David

FYI

PN-AAT-590

ISN 41676

PRE's Private Sector Policy: A Critique

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Steve Walworth
DSP/May/1982

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After two decades of primarily "public sector"-implemented development in mostly free market economies AID has recently redirected its attention toward the concept of the private sector as a more effective arena to use in stimulating economic development however defined. Raj Krishna's article in a recent issue of Scientific American on the performance of India's public enterprises vs. that of private enterprises classically supports this line of reasoning in that it demonstrates the much slower rates of growth of the public institutions.

Nonetheless, to the extent that AID is reaching a threshold in assessing its record with the Basic Human Needs Mandate this new initiative helps draw attention to the Mandates' weaknesses not only in its implementation but also with respect to its pivotal objective of ensuring broad, substantive and beneficial impact on targeted beneficiaries. As David Korten has pointed out application of the BHN approach has failed to include beneficiary participation for the most part in its projects' designs and otherwise has failed to generate effective demand in targeted beneficiaries. In this sense, and not necessarily because private sector efforts in and of themselves may achieve desired development objectives, the private sector merits another look as a set of economic interactions in which a majority of people are forced to engage in seeking opportunities for ensuring their survival and security.

The PRE's recently released Policy Paper on AID's private enterprise initiative raised hopes of pursuing new ways to capitalize on development achievements and effects to date such as increased productivity and employable working populations, which resulted from effective disease eradiction programs, and increased agricultural production and income from Green Revolution efforts. However, a closer reading of the assumptions implicit in the Policy objectives revealed a lack of continuity from previous AID experience, a lack of innovation and a lack of understanding of LDC private sectors. In this respect of some question is the proposed strategy to duplicate and supplement support to large-scale private investments of the kind that are readily subsidized/financed by the World Bank's IFC, OPIC, ExIm Bank and the international financial sector and whose impact is likely to be limited to LDCs' modern or traditional export sectors assuming these investments follow common short-term profit patterns.

In the interest of building a consensus among both donors, LDCs and the indigenous private sectors what follows is an assessment of the principle explicit and implicit assumptions of the Policy objectives keyed to the six sections of the first part of the Policy paper called "Goals of the Agency's Private Sector Initiative". No attempt is made here to assess the Policy strategy beyond those of its points which are relevant to the objectives. Those interested in analysis of this section should refer to PPC's critique. Rather my intention is to reveal some of the problems in the stated goal, "fostering productive and self-sustaining private sectors", as they relate to various theoretical literature, accounts of donor/LDC experience and a review of some 50 AID private sector-type projects undertaken since the late sixties.*

Program Rationale.

Under this section the first and most obvious question to ask about this "new" initiative is what has gone wrong in LDC private sectors that warrants AID's, i.e., public sector, intervention in what is supposed to be left to marketplace forces? According to PRE's Policy rationale LDC governments in general - those other than the "successes" such as Korea, Taiwan, Singapore, etc. - presumably have not "encouraged" or allowed their private sectors to flourish and as a result suffer from slower and less sustained growth - an unadjusted macroeconomic per capita growth being the assumed primary ingredient for economic development despite some proof to the contrary, e.g., Sri Lanka's achievements in human welfare at low growth. In addition some argument can be made that most of AID recipient countries have mixed economies that are at least as open as the U.S.'.

A second related question about PRE's Policy goal as stated involves the Policy's implicit philosophy that marketplace mechanisms operating in a free enterprise environment have proven themselves in such places as Taiwan and Korea to be the key to "productive, self-sustaining income and job-producing" development. By definition, the marketplace needs only a favorable environment, i.e., the provision of a legal system and other guarantees for the enforcement of contracts, to stimulate economic efficiency, growth and opportunity. If this condition prevails the next objective should be to identify the principle

*see appendix

constraint in PRE-targeted LDC economies* that prevents or restrains a more productive, self-sustaining income and job-producing private sector. However the Policy assumes what the problem is, failing to cite any of the literature or experience that may support the implicit assumptions surrounding the Policy goal. This presumptuousness potentially inhibits consensus-making efforts with LDCs on identifying and resolving the structural and other country specific problems in their economies and those bottlenecks precluding greater efficiencies, opportunities and profitable returns to wider segments of their respective populations.

Harry Johnson, in his argument promoting the market mechanism as a development instrument, suggests less intrusive government incentives such as tax concessions, subsidies, etc. as means of addressing those societal needs ignored by the market such as long run planning for economic growth. If AID Policy is to "foster the growth" of LDC private sectors, which appear to be very pervasive, vibrant and uninhibited, at least as much as Keith Hart would suggest in his micro-studies of West African indigenous enterprise, it may be more appropiate to begin the Policy rationale with the fact that private sectors are already growing quite well in spite of government efforts to control or guide them, and then proceed with the concept that further growth and innovation are more likely if entreprenuerial opportunities are allowed and/or helped to become more widespread or equitably available among the country's population. In other words there is no sense of what kind of and what optimal level of private sector growth is necessary or desirable nor how that growth relates to meeting equity concerns, at least to the extent that widerspread equity may contribute to an increased probability of greater depth, flexibility and adaptability in an economy. Before the Policy can assume that "the financial, technological and management expertise of the US" and elsewhere is universally appropiate to foster this growth, the above issues need to be addressed and clarified.

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* Indonesia, Sri Lanka, Thailand, Pakistan, Egypt, Ivory Coast, Kenya, Zimbabwe, Jamaica, and Costa Rica

The Program Rationale section states that it is "multi-faceted" as if to say there are many unrelated but important reasons to support its Policy. Simply being "multi-faceted" may expediently support the "multi-faceted", unlinked strategies which follow in the Policy paper but nevertheless it does not provide much of a rational basis for allocating scarce resources in a way that identifies and prioritizes the most serious constraints to broadening LDC private sector activities in the development process. Neither does it attempt to effectively complement other donor and LDC rationales for promoting private sector development. Instead it appears that a variety of normative rationales have been retroactively fitted to a preconceived strategy essentially mimicing other "successful" efforts such as those undertaken by the World Bank's IFC. If AID is to merely adopt IFC goals as implied, what is needed is a carefully researched assessment of why those goals vis a vis US foreign policy interests.

Of the various justifications given, the most outstanding, considering the strategy emphasis on leveraging or "harnessing" (as if private investment is overflowing but "undirected" and therefore not necessarily development-oriented) US and LDC private sector investment potential, is that LDCs, "by definition, are short of capital and management expertise". Both Harry Johnson, at the macro-level,and Keith Hart, the micro-level researcher, would contend that neither is the case. In addition, other literature from the World Bank, etc.* and my review of over 50 AID private sector projects from AID/DIU's listing reveal that much indigenous, informal capital is available in LDCs, however structurally distorted by LDC "open" economies' urban/modern/foreign-sector biases and/or by government policies favoring large capital-intensive industries. Additionally, the capital is available in spite of the country-specific non-monetarized characteristics of the large agricultural/rural private sectors common in most LDC economies. In fact AID private sector project evaluations recommend simply that LDC Central Bank policies be liberalized to allow such opportunities as wider spreads on loans to medium and small firms especially in rural areas as a more effective way of spreading already available capital. In addition, management expertise appears to abound**, only to be constrained by information flow constraints which in turn appear to be due in part to illiteracy and the variety of local, indigenous languages found in most LDCs.

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* see bibliography
**see Keith Hart

Objectives.

The first of the three stated policy objectives is to assist any interested institutions, private investors, etc. in the "establishment, improvement and expansion of productive, developmentally desirable private enterprises in priority sectors in developing countries". The problem with this objective are three: a) private enterprises, by definition, should already be productive/efficient and demand responsive within the marketplace, b) the relationship between developmentally desirable and private enterprise objectives must be made more explicit if the reader, be they AID personnel or host country officials, can understand, identify and agree upon a country-specific rationale and justification for allowing public sector interference in or distortion of the respective market economies, and c) although the policy paper makes reference to what are presumably "priority sectors" in developing countries, such as employment and foreign exchange earnings in Jamaica, it's still uncertain how one determines what priorities realistically belong to both the market and public objectives.

The second objective, "transfering technical, managerial and marketing expertise from the US to LDCs by bringing together investment opportunities in LDCs between US and host country capital and experienced management", implies that market mechanisms are somehow flawed and AID has the capacity to fill the void. It also implies that management expertise is a primary constraint to more rapid or greater private sector growth and general development and that US expertise is somehow appropiate to LDC needs. As mentioned before, Keith Hart would argue that the primary constraint is intra-country communication, illiteracy and information bottlenecks which suggest different solutions other than simply transfering US business expertise.

Secondly, the literature on LDC private enterprise, as presented in recent World Bank documents and elsewhere, has consistently pointed to distorted and/or overregulated markets, induced by biased, host country policies and economic structures, as being the primary constraints to a greater flourishing of private enterprise, not reduction of risk or greater financial inducements.

The last stated Policy objective, to "stimulate and help create conditions conducive to the flow of US and host country private capital into productive investments in priority sectors in LDCs", again runs into the same problem concerning market forces vs. public intervention. In this case, if capital is a constraint (and we're not sure that it is or even whether the market in LDCs is already operating at some optimum capacity), then what are some of the kinds of conditions that keep capital from flowing or being distorted towards non-optimal uses? How can public entities "create conditions" especially if those entities have limited impact within their respective countries and markets as is the case in many LDCs (and DCs) where black or parallel markets appear to flourish? In addition, the policy strategy recommends directly providing credit and equity capital which seems to contradict its claims of merely "stimulating and helping create conditions" in a least intrusive way.

Eight ways of carrying out the above three objectives are suggested by the Policy "based on Agency experience and observations of other entities committed to similar objectives". Basically the actions include making $0.5 to 5 million direct investments in any foreign or domestic private enterprise venture and/or finance company portfolio in LDCs; undertaking "private sector projects" which are to somehow enhance private sector activity; "encouraging capital market growth and foreign capital investment"; providing training and technical assistance in management; and counseling LDCs on creating appropiate climates conducive to private investment and sector growth. Most of these approaches are simply extensions of those policy "goals" already mentioned and therefore need little further critique. However, three issues do arise, one of which is adequately dealt with elsewhere in PPC critiques and by AID/PRE and need no further comment, i.e., the issue of limited AID expertise in this area. The others, the size of investments proposed and the range of acitivities, do fall within the perview of this critique.

First, there appear to be two problems with the relatively large size of the investments recommended. The first one is that the size of the investment implies that the investor(s) is of such a size that it already has access to substantial support provided by other agencies such as OPIC and IFC and/or by the commercial sector. Secondly, the policy ignores the larger number of small- and medium-scale enterprises (SMEs), which have been the focus of past AID efforts, and for which the demand and aggregate size of the need for capital exceeds that of all other sectors according to representatives of OPIC and IFC and to the literature in general. In addition, although SMEs, according to AID* and other studies, have demonstrated greater profitablity and employment generation and more efficient use of capital while operating under more perfectly competitive conditions, i.e., a greater congruence with a wider variety of development objectives than large-scale industry, not much attention is given to SMEs nor any specific size industry except implicitly to large enterprises. In fact, the type and direction of AID assistance envisioned, except possibly for policy advice, would tend to exacerbate the disadvantages SMEs suffer to the extent large, urban-based industries will be favored despite their inherent advantages in capital attraction and coping with or influencing government policies.

The Program as a Response to Policy and AID's Congressional Mandate.

This section provides little additional support for the proposed policy beyond a simple reference to that part of section 601 of the Foreign Assistance Act which advocates utilizing the private sector. However, there is a claim made here that AID's experience with private sector-type projects, such as "intermediate credit institution-building projects" and "investment promotion assistance", represent some of the "Agency's most conspicuous successes". However, my review of AID projects principally directed at the non-farm private sector reveals that the many if not the majority intended to support smaller-scale enterprises and nonetheless were primarily failures whose designs did not demonstrate any incorporation of knowledge gained from earlier projects of similar intent.

A typical project was the provision of $5.5 million in capital credit and technical assistance through an intermediate finance institution, the Paraguayan Private Development Bank, to SMEs beginning in 1971 in order to, among other goals, improve the private sector's efficiency in production and distribution of goods. However, a post-project evaluation revealed that the project's two principle assumptions - that there was a lack of management skills and medium and long-term financing especially for the targeted beneficiaries, SMEs, -

* see bibliography

were basically incorrect. It was discovered that local commercial banks were willing to provide medium-term credit if the Central Bank adjusted its rediscount terms so as to allow reasonable spreads. The Private Development Bank provided the project's subsidized credit only to established, traditional raw materials export industries with capital/worker ratios greater than $24,000, i.e., indicating capital intensive usually large firms. In addition, technical assistance for business project feasibility studies and business administration were never requested. The other project objectives - income distribution, employment generation, the process, marketing and distribution of foodstuffs, and increased and diversified exports - were never achieved and possibly worsened the situation.

The majority of AID private sector projects involved providing subsidized, selectively targeted capital credit and business management-type technical assistance through semi-public intermediate finance institutions which experienced results similar to most other donor/host country experiences as summarized by Keith Marsden in a recent World Bank document on promoting the private sector. In his summary of policy mistakes and recommendations, Marsden states that once the policy biases and obstacles to small enterprise growth that are implicit in existing incentive and regulatory systems are removed, the following interventions have proven relatively successful: a) refinancing credit facilities or guarantee schemes (with costs passed on to borrowers) and training of local bank staff in simplified project appraisal and supervision methods; b) governmental vocational training programs adapted to small-scale enterprise needs and circumstances; and c) public technical assistance institutions that are specialized and have intended beneficiaries adequately represented on the institutions' governing boards. Given the implicit large firm bias of AID's policy it is not surprising that none of these approaches are considered. However, by using AID experience in SME development to support a private sector policy oriented to large-scale enterprise its objectives can only become more confusing. In the least the argument should mention with the "conspicuously successful" private sector projects those that are less so.

Challenges Facing the Agency's Response to Policy.

In this section the policy paper provides five constraints to achieving its stated objectives which for the most part simply reflect more of the inherent procedural and organizational problems the Agency faces with implementing its policy such as the "limited amount of existing AID expertise" in business management and finance". Such observations are straightforward and fail to deal with any of the serious policy assumptions raised here.

Role Models for the Agency's Program.

This section is merely an attempt to support the proposed policy by demonstrating the success of similar policies undertaken elsewhere, i.e., the World Bank's IFC, that have "leveraged" private investment. As pointed out in PPC evaluations of AID's private sector policy, simply duplicating other donor efforts demonstrates a serious lack of innovation and a lack of consideration of the finance needed by the much larger, generally more efficient, productive and employment-oriented SME segment of LDC private sectors whose levels of individual investment needs fall below that which AID is proposing to fund and which other donors refuse to fund due in part to their own development objectives and exigencies of internal efficiency.

Role for AID Among Other Agencies Related Programs.

Although this section attempts to claim that AID's policy will be "compatible and complementary with those of other internationally-concerned agencies" such as OPIC, ExIm Bank, the IFC and others, a stronger case can be made that it is more duplicative of their objectives and efforts especially with regard to supporting large firms that either should have the capacity to get commercial help if needed or be suspect for requesting subsidized and potentially mismanaged public assistance, i.e., implying that the projected investment is not commercially viable or sustainable to warrant sufficient private sector interest. The Policy may be compatible and complementary to the extent its strategy calls for providing additional quantities and types of assistance to large US and "indigenous" firms. However, as I've emphasized, reaching the broader indigenous private sectors, i.e., SMEs, is ignored.

Conclusion.

As I've stated no attempt is made here to analyze the PRE Program Strategy, Roles and Process, nor Funding sections of the Policy Paper given my premise that more serious problems exist with the policy assumptions. It may very well be that host country government leaders, many of whom have one foot in the larger-sized interests in their private sectors, prefer AID's larger business focus. However, if accountability is at all sufficient in these countries such that larger investments are viewed as ineffective or possibly detrimental to the indigenous consensus of economic development, then AID may find itself more overexposed and aligned with narrow political factions than before without a well-reasoned, more even-handed rationale on which to rely.

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APPENDIX

AID/DIU Abbreviated List of AID Private Sector-Type Projects

'try/Reg	Project	Intl. Yr.	Type Assistance	Eval. Results
onduras	Private Enterprise Development	1965 –	TA & n.a. commodities for govt. tech. institute	
icrgua	Community Dev.	1968	TA, Credit & Trng for National Dev. Institute	n.a.
icrgua	Private Dev. Bank	1967	Credit & Equity for govt. invest. bank	n.a.
icrgua	Nicaragua Recovery Prog.	1980	Credit & TA to coops	n.a.
ırguay	Private Dev. Bank	1971	Credit to small/ medium banks/bus.	-failed to lend to small bus. -loans made to trad. exports -no need to promote dev. banks; comm. banks will provide cred. if med. term discounting available from C.B.
ru	Rural Enterpr. Dev.	1976	Credit & TA thru industrial bank to rural enterpr. for emplyt. generation.	n.a.
ribbn	Priv. Sectr. Invest. Asst.	1981	TA for Car. Assc. Industry & Commerce	n.a.
:u	Priv. Invest.	1968	Long term cred. for any industry esp. those supporting econ. dev.	
:ibbn	Agribus. Expansion	1980	TA & commodities for Agribus. Dev. Corp.	-incr. in employment thru backward links

trl.Am.	Reg. Rural Agribus. Dev.	1976	TA & Credit thru C.A. Bank to nat. Interm. Credit Insts. for sub-projects affecting productivity, employ., income of small farmer & tech. transfer, cost, efficiency of Agri-bus.	-TA should be for project loan appraisal - if capital/ cost more than $5000, deny proj. proposal
hile	Agric. Coop Dev. Fund	1975	Financing and TA to upgrade Institute for Financing of Cooperatives	-generally successful. -need more profitable loans.
hile	Small Scale Reg. Dev.	1976	TA for Industrial Corporations for Regional Dev. assisting small-scale industry	-allow each corp. assume own growth pattern
olombia	Small Industry Development	1975	Credit & tech. transfer thru Finance Corp.	-govt. policy change needed
om.Rep.	Private Dev. Finance II	1973	Credit & TA	-"successful"
l Salv.	Marg. Community Improvemt.	1980	Equity & working capital for small bus.	n.a.
ıatemla	Rural Enterp. Dev. Loan	1979	Credit, TA & tech. transfer	n.a.
"	Finance Priv. Industrial & Ag. Dev. Bank	1968	Finance creation of capital market	n.a.
"	Export Dev.	1971	Create export dev. center assisting non-traditional expt.	n.a.
ıiti	Haitian Dev. Foundation	1979	Create Priv. Credit Instit. providing credit & TA in mgt. to small bus. (20 or less employees)	-TA should be limited and paid for by bus. -greater authority for loan officers
rl.Am.	Human Res. Dev		TA and training in promoting invest. opportunities thru govt.	n.a.
geria	Indigenous Industrial Dev.	1966	TA, credit, bldgs. for Minstry of Industries' Indus. Dev. Centers	-need TA for assessing applications & monitoring implementation

anzania	Rural Credit Union Dev.		Establish credit unions	n.a.
frica	Entente States Afr. Entrprise	1973	Credit & TA for small & med. bus. thru dev. banks	-need for working cap. -abuse due to cheap credit & few guidels. -should be unrestricted loan sectors.
otswana	Rurl Enterpr. Ext. Service	1978	Training for entrepreneurs in bus. mgt. thru PVO	-lack of GOB policy support
. Volta	Rur. Enterpr.		TA & credit for rural enterpr. thru PVO	-high repaymt.
frica	E. Africa Dev. Corp.		Credit	n.a.
■	W. Africa Dev. Corp.		■	■
caragua	Industrl. Dev.		TA to public corps. in expt. promotion & trng.	n.a.
frica	Entente Afr. Enterpr. II	1974	(see above)	n.a.
araguay	Priv. Enterpr. Dev.		Trng & investment promotion	n.a.
gypt	Priv. Sctr. Credit	1979	Med./Long term loans co-fin. with priv. banks, etc. for large co.s	n.a.
rkey	Ind. Dev. Bank		Equity & Med/long term loans thru Priv. Ind. Bank to affect BOP position, expand essential goods & max. indust. investment	n.a.
ailand	Priv. Sector Dev.	1965	TA & trng. for govt. to effect policy and loan administration for export industry.	n.a.
livia	Rural Enterpr.	1978	Credit, TA & refinancing for agribus. & rural artisans thru credit institutions	-adjust int. rates to com. rates -streamline loan approval -target credit at job creatn.
donsia	Prov. Area Dev	1977	promote rural handicraft & food processing	n.a.

om.Rep.	Trng. Rural Management		For govt. and entrepreneurs in bus. admin.	n.a.
"	Dom. Dev. Foundation		TA & trng. thru govt. for rural credit institutions	n.a.
cuador	Institutional Development	1968	TA & credit for creation of rural credit institutions	-insuffecent & inadequate TA in adminn. to CUs
uatmla	Rural Dev.		Credit & TA thru coops in food process & cottage indust.	-lack of mktg. struct. -loan delinq.
"	Rural Enterpr. Dev.		Credit, TA & studies of GOG policies & tech. transfer	n.a.
caragua	Rural Small Merchts. C.U.	1977	Institutionalization	n.a.
ru	Rural Enterpr. II	1979	TA, trng., commodities, credit for small bus. thru bank syst.	-neg. policy environ. -not employmt. generating -mostly urban bus. benefit -lack qualified bank staff -overcentralize & need acctng. system
nzania	Arusha Plang. & Villge Dev.	1978	Create tech. transfer center	n.a.
beria	Nimba Valley Enterpr. Dev.	1977	TA & trng. thru govt. to diversify mining economy	n.a.
li	Trng. Center for Rural Womn.	1980	TA & trng in small bus. mgt.	n.a.
rica	Gara Cloth Industry	1976	TA & seed capital for cottage industry	n.a.
rica	Partnership in Productivty		TA & credit assistance to small bus. thru indig. PVOs	n.a.
s	Industry Dev.	1967	TA & revolving credit for resource exploitation industry	n.a.
.Rep.	Priv. Invest. Fund	1970	Med/long term credit thru C.B. for forex costs of fixed investments to improve BOP, increase competition & employmnt.	-already much similar credit available

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:uador	La Ecuatoriana de Desarollo	1970	TA & credit to create dev. bnk to service med/long term credt. of private enterprise & industry n.a.
)rea	(several private sector projects)		