3.2.2.3.2.42 Foreign investment and development

No part of the world has changed as rapidly over the past 40,50 years as has Asia, particularly East Asia and Southeast Asia.

For most of the countries in that part of the world, such as South Korea, Taiwan, Thailand, the Philippines, Malaysia, and Indonesia, the change occurred in the decades before the mid-1990s, and it was mainly driven by foreign investment.

In the decades before the early 1990s, these countries transformed from feudal, agriculture-based societies into rather modern societies with a strong export-oriented manufacturing sector. Foreign investment was an important contribution.

However, these countries haven't changed much in the decades after the mid 1990s because China has been soaking up most Asia-directed foreign investment. Furthermore, many of the benefits of foreign investment were reversed in the 1997 Asian financial crisis.

Foreign investments can come in many different forms.

The simplest, and most dangerous, form is dollar-denominated loans, given to local governments, local banks, and local companies.

Local banks would, for example, receive loans at a rate of 5 percent interest, and borrow it to local lenders as local currency at a rate of 15 or 20 percent interest. As long as a country's currency would depreciate at less than 10 percent per year towards the dollar, the banks would operate at a profit.

The fact that this kind of foreign investment was just a dollar-denominated loan often was hidden behind a contractual facade. For example, the loan could have been disguised as equity investment in a non-bank business. However it was then just used for playing the financial market, with the aim of profiting from lending rate discrepancies or similar financial benchmark figures.

Economies based on that kind of foreign investment regularly melt down, as has happened during the Asian financial crisis. Such meltdowns have happened in all parts of the world, before and after the Asian financial crisis, most frequently in South America.

Foreign investments that come as financing packages that somehow have to be repaid are a dangerous turf.

Foreign portfolio investments, where foreigners buy stock on a local exchange, aren’t much better.

Both, financing packages and portfolio investments, are linked to the exchange rate of local currencies, and if they are not carefully managed, their overall impact on the wealth of a country can easily be negative. This means: this kind of foreign investment can easily leave a country poorer than it was before the “investment”.

From the perspective of poor countries, the purpose of foreign investment is to bring foreign money into the country to spur economic development. But that effect can only be had if the foreign money is, in a long-term manner, converted into tangible assets.

For example, when a foreign company builds and operates a toll road in the developing country. Not, if a foreign company gives a dollar loan to a local entity, so that the local entity can contract the foreign company to build the toll road for them, and also not if a local entity gets that loan (repayable as dollars) so that it can purchase the necessary equipment from the overseas company.

If a foreign investor is actually converting own money into assets in the country where he invests, the talk is of foreign direct investment. However, on the scale of toll roads or other large infrastructure projects, there are much fewer foreign direct investments than the business sections of newspapers make people believe.

One does get foreign direct investment into production facilities, for example, if Nike sets up a shoe manufacturing plant in Indonesia, or when Isuzu moves their pickup truck production to Thailand, in both cases because of lower wages.

Such foreign investment is generally considered beneficial to countries that receive it because it generates jobs.

On the other hand, one should be careful not to overestimate the positive effect of such foreign investments, for all the profits are typically repatriated, and the actual asset transferred to a Third World country isn't much to brag about. Production facilities typically are outmoded within 5 to 10 years, and then their worth is barely above the scrap value.

Another kind of foreign investment isn't much better. That's when Western "services" companies like Wal-Mart and Carrefour, or franchise givers such as McD and KFC, or banks like HSBC or Citibank move in. They just displace local businesses, create large numbers of unemployed people because they have a higher turn-over with fewer staff and at lower costs, and they also repatriate the profits.

And then there are those foreign investments that buy into local companies, such as when a big US tobacco company buys a well-established local company, primarily to gain a distribution foothold. Local sellers who receive the money from overseas buyers usually have nothing better to do with the cash than to bring it to a Western developed country, in order to receive a residence permit there, and a subsequent citizenship. Such schemes are foreign investment indeed, but not in the Third World country where the company is purchased.

They generate net capital outflow, not capital inflow.

One can look at it from any angle: the best foreign investments a country possibly can get are foreigners who personally want to relocate to a Third World country and bring capital with them, in the range of 100,000 to 1,000,000 million US dollars. That normally is capital that really stays in a country into which it is brought.

The figures don't sound as impressive as the 100-million-dollar amounts of financial markets machinations, or foreign portfolio investments, but the money brought along by relocating foreigners relocating at least is genuine, not just a number in the clouds that will never rain down.

Precisely this kind of foreign investment is very much thought after by many countries of the world. Third World countries? Ha! No, it’s the most developed countries that seek that kind of foreign investment. And they know why.

Just check the “investment immigration” pages of the US, Germany, Canada, the UK, France, or whatever rich country. Anybody who brings a good amount of money (typically around 1 million dollars) into the country, and invests it into a new business (not the stock market) receives a fast-track residence permit.

One can look at it from any angle. The secret of genuine foreign investment in any country of the world is attracting rich foreigners to live in the country that wants to attract foreign investments. Everything else is either not genuine or outright trickery.

Countries that want to attract foreign investments should concentrate on making their countries as attractive as possible for rich foreigners to live in.

Countries that want to attract money from outside could make foreigners feel comfortable by providing good security and permitting a fair amount of personal freedom not available anywhere else (for example granting personal drug use). They shouldn’t obstruct sexual relationships with locals. Actually, sexual relationships of rich foreigners with locals are a country’s best option to bind foreigners, and foreign investments.

Countries can grant citizenship to foreigners who pay for it (by investing 100,000 US dollars or more), and investments in higher amounts will likely follow all by themselves.