Six Myths About the Benefits of Foreign Investment

The Pretensions of Neoliberalism

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There are several myths about foreign investment propounded by orthodox economists, publicists for multinational corporations, and the press:

Myth #1 - Foreign Investment (FI) creates new enterprises, gains or expands markets and stimulates new research and development of local technological 'know-how'.

In fact most FI is directed toward buying privatized and profitable existing public enterprises and private firms, taking over existing markets and selling or renting technology designed and developed at the "home office". Since the late 1980's over half of foreign investment in Latin America was directed toward purchasing existing enterprises, usually at below market valuation. Instead of complementing local public or private capital, FI "crowds out" local capital and public initiative and undermines emerging technological research centers.

With regard to market expansion, the record is mixed: in some sectors where public enterprises were starved for funds, like telecommunications, the new foreign owners may have expanded the number of users and enlarged the market. In other cases, like water, electricity and transportation, the new foreign owners have reduced the market, especially to low-income classes, by raising charges beyond the means of most consumers. The experience with foreign investment and technological transfers is largely negative: over 80% of research and development is carried out in the main office. The "transfers of technology" is the rental of sale of techniques developed elsewhere, rather than local design. The multinationals usually charge subsidiaries excess royalty fees, service and management costs, to artificially or fraudulently lower profits and taxes to local governments.

Myth #2 Foreign invesement increases the export competitiveness of an industry, and stimulates the local economy via secondary and tertiary purchases and sales.

In reality foreign investors buy up lucrative mineral resources and export them with little or no value added. Most of the minerals are converted into semi-finished or finished value added goods - processed, refined, manufactured - in home countries or elsewhere, creating jobs, diversified economies and skills. The privatization of the lucrative giant iron mine Vale del Doce in Brazil in the 1990's has led to huge profits for the new owners and the sale of raw ore overseas, particularly to China in the 21st century. China converts iron ore to steel for transport, machine industries and a host of job-generating metallurgical enterprises. In Bolivia, the privatization of the gas and

petrol industry in the mid 1990's has led to billions in profits in the 21st century and the loss of hundreds of thousands of jobs in processing and conversion of petroleum and gas into value added goods, plus failure to supply local low-income consumers. The extraction of raw materials is capital intensive using few workers. Processing and manufacture is more labor intensive and job creating.

Myth # 3 Foreign investors provide tax revenue to bolster the local treasury and hard currency earnings to finance imports.

The reality is foreign investors engage in tax frauds, swindles in purchasing public enterprises, and large scale money laundering. In May 2005, the Venezuelan government has announced billion-dollar tax evasions and frauds committed by major overseas petroleum companies which signed on to service contracts since the 1990's. The entire Russian petroleum and gas sector was stolen by a new class of billionaire robber oligarchs, associated with foreign investors, who subsequently evaded taxes, as illustrated by the trial and conviction of two oligarchs, Platon Lebedev and Mikhail Khodorkovsky for $29 billion in tax evasion facilitated by US and European banks.

The impact of the multinational corporations on the balance of payments over the long run is negative. For example, most assembly plants in export zones import all their inputs machinery, design and know-how and export the semi-finished or finished product. The resulting trade balance depends on the cost of the inputs relative to the value of exports. In many cases the imported components charged to the local economy are greater than the value added in the export zone.

Secondly most of the revenues from the export platform accrue to the capitalists since the key to success is low wages leading to the creation of personal empires. The Brazilian experience over the past decade and a half illustrates the negative external balances resulting from foreign investment and externally funded investment. In 2004 Brazil paid foreign bankers $46 billion (USD) in interest and principle while receiving only $16 billion dollars in new loans, leading to a net outflow of $30 billion dollars. (2) Between January and April 2005 Brazil was bled for $4.6 billion (USD) in interest payments, $3.7 billion in profit remittances by multinational corporations, $1.7 billion for 'external services' and $7.3 billion in payments of principle in the debt. (3) The total drain of $17.3 billion dollars far exceeded the positive commercial trade balance of $12.2 billion dollars. (4) In other words, the FI-led export model led to new indebtedness to pay for the shortfall, the loss of employment by small and medium farmers at the mercy of the agro-business elites and the destruction of the environment.

Myth #4 - Maintaining debt payments is essential to securing financial good standing in international markets and maintaining the integrity of the financial system. Both are crucial to sound development.

The historical record reveals that incurring debt under dubious circumstances and paying back illegally contracted loans by non-representative governments jeopardized the long-term financial standing and integrity of the domestic financial system and led to a financial collapse, as displayed in he Argentine experience between 1976-2001. A substantial part of the public external and internal debt was illegally contracted and had little development utility. A lawsuit launched by an Argentine economist, Olmos,

against payment of the Argentine foreign debt revealed that the foreign private debts of Citibank, First National Bank of Boston, Deutsch Bank, Chase Manhattan Bank and Bank of America were taken over by the Argentine government. (5) The same is true of debts of subsidiaries of overseas banks. The Olmos lawsuit also documented how the Argentine dictatorship and subsequent regimes borrowed to secure hard currency to facilitate capital flight in dollars. The foreign loans went directly to the Central Bank, which made the dollars available to the rich who recycled the dollars to their overseas accounts. Between 1978-1981 over $38 billion USD fled the country. Most of the foreign loans were used to finance the "economic" openings, luxury imports and non-productive goods, especially military equipment. The Olmos case pointed to a perverse source of greater indebtedness: the Argentine regime borrowed at high interest rates and then deposited the funds with the same lender banks at lower interest rates leaving a net loss of several billion dollars, added to the foreign debt.

Myth # 5 Most Third World countries depend on foreign investment to provide needed capital for development since local sources are not available or inadequate.

Contrary to the opinion of most neo-liberal economists, most of what is called foreign investment is really foreign borrowing of national savings to buy local enterprises and finance investments. Foreign investors and MNCs secure overseas loans backed by local governments, or directly receive loans from local pension funds and banks drawing on the local deposits and worker pension payments. Recent reports on pension fund financing of US MNCs in Mexico shows that Banamex (purchased in the 21st century) secured a 28.9 billion peso (about $2.6 billion USD) loan, American Movil (Telcel) 13 billion pesos ($1.2 billion USD), Ford Motor (in long-term loans) (9.556 billion pesos) and one billion pesos (in short term loans), and General Motors (financial sector) received 6.555 billion pesos. (6) This pattern of foreign borrowing to take over local markets and productive facilities is common practice, dispelling the notion that foreign investors bring "fresh capital" into a country. Equally important, it refutes the notion that Third World countries "need" FI because of capital scarcity. Invitations to FI divert local savings from local public and private investors, crowd out local borrowers and force them to seek 'informal' money lenders charging higher interest rates. Instead of complementing local investors FI compete for local savings from a privileged position in the credit market, bringing to bear their greater (overseas) assets and political influence in securing loans from local lending agencies.

Myth #6 The proponents of foreign investment argue that its entry serves as an anchor for attracting further investment and serves as a 'pole of development'.

Nothing could be further from the truth. The experiences of foreign-owned assembly plants in the Caribbean, Central America and Mexico speak to the great instability and insecurity with the emergence of new sources of cheaper labor in Asia, especially China and Viet Nam. Foreign investors are more likely than local manufacturers to relocate to new low-wage areas, creating a "boom and bust" economy. The practice of FI, in Mexico, the Caribbean and Central America, faced with competition from Asia, is to relocate, not to upgrade technology and skills or to move up to quality products. Finally, a long-term study of the impact of foreign investment on development in India has found no correlation between this foreign investment and growth. (7)

In sum, reliance on foreign investment is a risky, costly and limiting development strategy. The benefits and costs are unevenly distributed between the "sender" and receiver. In the larger historical picture it is not surprising that none of the early, late or latest developing countries put foreign investment into the center of their development scheme. Neither the US, Germany and Japan in the 19th and 20th century, nor Russia, China, Korea and Taiwan in the 20th century depended on it to advance their industrial and financial institutions. Given the disadvantages cited in the text, it is clear that the way ahead for developing countries is through minimizing it and maximizing national ownership and investment of local financial resources, skills and enlarging and deepening local and overseas markets through a diversified economy.

Because the negative economic, social and political costs of foreign investment are evident to increasing numbers of people in the Third World, particularly in Latin America, it is a major detonator of mass social movements, and even revolutionary struggles, as is the case in Bolivia during 2005. Since FI is a direct result of political decisions adopted at the highest level of government, mass social struggles are as much or even more so directed against the incumbent political regime responsible for promoting and mollycoddling foreign investment. The increasing turn of social movements toward political struggles for state power is directly related to the increasing recognition that political power and foreign investment are intimately connected. In the 21st century, at least in Latin America, all of the electoral regimes, which have been overthrown by popular majorities, had deep structural links to foreign investment: Gutierrez in Ecuador, Sanchez de Losada and Mesa in Bolivia and Fujimori in Peru. The leader with the greatest sustained support in Latin America, President Chavez in Venezuela, is precisely the only one who has increased regulations and taxes on foreign investment and redistributed the increased revenues to the poor, working class and peasants. The question still remains whether this new infusion of energy and class awareness can go beyond defeating pro-FI regimes to constructing a state based on a broad alliance of class forces, which goes beyond 'nationalization' and toward a socialist economy.

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Endnotes

(1) Paul Doremus et al, Myth of the Global Corporation, Princeton: Princeton University Press 1998

(2) Boletin: Cedada da Divida No 12, May 31, 2005, p2

(3) Ibid p2-3

(4) Ibid p2-3

(5) Cited in Boletin p6

(6) La Jornada June 7, 2005

(7) Tanushree Mazumdar, "Capital Flows into India", Economic and Political Weekly, Vol XL No 21, p2183-2189