that operate in a number of LDCs. More recently, the Europeans and Japanese have increased their efforts to place branches of their nationalized sectors in LDCs.[13]

Since the mid-'sixties when a number of LDCs gained their independence, there has been a rapid build-up in enterprises controlled by the governments of LDCs. While the track record of these state enterprises has not been good,[14] they have been given market advantages that makes them a competitive threat to U.S traders and investors.[15]

Finally, competition is coming from efficient local enterprises that have grown up in some of the more successful LDCs. For example, Japan, which used to be dominant in Asia, is now losing markets to enterprises of Taiwan and South Korea.

Of the competitors described above, perhaps the most formidable are those that have had a presence in the LDCs the longest. These entities have developed effective communications networks so necessary to knowing how to-conduct business in climates where personal contacts and government discretion play such important parts in business dealings.

4.4 Production Problems

One often hears the argument that because labor costs are lower in LDCs, American firms should be investing more and producing more of their products in LDCs. There are several problems with this line of argument. In the first place, while it is true that LDCs have low wage rates and often considerable unemployment, the number of persons with adequate training to work in American-type production operations is quite small, and these workers are in very high demand. In most LDCs, the demand for local managers

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13. See Kenneth D. Walters and R. Joseph Monsen, "State-Owned Business Abroad: New Competitive Threat", Harvard Business Review, March-April 1979, pp. 160-170.

14. For a discussion of their shortcomings, see The World Bank, Accelerated Rural Development in Sub-Saharan Africa: An Agenda for Action, 1983.

15. See Joel Davidow, "Multinationals, Host Governments and Regulation of Restrictive Business Practices", Columbia Journal of World Business, Summer 1980, pp. 14-19.

far exceeds the available supply. This means that a company setting up in a developing country will have to undertake considerable training; it will also have to pay for a large cadre of expatriate managers.

If a company is fortunate enough to recruit some good local managers, there is often a problem of differing management styles that must first by understood and then overcome.[16] Style differences can involve such things as how staffers at different line levels are treated and criteria for selecting a contractor. In time, these problems can be overcome; the point to make here is that management talent is in short supply in LDCs, and there are no inexpensive substitutes.

In the U.S., labor is expensive and as a consequence, business has developed capital-intensive methods of production. If a firm is to really take advantage of the inexpensive labor supply in LDCs, it should employ methods of production that are more labor-intensive. When it was initially observed that U.S. business was not using more labor-intensive methods in regions of low-cost labor, it was concluded that business was displaying a non-economic inflexibility. Later studies have indicated that once a production approach has been introduced and used extensively within an industry, it is expensive to develop and use a different production method.[17]

There are other production problems in LDCs. Efficient production requires a predictable flow of inputs, and the flows in LDCs are often quite unpredictable. Imported inputs might be delayed because of shortages in foreign exchange or transport inadequacies(e.g., in Lagos, freighters have had to wait more than 8 months to unload because of inadequate port facilities). Also, there can be frequent irregularities in the supply of electrical current. Again, ways can and have been found to deal with these problems; however, they are not the sorts of problems that American businessmen are accustomed to coping with.

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16. See Brian Toyne, "Host Country Managers of Multinational Firms: An Evaluation of Variables Affecting Their Managerial Thinking Patterns", Journal of International Business, Spring 1976, pp. 39-55; see also Stanley M. Davis, "U.S. Versus Latin America: Business and Culture", Harvard Business Review, November-December 1969, pp. 88-98.

17. James A. Lee, "Cultural Analysis in Overseas Operations", Harvard Business Review, March-April 1966, pp. 106-114; see also Walters and Monsen, op. cit.

4.5 Marketing Problems

Both U.S. traders and investors must concern themselves with marketing problems encountered in LDCs. As has been mentioned earlier, markets in LDCs are small as compared with markets in industrial nations. Beyond this, populations are often spread over large land areas which, when coupled with poor communications and transportation infrastructure, makes marketing an uncertain and costly undertaking.

4.6 Weak Macro Economic Situation

In the vast majority of LDCs, economic policies are such that aggregate demand exceeds what can be supplied locally and what can be provided by the proceeds of exports. As a consequence, both the importer and foreign investor are likely to encounter problems in trying to obtain needed resources. For example, cement might be needed for construction; there may be a long waiting line for locally-produeed cement, and because of a large balance of payments deficit, the government may be willing to provide foreign exchange for the importation of cement. Consider another example: an importer needs foreign exchange to import; because of a payments deficit, the importer might not be able to obtain the needed foreign exchange for imports. As a country's economic circumstances worsens, private sector economic activities are often the first to be squeezed. The government feels that its first responsibility is to maintain the consumption level of its citizens. The irony of this is that in the long run, this will just make matters worse because the economic activities being cut off are the only vehicles a country can use to emerge from an economic crisis.

4.7 New Trading Mechanisms

For reasons discussed in earlier sections, a large number of developed and developing nations are facing unprecedented balance of payments problems: they simply do not have adequate hard currencies to import what they feel they need. To deal with these problems, new trading mechanisms have been developed. In essence, these mechanisms place a requirement on the potential exporter to assist the buying nation deal with its payments problem. Three of the most popular mechanisms are counterpurchases, buybacks, and clearing agreements.

Under a counterpurchase arrangement, a supplier agrees to find export markets for a specified value of goods from the recipient nation. For example, the Italian fuels monopoly(E.N.I.) has an arrangement with Russia whereby its natural gas purchases are limited to what Russia agrees to purchase from Italy.

Under a buyback arrangement, a country exports a plant to another country. The exporting country agrees to either purchase or find markets for a certain share of the plant's output in future years. For example, Occidental Petroleum has helped Russia build ammonia plants; in exchange, Occidental is purchasing a portion of the plants' output.

Clearing agreements are used extensively by Eastern Bloc countries. Under such arrangements, countries agree to purchase certain amounts of goods and services from one another. Over the longer run, the sales are supposed to balance, but in the shorter run, large surpluses and deficits might be built up.

Clearly, such trading requirements constitute an additional complication for a potential American businessman attempting to do business in LDCs. Where an LDC is in a position to insist on such arrangements, the U.S. businessman will have to help the LDC deal with its balance of payments problem.

5.0 GOVERNMENT CONTROLS

5.1 Introduction

In the above section, attention has focused on basic economic considerations that have limited U.S. trade and investment activities in LDCs. However, in addition to these economic considerations, the governments of LDCs have adopted policies that have discouraged more U.S. business involvement. These policies, and the reasons for them, are presented in this section of the report.

There are four primary reasons the governments of LDCs have adopted controls that create disincentives for greater U.S. private sector involvement: an unwillingness to use monetary, fiscal, and exchange rate policies to reduce excess aggregate demand pressures, a desire to promote and protect local industry and related resources, fear of being exploited by foreign corporations, and a general preference for government rather than free market determination over how economic resources are allocated and benefits distributed. The restrictions that have been introduced for each of these reasons will be discussed below, with illustrations of how they have contributed to disincentives for greater U.S. private sector involvement.

5.2 Reluctance To Adopt "Western" Policies To Control Excess Demand

Among the Western, industrialized nations, there is general agreement that conditions of excess demand should be corrected through the adoption of policies that work through free market mechanisms. This agreement is manifested in the support of the International Monetary Fund and in the various efforts to codify free market practices through such mechanisms as GATT and the OECD. So, for example, when a country, either developed or developing, is manifesting excess demand in a balance of payments deficit, the Fund will insist on it adopting tighter monetary and fiscal policies, a reduction in market controls, and often a reduction in the value of its currency as preconditions for Fund support.

For various reasons, LDCs and some developed nations have been reluctant to adopt the Fund's recommendations.[18] Of course, if the Fund's recommendations are not adopted, the excess demand will have to be dealt with through other means, and frequently,these other means create disincentives for greater involvement on the part of U.S. and other foreign businessmen.

Consider, for example, an excess demand manifested in a balance of payments deficit. This deficit will result in a foreign exchange shortage, and some method will have to be employed to allocate the limited foreign exchange. Governments will often attempt to deal with this by imposing foreign exchange controls. Through these, interest, dividends and profits due foreigners will often be delayed; in addition, the amount of foreign currency available for imports will be restricted. Government bodies will frequently be empowered to determine foreign exchange allocations through the issuance of licenses, thereby inviting bribery and other forms of corruption to influence allocation decisions. Foreign exchange restrictions are by themselves disincentives to greater foreign trade and investment; corruption makes matters worse. A country might attempt to resolve its balance of payments problems by imposing import quotas or stiff import duties. Here again, both the U.S. investor and exporter are discouraged.

Internally, attempts are often made to resist the effects of excess demand through the introduction of price ceilings on the goods in greatest demand. Effective price ceilings reduce the incentives to produce the goods in greatest demand, thereby compounding the problem; frequently, the price ceilings are not effective and a black market develops. Governments attempt to minimize black market activity by giving government agencies monopoly power to purchase and sell goods in greatest demand. These agencies have often been inefficient and corrupt, thereby exacerbating the problem.[19]

There can be no question that when a country is facing an excess demand imbalance, whatever steps are taken to correct the imbalance will not be popular with certain groups. Consider the Western free market solutions. Tighter fiscal policies mean either higher taxes, a reduction in government expenditures, or

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18. For an interesting discussion of the reasons for this reluctance, see Robert H. Bates, Markets and States in Tropical Africa, University of California Press, Berkeley, 1981.

19. For documentation on how the above policies have failed, see The World Bank, Accelerated Development in Sub-Saharan Africa: An Agenda for Action, 1983.

both. Tighter monetary policy means credit will be more expensive for both public and private sectors. A currency devaluation will cause the costs of imports to increase. However, it is also clear that the selective controls that LDCs often choose to impose to deal with excess, such as those described above, create particular disincentives for foreign private sector involvement.

5.3 A Desire To Promote and Protect Local Industry and Local Resources

Many of the disincentives to greater U.S. business involvement in LDCs stem from their desire to promote local development. So, for example, regulations are established to limit imports that would compete with the expansion of local industries thought important to overall national development. So also, performance requirements are imposed on foreign private investors. These performance requirements take various forms, such as local employment targets, output targets, domestic value added targets, import ceilings, export goals, limitations on expatriate employees, the sharing of technologies, and local ownership stipulations. Of course, there is much controversy over whether these restrictions impede or promote LDC development.[20]

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20. For a detailed discussion of these restrictions and how they can impede local development, see Enyinna Chuta and Carl Liedholm, "Rural Non-Farm Employment: A Review of the State of the Art" Michigan State University Rural Development Paper # 4, 1979; for arguments that justify some of these restrictions, see Richard Newfarmer(ed.), _Profits, Progress and Poverty: Studies of International Industries in Latin America_, University of Notre Dame Press, forthcoming.

It is notable that developed nations, including the United States, are discussing or actually imposing similar requirements on foreign investors;[21] it is also understandable that American businessmen would argue against such restrictions in LDCs.[22]

In one area, LDC governments' unwillingness to impose restrictions appears to be a significant deterrent to greater U.S. business involvement. This is the area of patent, copyright and trademark laws and enforcement. Increasingly, infringements in these areas are a cause of concern for U.S. business.[23] U.S. businessmen argue that the returns for trade and investment are greatly reduced by pirating in these areas.

5.4 Fear of Exploitation by Foreign Multinationals

Over the last two decades, there has been an outpouring of literature on how multinational corporations have exploited developing nations for their own profit and forced the LDCs into a dependency role. Perhaps the most widely read case study was done by a group of Northwestern University professors on iron ore development in Liberia.[24] The question here is not whether these charges are correct; the important point is that they have made LDCs cautious in their public dealings with multinationals, and this caution has taken the form of various restrictions on corporate activity.

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21. For example, see Rajan Das, "Impact of Host Government Regulations on MNC Operation: Learning From Third World Countries", Columbia Journal of World Business Spring 1981, pp. 85-90; see also C. Fred Bergsten, Thomas Horst, and Theodore H. Moran, "Home Country Policy Toward Multinationals", Chapter 16 in International Trade and Finance, R.E. Baldwin and J.D. Richardson, eds., 1982.

22. See International Investment: A Plan For Action, a statement of the Business Roundtable, April 1983; see also the Fowler-McCracken Commission Survey, op. cit.

23. See ibid.

24. Robert W. Clower et al, Growth Without Development: An Economic Survey of Liberia, Northwestern University Press, 1966; for an example of the literature on other LDCs, see Andre Gunter Frank, Dependent Accumulation and Underdevelopment, Monthly Review Press, New York, 1979.

For example, in many LDCs, foreign companies are only allowed to operate in certain industries, and many of the performance requirements have been inserted in response to fears of exploitation.[25] There are also increasing fears in some of the emerging LDCs for the environment.[26]

Taken together, the red tape and regulations erected with the aim of protecting LDCs from alleged exploitation are indeed formidable. It should be remembered, however, that these are signs of public concern, and large firms using contacts and the right tactics are often afforded quite different treatment.[27] The area of corporate taxation is a case where past arrangements have lead to charges of "sweetheart deals". Today, efforts are being made to conform tax practices worldwide, but ignorance of what others are doing, differing philosophies of taxation and court rulings that sometimes appear inconsistent with the intent of a country's tax legislation make progress in this area slow.[28] The results can be overtaxation of corporate activities; but the results can also be extremely favorable to foreign corporations.

5.5 Preference for Government Controls

With the exception of a few Asian countries, Americans are bound to be struck when travelling in LDCs by the extent of government control over economic activities. In talking with government officials, there is a much greater fear of negative effects from free market policies than of negative effects from government-controls than is the case in the United States. In part, this is attributable to the training government leaders

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25. See R. Das, *op. cit.*

26. H. Jeffrey Leonard and Christopher J. Duerksen, "Environmental Regulations and the Location of Industry: An International Perspective", *Columbia Journal of World Business*, Summer 1980, pp. 52-64.

27. See Fumihiko Matsuda, "Aggressive Tactics Launched to Win Plant Export Contracts", *Business Japan*, November 1980, pp. 69-79.

28. For an excellent summary of international tax developments. see Elizabeth A. Owens and Gretchen A. Hovemeyer, *Bibliography on Taxation of Foreign Operations and Foreigners: 1976-1982*, International Tax Program, Harvard University, 1983.

received in Western universities, both in Europe and in the United States. In most of the development programs at Western universities, much time and attention is devoted to market imperfections and how they impede meaningful development with equity.[29] The documentation on the bad effects of market solutions is quite convincing, and it does suggest the need for greater government intervention than U.S. firms are accustomed to. The problem with these courses is that they do not then examine the shortcomings in the performance of planned economies, and even if they do, they do not provide one with the pragmatic tools(if there are such tools) whereby to effectively develop a government controlled economy.

In short, development courses spend a lot of time on free market shortcomings; they do not spend an equivalent amount of time debunking government control shortcomings. This can leave the student with the impression that government controls are preferable. In addition, little time is given to the practical issues of how to effectively manage a controlled economy. The result is that when students return to their countries and become government leaders, they impose government controls that are often poorly conceptualized and poorly implemented.

29. For an interesting article on this phenomenon, see Daniel P. Moynihan, "The United States in Opposition", Commentary, March 1975, pp. 31-44.

6.0 OTHER FACTORS

This report has dealt with both economic considerations and LDC government restrictions that tend to discourage greater U.S. trade and investment. This section looks at certain other LDC circumstances that discourage greater U.S. business involvement.

6.1 Political and Military Uncertainties

Over the last two decades, nearly all LDCs have been associated with political and/or military activities that have concerned foreign businessmen. These uncertainties are likely to continue as long as there is U.S. pressure for LDCs to adopt more democratic institutions.[30] As mentioned earlier, there is no shortage of information on these uncertainties; in addition to almost immediate media coverage, there are all sorts of organizations to help business assess risks in LDCs.[31]

While this new information on risk is undoubtedly of some benefit, risks remain, and the larger companies that already have associations with LDCs are likely to be in better positions to cope with the uncertainties than are firms considering first-time involvements.

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30. As Samuel Huntington pointed out in 1968, increasing the say of the citizenry is likely to increase the chances for change: Political Order in Changing Societies, Yale University Press, New Haven.

31. E.g., Thomas L. Brewer, "Political Risk Assessment for Foreign Direct Investment Decisions: Better Methods for Better Results", Columbia Journal of World Business, Spring, 1981, pp. 5-12.

6.2 Expropriation

Expropriation, which in this context means the take-over of American overseas investments, is a clear and obvious deterrent to greater U.S. business involvement. A deterrent effect is likely to exist whether or not the actions occur in accordance with the U.S. government interpretation of international law.[32] There is some evidence to suggest that the frequency of expropriations is on the decline.[33] This decline is consistent with the hypothesis that an expropriation increase occured as nations became independent and took actions to throw off their colonial pasts. The decline is also partially attributable to the recognition by LDCs that expropriation is likely to eliminate any significant inflow of foreign private capital.

In order to make a determination of the proper U.S. government policy towards expropriation, several points need to be kept in mind. Firstly, inasmuch as almost 50% of all foreign investments in LDCs have been made by U.S. businesses, the U.S. government must strongly defend these investments.

A tougher question is whether U.S. government policy should be to promote additional U.S. investments in LDCs, as the OPIC program currently does by providing insurance against certain expropriation risks. The traditional argument in support of overseas investments are that they will result in future profit remittances, thereby strengthening the U.S. balance of payments. Today, there are two additional arguments they need to be considered. Firstly, it is said that an investment must be made as a precondition to doing business in many developing nations. Secondly, it is argued that it is easier to maintain control over a technology if it is used in a plant owned by a company than if it is provided through a technical assistance contract. There are those who question the legitimacy of each of the above arguments.

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32. Under the U.S. interpretation, expropriation should not occur unless the taking: a)is done for a public purpose; b) is accomplished under due process of law; c) is non-discriminatory; d) does not violate any previous contractual arrangements between the national or company concerned and the government making the expropriation; e) is accompanied by prompt, adequate and effective compensation.(Taken from a "Statement by the President on International Investment", September 9, 1983, p. 5.)

33. See U.S. Department of State, Bureau of Intelligence and Research, "Disputes Involving U.S Private Direct Foreign Investment: March 1, 1980-September 30, 1982".

However, in order to get a balanced perspective of the pros and cons on this issue, it is important to understand the views of LDCs towards these investments. Empirical studies show that expropriations occur most frequently in the extractive industries(i.e., oil and minerals.[34] A significant number of expropriations have also occured in utilities, transportation, and finance. Relatively few have occured in manufacturing and other sectors.

Regarding extractive industries, LDCs view these as non-renewable assets and believe that they should have greater control over their exploitation then they can when they are owned by foreigners. Utilities and transportation sectors are viewed as vital to national security and again, there is a desire for control. Rightly or wrongly, LDC governments have always been suspicious of foreign banking operations, believing they should do more to promote local industry.[35]

One troubling aspect foreign investment in LDCs "...relate to the special rights derived from ownership, which theoretically extend to perpetuity."[36] When a country accepts a foreign investment, it gains access not only to financial resources but also to entrepreneurship, management skills, technical knowledge, and organization required to put these assets to effective use. As time passes, an LDC's capabilities in these areas will increase, and a point is usually reached where they seriously question the need for one or more these foreign services. Indeed, there are numerous examples of LDCs that have learned their lessons well and where local industry successfully competes in international markets.

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34. David G. Bradley, "Managing Against Expropriation", Harvard Business Review, July-August 1977, pp. 75-83.

35. For a fuller discussion of these views, see Robert G. Hawkins and Norman Mintz, "Government Takeovers of U.S. Foreign Affiliates", Journal of International Business Studies, Spring 1976, pp. 3-16.

36. Peter P. Gabriel, "MNCs in the Third World: Is Conflict Unavoidable?", Harvard Business Review, July-August 1972, pp. 93-102.

In these circumstances, some have doubted whether the interests of either developed or developing countries are served by traditional forms of direct foreign investment. As one expert suggested back in 1972, "...it is hard to resist the conclusion that the era of the MNC as a traditional direct investor is coming to an end in less developed countries."[37] Since then, foreign businesses have developed new working relations with LDCs. One of the most popular is to provide management and technical assistance services under contract to LDCs. To cite but one example, an African country nationalized the tire industry several years back, taking over the operations of a large foreign corporation. The foreign corporation now has a service contract with the government. The author of this report was told that the management fee is more lucrative than profit remittances were formerly. Recently, because of a balance of payments crisis and ideological reasons, all profit, interest and dividend payments were suspended; nevertheless, the management fee continues to be paid in hard currency.

The above discussion raises interesting questions concerning what role, if any, the U.S. government should play in the promotion of U.S. investments in LDCs. It also suggests attention should be given to developing new government mechanisms to encourage the sale of U.S. technical and management services to LDCs.

6.3 Differing Business Practices

In some LDCs, bribes and what U.S. businessmen would see as blatant conflicts of interest are the accepted ways of doing business. For example, in one large Asian country, licenses for foreign concerns to do business are handed out by the Ministry of Foreign Affairs. The Minister is also a senior partner in the country's largest law firm, and it is understood that one should hire his firm to obtain the business license.

Consider another example. While LDCs are afraid of being exploited by multinational corporations, their laws rarely reflect the concern for competition that serves as the basis for U.S. anti-trust laws. Single firms dominating the market are common in LDCs.

37. Gabriel, *op. cit.*

Given these realities, there is some question as to whether U.S. laws should apply to U.S. corporations operating outside of U.S. boundaries. It has been noted that the United States is the only country that makes its anti-trust laws applicable to its foreign as well as domestic commerce.[38] Similar observations have been made about the Foreign Corrupt Practices Act. Detailed attention has been given to how U.S. laws might be changed,[39] and it now appears that changes are underway.[40]

38. See Davidow, _op. cit._

39. See Raymond Vernon, "Antitrust and International Business", _Harvard Business Review_, September-October 1968, pp. 78-87

40. An example of change is the government's recent decision to allow U.S. computer companies to pool certain types of information and work together in international markets.

7.0 RECOMMENDATIONS

7.1 Promoting World Recovery

At the outset of this report, it was suggested that the worldwide recession, high U.S. interest rates, and an over-valued dollar are probably the most important deterrents to greater U.S. business involvement in LDCs. Quantitative estimates of the importance of these factors are subject to various reservations, but the modelling work that has been done are at least indicative of the magnitudes involved. For example, William Cline has recently developed alternative scenarios for LDCs based upon different growth rates for industrial countries.[41]Using as a sample the 19 LDCs facing the most serious debt problems, he estimates that the 1986 exports of these countries will be $304.7 billion if industrial countries growth rates have rebounded to 3.5% annually by then. If industrial countries come out of the recession more slowly and are only growing at a 1.5% rate by 1986, their exports will only amount to $254.3 billion. Under this latter, more pessimistic scenario, Cline estimates the debt problems of these countries will be almost unmanagable, with the overall net debt to export ratio of 2.20; in contrast, if industrializeo countries are growing at a 3.5% rate, the overall LDC debt to equity ratio will be a far more managable 1.41. Of course, the LDCs will be able to attract more foreign investment and be able to purchase far more imports under the more optimistic scenario.

The value of the dollar is closely tied to U.S. interest rates. So long as rates remain high, capital will continue to enter the United States. This capital inflow keeps the dollar strong, despite our worsening competitive position which is manifested in projected trade deficits approaching $100 billion annually. Putting it somewhat differently, high U.S. interest

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41. William R. Cline, "International Debt and the Stability of the World Economy", working paper 4 in the Policy Analyses in International Economics series of the Institute for International Economics, September 1983.

42. In passing, it should be noted that reducing the size of the U.S. government deficit--the solution often put forth to reduce interest rates-will have a deflationary effect and hence work against the recovery. To this author, the best solution is to have the Federal Reserve buy up a sufficient portion of the deficit so that interest rates move downward. Of course, the Fed should at the same time keep an eye on the domestic inflation rate.

rates[42]are keeping the dollar from falling to values needed to bring our trade balance back to equilibrium. As a result, our exports are artificially low(expensive) and our imports are artificially high(inexpensive). The overvalued dollar worsens LDC debt problems and reduces American jobs in export industries.

Concerted efforts on the part of industrial nations are needed to end the worldwide recession and to reduce the value of the dollar relative to other currencies. Such steps are "positive sum games" in the sense that all the nations of the world will benefit. In contrast, the current efforts of governments to defend their jobs through higher protective walls and subsidized export promotion schemes are "negative sum games" in the sense that these efforts are costly and are likely to hurt all nations. The President should call for another economic summit to initiate the needed actions.

7.2 Continued Codification

There is ample documentation that controls imposed by the governments of LDCs are limiting U.S. business involvement in these countries. The most important areas requiring further codification involve: tariff and non-tariff barriers to trade, regulations on foreign investments, government-sponsored trade and investment promotion schemes, and information flows(including the protection of "intellectual" property).

Because the interested parties have conflicting agendas and are often not aware of the problems facing others, it is important that these matters be discussed in arenas where all interested parties are represented. Such discussions tend to generate understanding and respect for the legitimate concerns of others, which in turn can lead to appropriate compromises.

Unfortunately, the last decade has seen a fragmentation of the dialogue and the development of warring camps[43]. Some of the best work on foreign investments is being done by various committees of the OECD, an organization whose membership is restricted to developed nations. UNCTAD has done some excellent work on trade questions, but Western nations see this organization as a captive of the LDC bloc. The ILO has done and continues to do good work on labor standards, despite the abrupt withdrawal and return of the United States. In the area of trade

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43. Meetings centering around the GATT have tended to be the one exception to this rule.

barriers to information flows, many Americans view UNESCO solely as a spokesman for LDCs and yet in this author's view, some of the best work on what is happening and its legal ramifications is being done by UNESCO's Commission on Transnational Corporations[44] Because of disagreements over certain provisions in the Law of the Sea Treaty, this Administration chose to walk out on the Law of the Sea negotiations rather than to continue the dialogue; and yet U.S. corporate executives interested in exploiting the oceans' resources today express real ambivalences over whether or not we should be treaty signatories.

The United States is a major financial supporter of most of the international agencies(both within the UN and outside) intended to increase the level of codification. It is high time the US reviewed the work of these agencies. These reviews should not focus on whether the organizations have traditionally supported U.S. interests; instead, the question should be which of these organizations have developed the data bases, broad constituencies, and the legitimacy needed to hold fruitful dialogues and work out agreements on these complex codification issues. The organizations that receive positive reviews should be given continued support; equally important, the U.S. should insist on an appropriate allotment of senior slots and send highly qualified personnel to fill them. The U.S. should withdraw support from those that have degenerated into simplistic polemical societies.

The U.S. should also review the appropriateness of these organizations as negotiation sites for all of the interested parties. For example, as was suggested above, the OECD is not the proper organization to host regular meetings between developed and developing nations. If organizational gaps are found, new entities should be established or the charters and/or membership regulations of existing organizations should be changed.

Another question that warrants a new "institutional" review concerns efforts to codify the investment practices of LDCs. At present, there are three ways in which this is being attempted. Firstly, U.S. firms are negotiating their own investment agreements with LDCs. Secondly, the U.S. government is negotiating bilateral investment treaties with certain LDCs. Finally, the U.S. is participating in negotiations at the OECD and other multinational bodies to codify investment practices. One can ask whether it makes sense to be active in all three

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44. See, for example, "Transnational Corporations and Transborder Data Flows: An Overview", Commission on Transnational Corporations, UNESCO document, E/C.10/87, July 6, 1981.

arenas at the same time or whether some consolidation of activity is warranted.

AID has an important, albeit indirect, role to play in the codification process. As part of the policy dialogue initiative, AID field staff should discuss codification questions with their LDC counterparts. These discussions should be done in recognition of the fact that the middle level LDC government officials that AID staff usually meet with will someday be senior government officials. The primary purpose of these discussions should be to explain how the absence of codification works against the development interests of the LDCs.[45] These discussions should not be based on "leverage" considerations, i.e., what the U.S. can force a country to do. There is little point in applying pressure at this level. Further, there are real questions about whether can apply any sort of leverage so long as the bulk of its assistance portfolio is in project form.[46]

45. These dialogues will rarely be one-way streets. Usually, the AID staffer will also get insights into problems facing the LDC.

46. For an excellent discussion of the potential of influencing LDC policies through leverage, see U.S. AID PPC/Evaluation Staff, "The Use of Program Loans to Influence Policy", Evaluation Paper 1A, March 1970.

7.3 <u>Towards a More Appropriate Investment-Trade Promotional Balance</u>

Earlier on, questions have been raised about the desirability of devoting additional U.S. government resources to the promotion of new U.S. investments in LDCs. The issue is complex, and this report does not reach definitive conclusions on the matter. However, in light of the previous discussion, it does seem appropriate to recommend that greater efforts be made to promote U.S. trading activities with LDCs..

Consider the fairly typical case in which an LDC wants an industrial plant and associated technology. The traditional approach would be for an American firm to make a direct investment in that country that would would give it title to the plant and the products generated by the plant. Ordinarily, the firm would be reluctant to transfer technologies and frictions would be generated. An alternative approach, and one that is becoming increasingly popular from many standpoints, is for an American firm to do a feasibility study, obtain the financing on credit for the LDC, and send a team out to manage the plant and market the resulting product. Under such an approach, the American firm would enter into a contract with the country to provide training, financial, management and marketing services to the LDC. Payments for training would be <u>de facto</u> payments for technology transfers, and this is likely to be an arrangement that is far more satisfactory to all parties involved than the traditional "investment means perpetual title" approach.

Such an arrangement has a number of attractions but there are few if any government programs to support such activities. Service contracts cannot be insured against contingencies such as OPIC guarantees American investments against, and there is nothing in the existing AID programs to support such approaches. It is recommended that U.S. adopt programs to support the sale of such services both within and outside of AID.

More specifically, OPIC or some other organization should be mandated to provide service contract insurance. In addition, AID should re-examine the mechanisms and incentive structures through which American technicians and managers are paid to work in LDCs. At present, AID provides services to LDCs through various technical assistance arrangements. However, there is no mechanism to encourage the recipient countries to assume the costs of these services. In addition, U.S. managers and technicians usually work through cost-plus contracts for AID. Under such arrangements, there are no incentives for the service personnel to do exceptional development work. Instead, the incentives are for them to file reports on a timely fashion.

7.4 Involving A Greater Segment of U.S. Business in LDC Trade

The report has documented that only large American firms are actively involved in trade with LDCs. The report has concluded that the primary reason for this are largely economic: the investments and risks associated with breaking into the LDC markets don't warrant the effort. That smaller U.S. firms do not sell to LDCs is unfortunate inasmuch as they are often more efficient and produce more technologically-advanced products than larger firms.

If these smaller firms are to sell to LDCs, they will need marketing "brokers". These brokers will have a number of roles to perform. Firstly, they must register to do business in LDCs, an activity that is only cost-effective if a firm has a wide array of products to sell. Secondly, the broker must find ways to finance the sale of the product, either through some form of commercial loan or through countertrade activities. To find countertrade opportunities, the broker will have to assess LDC export prospects and find new markets for its products.

The Export Promotion Act was intended to spur the creation of such brokers by a) allowing U.S. banks to buy equity in them and b) allowing U.S. firms to join together in an export "cartel" without fear of prosecution. In fact, no trading companies have come into being as a result of the Act's provisions. Nonetheless, several U.S. trading companies have emerged in recent years, presumably as a result of market forces. The Sears World Trade Corporation has been set up by the parent Sears Roebuck, and the Boles World Trade Corporation has been established with the support of private investors. In addition, a number of U.S. multinational corporations are increasingly engaging in countertrading activities. It remains to be seen whether these organizations serve as brokers for smaller U.S. firms or whether they end up simply providing more effective marketing channels for existing U.S. exporters.

Despite these uncertainties, it is recommended that AID support American firms that appear capable and willing to take on broader trading responsibilities in the following manner. Traditionally, AID pays consulting firms to identify and design projects for AID funding. These projects are usually direct government-to-government operations, and their record for sustainability after AID monies have ceased are not impressive.

It is proposed that representatives from trading companies be made part of AID's sector assessment and project identification/design teams. Whereas in the past, such teams might identify five projects for exclusive AID funding, it is hypothesized that the trading representatives would attempt to find non-AID sources for project funding. They would attempt to develop projects that were commercially bankable; in addition, they would look for opportunities to finance projects through counter-trade activities.

Why would one expect different behavior from these firms than the firms that AID usually employs to design projects? The theory is that the trading companies are interested primarily in generating commission monies from the sales of goods and services both into and out of LDCs, activities that potentially yield far higher returns than cost-plus contracts with AID. The theory is plausible enough to warrant testing.

There are some who will argue AID should not employ firms that have the chance of profiting from their design work. Indeed, The World Bank consulting contracts explicitly exclude persons who have the chance of profiting from follow-on activities. However, this is not the case at AID: it is common for firms that have assisted in the design of projects to bid on and win the consequent project implementation contracts.

There is admittedly a danger that some abuses will be encountered, but one has to put these dangers against possibilities that through such arrangements, AID monies will be leveraged into greater development and trade benefits than has been true in the past.

There are some immediate and longer-term steps that AID should take to involve trading companies in its development efforts. Immediately, representatives of trading companies should be hired as consultants to participate in AID's project identification and design work; they should also be asked to work on sector assessments and AID's country strategies. Their job would be to find ways to "leverage" AID's monies by developing commercially viable projects and looking for counter-trade possibilities. If this work appeared to be bearing fruit, AID should ask for bids on a new indefinite quantity contract for project identification and design that encouraged the involvement of trading companies.

There is a second type of brokering that is needed if the smaller U.S. firms are to be involved in LDCs. Technologies are increasingly complex, and firms that can relate the needs of developing countries to the emerging technologies are required. That is, brokers are needed that can find the technologies that are most applicable to the needs of LDCs. There are example of AID hiring such technology brokers. The most recent example is probably the energy field where AID hired a number of firms to find applications for fossil fuel substitutes being developed in the U.S. and other countries. Of course, AID has hired land grant colleges for many years to play a technology broker role.

There is a question concerning what position the U.S. government should take on countertrade activities. On the one hand, these activities are in violation of free trade principles inasmuch they tie the purchase and sale of different goods together. However, it appears that such arrangements are becoming increasingly popular, and that large American firms are involved in them. It is beyond the scope of this report to make recommendations on these activities. However, the U.S. government should continue to monitor these activities and reach a policy position regarding them.

7.5 <u>Needed Changes in AID Personnel</u>

The AID staff reflects an amalgam of talents that were deemed important as the foreign aid program historically adopted new areas of emphasis.[47]The most recent enthusiasm was the "New Directions Mandate" which was intended to eliminate hunger and poverty in LDCs by focusing AID's development activities on rural areas and by attempting to satisfy basic human needs for food, education, and medical care. During this period, attention turned away from macro economic policies and infrastructure needs; most importantly, little attention was given to how AID's initiatives could complement a sustainable development dynamic in which foreign and domestic private enterprise played the dominant role.

During this period of concern for the poor which started in the early 'seventies, AID hired numerous area specialists, sociologists, anthropologists, attorneys, and experts on the delivery of public social services. These groups demonstrated little understanding of what was essential to initiating a sustainable growth processes; indeed, it is fair to say that many of them slowed or derailed legitimate development initiatives by focusing on the costs of change rather than the benefits of development and by arguing over differing legal interpretations of the AID legislative mandate.[48] In the early days of our

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47. For a history of these views, see Elliott R. and Victoria A. Morss, <u>U.S. Foreign Aid: An Assessment of New and Traditional Development Strategies</u>, Westview Press, 1983.

48. For example, see Donald R. Mickelwait <u>et al</u>, <u>New Directions in Development: A Study of U.S. AID</u>, Westview Press, 1979.

foreign assistance program, AID recruited leading economists to fill senior policy slots in the Agency. Today, there are very few economists in senior AI^ positions, and overall, there are not nearly enough economists in the field to pursue the policy dialogue recommended earlier.

In recommending changes in AID staffing patterns, it is important to learn from past mistakes and not push too hard for the latest development enthusiasm. Until the legislation changes, AID is intended to be an agency that promotes American interests by helping LDCs overcome their development problems. AID is not intended to be a trade promotion vehicle for U.S. corporations; it is certainly not intended to subsidize the sale of military equipment to LDCs.

In light of the above, there are three areas in which AID's personnel need to be supplemented. Firstly, there is a need for more economists who have specialized in international trade and finance rather than those with strictly development economics backgrounds. Secondly, and in a closely related area, AID should start recruiting persons that have MBAs with a specialization in international business. A number of universities, have advance degree programs where students must study both public policy and business that focus almost exclusively on LDCs. Students from such programs should also be recruited.

Finally, AID needs to recruit more technologists to interpret the significance and applicability of the emerging technologies for LDCs. AID is not a trade-promotion agency, but AID should at least be in a position to facilitate technology transfer as needed where the U.S. is the technology leader. Communications is an immediate area which comes to mind, but there are others.

It is worth examining the potentials for change through new recruitment. Overall, the AID annual attrition rate is 12%.[49] Since the clerical and unskilled categories turn over more slowly than the professionals, it can be conservatively estimated that the attrition rate among professionals is 20%. However, AID has entered into an agreement with the Office of Management and Budget to reduce its overall staff total by slightly less than 7% between now and 1986. Also, it should be kept in mind that AID will have to continue to hire in areas where it is losing staff. Putting all of this together, AID would be doing extremely well if it could make changes in its staff along the lines recommended of 5% annually.

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49. Memo from R.T. Rollis to K. Kammerer, "Permanent Full Time Employment", April 29, 1983.

Fortunately, recruiting is not the only way to change the orientation of AID's staff. New training programs can also play an extremely important role in the re-orientation effort. It is recommended that a new training program be established to equip AID staff with the skills that have been outlined above as needed. Critical to the success of this training program is finding a program manager sensitive and sympathetic to the new needs. This person will have to go outside of AID to find teachers and educational material.

It should be emphasized that we are not here talking about a propaganda program; rather, a very concrete program that focuses on the needed skills and how the AID staff should make use of them is being recommended.

Currently, AID holds short training courses for headquarters and overseas staff in Washington on a variety of topics. In addition, regional seminars are held occasionally in LDCs that provide a useful training role. Both approaches should be employed to transfer the needed skills. In light of the excessive cable and paper traffic that now exists, it cannot be expected that cable/paper flow will contribute significantly to the needed skills transfer.

U.S. TRADE AND INVESTMENT PERFORMANCE

U.S. trade and investment performance, both world-wide and with LDCs, has been and remains impressive. As Table 1A indicates, the United States remains the leading world exporter, followed by West Germany and then Japan. The table shows that as a result of the oil price increases that took place in the 'seventies, the U.S. market share fell to 12.7%, an 8.7% drop. During this period, Japan was able to increase its market share, but the rest of the industrial countries suffered a dramatic reduction in market share. The oil exporting countries increased their share, but so also did the non-oil exporting LDCs.

Table 1A. Export Performance, 1971, 1981

Region	1971 $ bill.	1971 %	1981 $ bill.	1981 %	1971-81 percent change
World	319.7	100.0	1842.7	100.0	
Industrial Countries	247.7	77.6	1227.4	66.5	-16.5
of which:					
United States	44.2	13.8	233.7	12.7	-8.7
West Germany	39.1	12.2	176.1	9.6	-27.1
Japan	24.1	7.6	151.5	8.2	7.9
Oil Exporting LDCs	21.8	6.8	272.4	14.8	117.6
Non-Oil Export. LDCs	48.8	15.3	321.2	17.4	13.7

Source: International Monetary Fund, International Financial Statistics, 1983 Yearbook.

It is also interesting to examine how well U.S. exports to developing countries have done relative to exports from other developed nations. Information on this subject is presented in Table 2A. Both before and after the oil price increases, the United States has exported a greater share of its exports to LDCs than have other industrial nations. West Germany, the world's second largest exporter, sells a considerably smaller share of its exports to LDCs; in contrast, Japan sells a somewhat greater portion to LDCs. A comparison between 1971 and 1981 data indicate that an increasing share of U.S. exports go to LDCs.

Table 2A. Share of Industrial Country Exports Going To LDCs, 1971, 1981 (in percent)

Industrial Country	1971 non-oil export.	1971 oil export.	1971 total	1981 non-oil export.	1981 oil export.	1981 total
All	14.9	3.7	18.6	14.8	8.3	23.1
of which:						
United States	25.4	5.0	30.4	31.8	8.9	40.7
Germany	9.0	2.9	11.9	14.0	8.7	22.7
Japan	30.4	5.5	35.9	31.1	15.1	46.2

Source: International Monetary Fund, Direction of Trade, various issues.

Consider next investment performance. It should first be said that aggregate investment data are not very reliable because investment flows are not comprehensively monitored and because there are complex accounting problems associated with both the valuation and measurement of investments of overseas subsidiaries. The best comparative information on the private investments of industrial countries in LDCs is assembled by the Organization for Economic Cooperation and Development(OECD) on the members of its Development Assistance Committee(DAC).[1]

Table 3A provides information on total investment capital in LDCs made and owned by DAC members. It indicates that the U.S. owns about one-half of all the capital investments that have been made by industrialized nations. The United Kingdom remains the second-largest owner of capital stock, and Japan is now challenging West Germany for the third position.

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1. DAC countries include: Australia, Austria, Belgium, Canada, Denmark, Finland, France, West Germany, Italy, Japan, The Netherlands, New Zealand, Norway, Sweden, Switzerland, the United Kingdom, and the United States.

Table 3A. Industrial Countries Shares of Their Investment Stock in LDCS, 1971, 1981

Country	1971 $ million	1971 %	1981 $ million	1981 %
Total DAC	42,712	100	131,252	100
of which				
United States	22,300	52	63,118	48
United Kingdom	5,912	14	14,713	11
Germany	1,942	4	11,590	9
Japan	1,218	3	11,022	8
France	3,832	9	8,674	7

Source: OECD, Investing In Developing Countries, 1983.

A better measure of recent investment activities is provided by investment flow data, and this information is presented in Table 4A. It appears that the United States is maintaining its fifty percent share of private foreign investments in LDCs. It also appears that Japan is moving aggressively in the investment field, and France somewhat less so.

Table 4A. Industrial Country Shares in Private Investment Flows to LDCs, 1970-1981 (in percent)

Country	1970-72	1979-81	Average Annual Growth Rate, 1970/72-1979/81
Total DAC	100.0	100.0	14
of which			
United States	47.3	48.2	14
Japan	6.1	10.9	22
Germany	11.4	10.1	13
United Kingdom	8.6	8.9	15
France	5.7	7.3	18

Source: OECD, Investing in Developing Countries, Paris, 1983.

Let us consider now the conclusions that can be drawn from this brief empirical review of the trade and investment activities of developed nations. It was to be expected that the dominant economic position the United States found itself in at the end of World War Two would deteriorate somewhat as the warring nations of Europe and Japan were reconstructed. Further deterioration was to be expected as the emerging nations of Latin America and

Asia became increasingly competitive. Despite this and despite expensive efforts by governments of other industrial nations to promote foreign trade and investment(and with developing nations in particular), there has been little deterioration in the dominant position of the United States. The United States has lost a very small portion of its share of the world export market, and an increasingly large portion of its exports go to developing nations. Traditionally, the United States accounts for about half of all private investments in the developing world, and this portion seems to be holding up.[2]

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2. To the author of this report, the above suggests that the U.S. private sector is not in desperate need of government assistance to remain competitive. If the experience of other industrial nations should teach us anything, it is that government assistance is more likely to create inefficiencies and reduce competitive standing than it is likely to yield long-run benefits.