Chapter 7: Conclusions and Future Directions of Study

7.1.0: Conclusions

This chapter summarizes the main findings of this study and highlights the issues that arise which may require further investigation. In Kenya, over the period 1975-1996, the rate of private investment fell by 3.1 percent per annum, while the rate of public investment fell by about 2.9 per cent per annum over the same period. Investment performance by sector was also dismal. Although our findings support certain aspects of the recent economic reforms, this study suggests that additional measures may be necessary to invigorate the private sector in developing countries.

Our empirical findings underscore the importance of the financial sector for real private investment. Thus suggesting that current measures to strengthen the financial sector should be encouraged. Excessive borrowing by the government from the financial sector to finance its deficit may have occasionally 'crowded out' private investment. On interest rates, computer simulations of the macroeconomic model raises some doubt on the argument that high interest rates may mobilize financial savings leading increased intermediation and thus investment activity. Our results indicate that there is a positive impact on financial savings of high deposit rates but a negative impact on credit of increase in lending rates. It seems that the negative effects through the cost of credit may outweigh the 'mobilization effect' of high interest rates on financial savings. Since interest rates (deposit and lending rates) move together, our simulation results indicate instead of high interest rates raising private investment (as repression theorists suggest), they may actually have a depressing effect on the economy.

Declining returns on investment on account of weak domestic and foreign demand coupled with declining productivity help explain the observed weak performance in private investment. On the complementary effects of government investment, our results suggest that measures to rationalize government expenditure should be encouraged, especially increased expenditure on basic infrastructure. Recent reforms in developing countries place emphasize on macroeconomic stability. Empirical results obtained here suggest that macro economic policies in terms of price stability, budget deficit, exchange rate, external debt and financial intermediation may help explain differences in investment performance among countries in Sub - Saharan Africa. This then suggests that improved macro economic management is important for recovery and sustained investment activity in Sub - Saharan Africa.

There are also important theoretical implications of this study. Although recent policy reforms in developing countries emphasize the importance of private sector and integration in the global economy, little or no attention is given to the nature, capacity and effects of the business enterprises in developing countries and how they relate to the material welfare of the people in these nations. Neoclassical economists recognize that, the objective of the firm is to maximize profits. Therefore, public policy recommendations hinge on 'creating an enabling environment for business' or reducing the cost of doing business. Though this study recognizes the importance of profits and factors that relate to the costs of investment, we argue that the central element of private investment in a developing nation is upgrading in terms of product technology or production efficiency.

Considering that a business enterprise is just part of the interconnected institutions of the whole social system that form an economy, its nature and performance will to some extent depend on what is happening elsewhere in the system. Within the economy, there are socio-political institutions such as: state agencies, informal networks, worker and business associations or interest groups. Mainstream neoclassical economists pay scanty attention to the importance of socio-political institutions of governance on the economic performance. However, in Sub - Saharan Africa such an approach is likely to produce poor policy. In many parts of Africa, failure of state agencies to protect collective resources, govern effectively and fulfill basic requirements of transportation, communication, health, education can not be neglected. Whenever the judicial and political processes breaks down violence and ethnic skirmishes erupt. Institutional weaknesses manifest themselves in terms of excessive corruption, avoidance of accountability, discrimination, ethnicity, sycophancy, overstaffing, under staffing, waste of resources, bribery and undue delays. World Bank and IMF seem to have recognized the weaknesses of the state evident in the increased emphasize on eradication of political corruption. However, the discourse is silent on 'state weakness' in terms strategic development policy.

Perhaps most economists would agree on the interaction between 'productive', 'merchant' and 'financial' capital and the need for firms to upgrade and gain the capability to produce and compete in new products. What is controversial is what role the state should play to facilitate the growth and transformation of firms in a nation. According to neoclassical economists once the institutional arrangement (liberalized markets, property rights and rule of law, macroeconomic stability, investment in necessary infrastructure and education; a position the World Bank ascribes to) is in place, self-seeking behavior among firms will produce the highest level of social welfare. This is indeed, equating personal economy (personal interests of firms) to national economy (public economy), what is good for the individual is good for the society. Apparently according to this approach the wealth of the society is nothing but a sum of individuals' wealth. As such it fails to recognize the strategic difference between 'merchant' and 'productive capital' for long run growth as discussed in chapter 1 of this study. The neoclassical school fails to recognize national or regional differences, yet there is no doubt that some nations have not transcended the 'merchant empire' status that they were introduced into international capitalism through colonization: upgrading or sophisticated production was the domain of the powerful nations. The failure to recognize this important fact, has led to a situation where most developing countries are forced to accept 'shallow integration'. There may also be conflicts of interest between 'productive' and 'merchant' capital, akin to the 'infant industry' argument. What one wonders is whether conflicting interests of firms will produce socially acceptable outcomes as the neoclassical approach suggests. In trying to address some of the imbalances created during the period of colonization, the post-colonial government in Kenya attempted to pursue the policy of Kenyanization to empower the majority of Kenyans formerly marginalized. However, it seems that this policy has had adverse impacts on the productive capacity of the private sector in Kenya. Perhaps instead of public policy discriminating on grounds of ownership, the policy should be directed at rewarding firms that upgrade irrespective of whether they are Kenyan or non-Kenyan owned. The discussion in chapter 1 suggests that instead of 'merchant' capital serving 'productive' capital, in Kenya, 'productive capital' is subordinate to 'merchant capital'.

Some economists accept the limited neoclassical functions of the state, however, they argue that latecomer firms in developing countries are confronted with numerous market failures and thus upgrading is not automatic and costless but rather it is uncertain and prolonged and thus argue that there is need for additional appropriate policies to empower firms in a developing nation (Lall, 1994; Wade, 1990, 1992; Yanagihara, 1994; Perkins, 1994 and Hobday, 1995). They argue for selective targeting of firms that have the potential to prosper by ensuring that necessary skills are provided and information and infrastructure support services are available. Another important aspect this approach is that promotion and protection (short-lived) should be accompanied with standards and performance requirements or 'reciprocity' from firms - such as export targets and local content. This approach differs markedly from the old protectionism in that promotion and protect, is focussed and it involves reciprocity and monitoring. This approach may be interesting for countries, like Kenya, except that it may meet some political hurdles. There is a danger that targeted intervention may be interpreted as promoting tribal interests. Government policies toward the Jua Kali sector, do not reflect the fact that the rapid expansion of this sector is partly a reflection of the crisis in the modern capitalist sector. There may be need to identify those enterprises within the Jua Kali sector that have the potential for growth and upgrading. The sector is massive and includes 'survival activities'. Where possible, the government would help those enterprises with potential by helping them form networks or links with the modern sector producers. In other words, there is need to separate the chaff from wheat.

Looking at the private sector from the point of view of upgrading, import substitution and export promotion may not be mutually exclusive policy strategies at least from a dynamic comparative advantage standpoint. In the literature these two strategies are presented as mutually exclusive, with current reforms emphasizing export promotion and denouncing import substitution. There are also important implications for foreign direct investment. Many studies show that multinational corporations with global interests may prefer to import certain goods even if local substitutes are available. Perhaps, in this era of globalization, developing countries would benefit more from local sourcing by multinationals. In other words, multinationals should be encouraged to move certain production activities to the developing countries. In the past, most countries used mandatory local content requirements, however, such practices are becoming unacceptable within the WTO rules. This suggests need for new strategies, so that more and more developing countries can better benefit from world output. Creditor nations can also help promote production in developing nations by moving away from tied-aid and reducing import restrictions. However, politicians in industrial nations will support such policies only during periods of rapid economic expansion, when employment can not be compromised in their countries.

If private investment is studied in terms of its relation to social economic welfare, then as this study suggests, public policy should not be directed only toward creating an enabling environment for business (as the neoclassical theory suggest) but also to 'challenge' firms to upgrade their activities. The current approach seems one-sided. In conclusion we can say that, if the nature and capacity firms operating in a particular economy and the factors that impact on them and their effects are important for economic growth, then the macroeconomic issues that World Bank and IMF policies address in developing countries are simply the 'skeleton'. There may be need to address firm or industry specific constraints and perhaps continually monitor performance.

7.2.0: Possible Future Directions of Study

There are important theoretical and empirical issues raised in this study that can be investigated further. This study underscores the importance human capital but the main focus has been on physical capital. A study on issues related to the importance of education, training and skills in the context of firm upgrading could make this study more comprehensive.

On account of data availability it would be of interest to carry out a firm level study on upgrading, which would be useful in the understanding of specific constraints to 'catching up' in product technology and processes. As far as the empirical analyses are concerned, as more and more data become available, there may be need for re-estimation and updating of the macroeconomic model equations as well as incorporating new policy issues.