
Aiding Development

Peter Young



ADAM SMITH
INSTITUTE

A I D I N G D E V E L O P M E N T

by

Peter Young

Adam Smith Institute

London

1986

First published in Britain in 1986 by
THE ADAM SMITH INSTITUTE
This edition (c) Adam Smith Institute

All rights reserved. Apart from fair dealing for the purpose of private study, research, criticism or review, no part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means electronic, mechanical, photocopying, recording or otherwise, without the prior permission of the publishers,

The Adam Smith Institute, 2 Abbey Orchard Street, London SW1.

The views expressed in this publication are those of the author and do not necessarily reflect those of the publisher. They have been selected for their independence and intellectual vigour, and are presented as a contribution to public debate.

ISBN 0-906517-89-3

CONTENTS

	Page
Britain and the Third World	4
The British Lead	7
The Third World and the Private Sector	10
Aiding Development	12
Patterns of Assistance	18
New British Aid Policies	21
Footnotes	23

BRITAIN AND THE THIRD WORLD

Britain has not done much to assist third world development after its former colonies received independence. Their elites were educated in the Universities and colleges of Britain, and were taught ill-conceived and ultimately unsuccessful collectivist ideas. The example which Britain and other European countries provided was that centralization was good, that government should solve problems, and that industry should be nationalized. It was entirely the wrong example for their countries to follow.

The third world country which has prospered the most is one which did not take any of this advice - Hong Kong. Indeed it has remained under very loose British rule as a colony, thus never having to undergo the process of decolonization. It has done well because of the absence of government interference and direction. Few if any Hong Kong millionaires studied at the London School of Economics.¹

Another country, formerly a British colony, which rejected western-inspired socialism and has since done very well for itself, is Singapore. It is unfortunate that the lessons of the success of these countries have not been learned by the Western aid agencies.²

British aid policy has rarely recognized the mistakes of the past, and has generally served to prolong them. Aid is directed to third world governments without regard to the policies which those governments are pursuing. Thus large quantities of money are received by Tanzania, Zambia and Mozambique, despite their disastrous collectivist agricultural policies, policies which might have been specifically designed to destroy every last vestige of efficient agriculture.

The recipient of the largest quantity of British aid is India, which constructed the epitome of a centralized, bureaucratic, socialist economy, with predictably disappointing results. Only recently has India started to change.

The British aid agency itself, the Overseas Development Administration, (ODA), has admitted the effect of western socialist thought on the third world. In the first annual review of its operations, an ODA official, B.R. Ireton, states that:

"Many of the first generation of leaders of newly independent countries (both politicians and bureaucrats) were influenced by European socialism and by the Latin American economists of the early 'dependency' school...There was a strong belief that governments should, and, with the bureaucratic machines they had inherited, could, act indirectly and directly to promote economic development..."

Against this background it is not surprising that many early development plans sought a large increase in domestic investment, and an expansion of the modern industrial sector based

largely upon import substitution, which it was hoped would absorb surplus labour and help diversify the economy. They also involved a substantial expansion of the public sector, both in terms of the administrative apparatus, and the activities to be carried out. In many cases the public sector expanded into manufacturing, either to establish new industries or to nationalize existing plants."3

There seems to be little sign of any major effort on the part of the ODA to press for changes in these policies. An examination of the main beneficiaries of British bilateral aid reveals a number of countries which are not renowned for their devotion to market policies:

UK Aid in 1984
(Main beneficiaries)4

	£m cash
Bilateral aid - total	780

The main recipients are:

India	146
Kenya	37
Bangladesh	35
Zambia	32
Tanzania	30
Indonesia	28
Sudan	27
Sri Lanka	26
Thailand	20
Pakistan	18
Botswana	16
Zimbabwe	15
Egypt	15
Jamaica	15
Malawi	13

The former British colony of Zambia is a good example of a country whose economy has gravely suffered from being directed by collectivist precepts. After independence in 1964 government thinking was influenced by a group of economists seconded from the UK who subscribed to such views.

In the Mulungushi Declaration of 1968 the government announced its intention to participate in the economy and to restrict retail trade to Zambian citizens and companies. The government purchased controlling interests in all significant commercial interests including brewing, building supplies, finance, chemicals, hotels, and major road transport firms.

These newly acquired government shareholdings were placed in the Industrial Development Corporation, (INDECO), which needless to say has since embarrassed the government by the huge losses it has accumulated.

It would be wrong to castigate all third world leaders for following incorrect policies. They only did what the leading economists and the aid agencies were telling them to do, and what western governments themselves were doing. There have recently been increasing signs that they realize that these collectivist policies were a bad mistake, likely to consign their countries to a perpetually 'underdeveloped' status.

The intellectual impetus behind collectivism has evaporated. Marxism-Leninism is by and large regarded as a failure. Even the Khmer Rouge, who managed to massacre 2 million people in an attempt to implement their own brand of marxism in Kampuchea, have renounced marxism and said that they envision "Kampuchea in the future as a liberal, capitalist regime in economics and a parliamentary regime in politics".⁵ In communist countries themselves, as recent studies have documented, the first flowerings of the free market are beginning to appear. Many third world leaders today are looking for new ways forward.

Quite simply, many developing countries can no longer afford to maintain their huge loss-making public sectors. The burden of subsidies has become too great. It is also clear that the state-owned companies are just not working properly. Inefficiency, sloth, red tape, are rife. Privatization is the only solution, which is why an increasing number of third world leaders are turning to it. Asset sales, furthermore, provide a useful source of revenue to these financially strapped governments, and can help to pay off some of the burden of debt.

These encouraging developments, now taking place in the third world, are spasmodic, rather than systematic. Many governments are experimenting with ways to dismantle their over-large and inefficient public sectors. In this they have been inspired by the recent British experience of privatization.

Britain, which gave some bad economic ideas to the developing world, is now beginning to serve as a model for their removal. There is no doubt that Britain, of all western countries, has moved fastest and most successfully to dismantle its public sector. A number of third world governments are starting to emulate the British privatization experience, but they have received little encouragement so far from Britain itself.

The time is long overdue for Britain to change its thinking on foreign aid, and to redirect it into helping along and speeding up the process of privatization in the third world. There is a good case for supposing that more lasting economic development will result than any generated by unconditional grants of cash to be spent by governments.

THE BRITISH LEAD

Britain is clearly seen as the world leader in privatization. Other countries look to the British example and experience when they seek to privatize. Over 20 countries - including communist China - have sent delegations to Britain seeking privatization advice. Throughout the world, people are looking to Britain's achievements as a guide for their own policies. A typical attitude is that of Pratap Bhogilal, President of the Indian Merchant's Chamber :-

"Privatization seems to be the only solution for the ills of our economy. Our country can emulate the process of privatization introduced in the UK, popularly known as Thatcherism, since it was Mrs Thatcher who sought to reverse the Labour Party's policies of nationalization. For an accelerated economic growth and to remove poverty and inequality, privatization of the public sector units is a solution worth trying out and it should be resorted to without any inhibition".⁶

Foreign governments are modeling their privatization policies on those of Britain. Mrs Thatcher was consulted by the Malaysian government about their accelerating privatization programme, and the flotation of British Telecom is being used as the basis for transferring the Malaysian telecommunications system to the private sector.⁷

The minister responsible for the Turkish privatization programme, Mr Vahit Erdem, has said that he is being guided by British experience, and is seeking to recreate in Turkey the improved motivation and efficiency he says he found at all levels when he visited British Telecom, Cable and Wireless, and the British Freight Corporation.⁸

Many more examples of similar interest could be found. Indeed the Adam Smith Institute itself is frequently approached by foreign governments and legislators for information about privatization, but being a small organization there is a limit to the assistance it can provide.

Thus there is worldwide interest in British privatization experience, providing Britain with an opportunity to effect profound changes for the better in the economies of developing countries. So what is Britain doing to take advantage of this opportunity? The answer, it seems, is nothing much. Apart from showing around visiting delegations, a function carried out by the Central Office of Information with the assistance of the Treasury, very little is being done.

It is sad that western governmental interest in encouraging privatization in the third world seems to exist only in the United States. This is particularly ironic as the US privatization record, with the exception of contracting out at a municipal level, is poor.

The US Agency for International Development held an international conference on privatization for third world leaders in February, 1986. The US-funded Asian Development Bank held a conference on privatization policies, methods, and procedures in Manila in January 1985, attended by representatives of a number of Asian countries. And the US Representative to the European Office of the UN, Gerald Carmen, took the initiative in organizing a conference in Geneva on encouraging entrepreneurship in developing countries.

Britain, however, is the only nation with the depth and breadth of practical experience in privatization to be of real assistance to the third world in this field. This experience is contained both in the government and in the private sector. British merchant banks for example, have developed extensive privatization expertise. Privatization could become one of our most valuable exports to developing countries.

Unfortunately, there is little sign yet that the British government and its agencies are receptive to the new thinking on third world development. The government seems to be leaving this area alone. The aid bureaucracy itself is naturally resistant to any policy change which might disturb its work practices. The bureaucracy largely sees its task as one of handing over money, and does not welcome changes which involve it in promoting policy changes in recipient countries.

Undoubtedly giving away money is easier than actually promoting real economic development. Placing conditions upon aid would involve much work and many problems. Friction would arise between British aid officials and recipient countries. The work of these officials would become more difficult and demanding. But there is little doubt that they could do it, and make a good job of it, if properly directed and motivated.

The attitude of the government and the bureaucracy may be short-sighted. The political costs of increasing economic dislocation in the third world are high, both in terms of damage to the international trade and the international economic system, and in terms of heightened domestic political pressure to throw good money after bad in third world aid.

Few members of the public knew of the degree to which the Ethiopian regime's agricultural policies contributed to the Ethiopian famine. Ministers made little reference to this subject, largely because the government has not in the past exerted itself to draw attention to, or to try to change, damaging agricultural policies in African countries. The persecution of the private farmer in the cause of socialism and cheaper food for city dwellers continues unabated in Africa without influencing British aid policy.

In fact none of the three annual reviews of the ODA's work advocates privatization as a desirable policy. The word privatization is mentioned once in the most recent of these reviews, 'British Overseas Aid 1984', but only in the context of reporting

on developments in Africa. The main impetus of British policy towards the public sector in developing countries seems to be to try and improve the efficiency of the public sector.

"It is important that the public sector should improve its resource planning and decision-making processes, raise the technical competence and efficiency of its institutions and find more cost-effective delivery systems in extending education and health services to the poor",⁹ writes ODA official B.R. Ireton in 'British Overseas Aid 1982'. This of course misses the crucial point that generally speaking the most effective way of improving the efficiency of the public sector is to privatize it.

THE THIRD WORLD AND THE PRIVATE SECTOR

There is a view, which may be based on no more than simple prejudice, that the third world is insufficiently sophisticated to develop modern entrepreneurial market economies with functioning private markets to supply the diverse needs of millions of consumers. This paternalist view supposes that the third world must be run by centralized bureaucracies, (advised of course by knowledgeable westerners), which take decisions for the rest of the population.

This view ignores all the available evidence that centrally planned economic systems with their inefficient collectivist bureaucracies invariably deliver third-rate economic results. Short of nuclear devastation, there is no better way of keeping the third world in a state of poverty and misery.

The paternalist view also ignores the extensive evidence that third world countries, whenever given the chance, have demonstrated great reserves of entrepreneurial talent and ability. Quite apart from the oft-quoted examples of Hong Kong, Singapore, Taiwan, and South Korea, there is an extensive record of successful private provision of public services in a large number of third world countries. There is also strong evidence of great entrepreneurial ability.¹⁰

A superb example of the free market at work is the 'dabbawalla' system in Bombay. The 'dabbawallas', who number about 2,000, are runners in an ingenious relay delivery system that carries more than 100,000 home-cooked hot lunches every day up to 40 miles from home to office and virtually never results in a mix-up. The operation is supervised by contractors called mudadams, who usually employ three or four dabbawallas, and who themselves answer to a dabbawalla guild, the Bombay Tiffinbox Suppliers Association.

The Washington Post, in a feature article on the dabbawalla system, commented that:-

"How a tiffin makes its way to its proper destination amid the chaos of Churchgate station in the morning remains a puzzle to an outsider. Tens of thousands of seemingly identical lunch pails suddenly come together in the swarming concourse of the station and, in a frenzy of loudly shouting dabbawallas, are shuffled like a deck of cards with blinding speed and transferred to the six-foot trays before suddenly disappearing into the crowd-filled sidewalks. The dabbawalla system - devised and run by illiterate peasants - works as if it were orchestrated by computer and managed by efficiency experts."¹¹

The private provision of water is not common, even in the most advanced industrialized countries, yet it works well in the Ivory Coast, Guatemala, and Chile.¹² A private company, SODECI, (Societe des Eaux de Cote D'Ivoire), is responsible for water

supply in the Ivory Coast, and despite rapid expansion of the system offers one of the highest standards in West Africa. The system is well designed, equipped, managed, and operated. Water quality and pressure are uniformly good. Consumption is metered and water losses are low.

Electricity, again, is a utility that is commonly provided by the public sector in most developed countries, but Brazil and Korea have passed laws designed to encourage the generation of electricity by the private sector.^{13A} A Brazilian company, SATHIEL, now generates electricity from wood-fired steam turbines, and currently has three contracts to sell power in the Amazon state of Brazil.

Telecommunications, another service normally constituted as a state monopoly with all the problems which that entails, is provided privately in the Dominican Republic.¹⁴ A private company, CODETEL, provides a cheap and efficient telephone service.

Urban transport, provided publicly, expensively and inefficiently in developed countries, is supplied profitably and efficiently by deregulated private enterprise in such diverse cities as Kuala Lumpur, Buenos Aires, Hong Kong, and Calcutta.¹⁵

It may be seen that many public services are provided privately with great success in some developing countries. This has important lessons not only for other developing countries, but also for western policy towards the third world. Much greater attention might be paid to the encouragement of private provision of public services.

AIDING DEVELOPMENT

The western agencies could do much to promote privatization in developing countries. They have it in their power, if properly directed, to give exactly the kind of assistance which will lead to growth and enterprise within the recipient countries. State schemes should be phased out of development aid, and privatization should assume a much larger role in the thinking of development agencies.

As a first step, direct monetary aid to countries should be conditional to a much greater extent than hitherto on their economic policies. The adoption of sensible economic policies, including progress on privatization, should be sought. When aid is given for specific development projects, private sector involvement should be urged and, insofar as is possible, should be made a condition of development aid. For example, aid to construct and operate irrigation networks, roads, or electricity generation facilities could be given subject to the condition that these were privately built and operated.

Capital Needs

One major obstacle to privatization in developing countries is the lack of adequate capital markets. For this reason, conventional western style privatization will prove difficult to transplant to the third world. However, there is much that the west can do to remedy the problem of lack of capital. Indeed, privatization itself could prove an important means of building up capital ownership in developing countries, and thus spurring further economic growth. Policies should be crafted to achieve precisely this effect.

An additional problem is that of the antipathy to foreign ownership which is felt by many of the developing countries. This is often a legacy of the colonial period, when much of the economy of the undeveloped nations was controlled by western interests. It was often the desire for domestic ownership of their industries which prompted their nationalization them in the first place. The takeover of nationalized concerns by foreign interests cannot therefore be reckoned as a viable option in most countries.

These concerns about capital and foreign ownership do not, however, apply to the variety of privatization known as contracting out. Here the LDC government remains in charge of the government function, but contracts out the provision of it to qualified and experienced firms.

A number of western companies already specialize in providing such services as garbage collection, street cleaning, air traffic control and hospital management to the governments of less developed countries. This is a practice which can be both encouraged and extended.¹⁶

By providing services at less cost, contracting out gives LDCs the chance to spend their scarce resources elsewhere. It also helps to build up an indigenous private sector expertise in the provision of these services. Western companies usually employ local management and local workers for their subsidiary service operations in LDCs, and thus give them the opportunity to gain an experience which can stand them in good stead with local contracting firms, once they start to be established.

Western policy should be designed to increase the practice of contracting out, by providing advice about the preparation and supervision of contracts, by encouraging western firms to employ indigenous personnel, and by promoting training schemes for such of the latter who wish to form their own contracting companies. There is scope for a system of loans to be made available to assist in the start-up process.

Special Development Zones

A method of attracting foreign capital yet avoiding many of the attendant political problems is the creation of Special Development Zones within the developing countries. These SDZs are a combination of freeport and enterprise zone, attracting investment to a low tax and low regulation area set aside for the promotion of growth.

Developing countries should be given advice and financial assistance to set up SDZs to act as the focus for investment and private sector development. In this way private companies can be set up and fostered, so that the capital can be built up for successful privatization. Freeports are already in use in the developing world, and their numbers have increased dramatically over recent years. This means that the model already exists, and the nucleus can be extended.¹⁷

Certainly, western governments could play a key role by the use of tax incentives for their own companies to promote investment within special development zones in the third world.

Employment

The problem of surplus staff needs to be handled if public sector bodies within the third world are to be privatized successfully. The overmanning of public sector entities is not confined to the advanced countries. It is endemic in public supply, and needs to be handled intelligently and sensitively if the less developed countries are to gain the benefits of privatization.

The most effective way is probably the use of cash incentives to procure the appropriate level of voluntary retirement. While the LDCs lack the resources to fund such an operation, they run the risk of political hostility from the displaced staff, putting the move to the private sector in jeopardy.

It would be sensible, given these circumstances, for development agencies to make funds available to LDC governments in order that suitable generous lay-off payments can be made. Despite the fact that this involves payment to people, it should be seen as legitimate capital spending, putting out money now in order to secure more efficient operation in the future.

Equity Participation

While the use of contractors, the promotion of special development zones, and the provisions of funds for reduction of manning levels are all useful, more radical measures are clearly needed if the problems of capital shortage in the third world are to be surmounted.

One of the most radical proposals would involve development agencies in direct purchase of the equity of privatized public sector operations in the third world. This is a form of transfer of funds to the government of the developing country, on a basis which makes them available for general revenue, or to back a particular project. It is thus a form of foreign aid, but has the added advantage that it promotes privatization.

Equity participation by development agencies has both advantages and drawbacks. There is a strong likelihood that such participation by reputable bodies will increase investor confidence in the projects concerned. In addition, the agencies will be in a strong position to monitor the progress of particular privatization programmes, and to give help and advice where they were needed.¹⁸

The injection of outside funds by the international agencies will prevent the drying up of local capital markets, and enable vastly more privatization projects to be undertaken than would otherwise be the case.

On the negative side, there would have to be a standing policy on the part of the agencies not to hold this kind of equity as a long term investment. They should attempt instead to sell to local investors as soon as practicable, not only returning the proportion of ownership they held back to the developing country, but helping to build up the local capital market as well.

Strict limits would need to be observed on the extent of share purchase by western agencies. It would hardly be privatization to transfer ownership from one government to another, and would cause the issue of foreign control to be raised again. The purchase of shares by the agencies should not result in any case in a private sector ownership of less than 50% of the equity.

It could happen that, owing to difficulty in attracting private buyers for their holdings, western agencies found themselves owning and running various enterprises in developing countries. This is not a role for which they are suited. Nor is there any indication that selection by agency officials of projects to back would be as good as that of local investors and entrepreneurs

taking risks with their own resources. The record of investment by government agencies throughout the world is a disastrously poor one.

Returning the Stock

Development agencies could return their holdings in newly privatized third world operations by distributing free shares to the local populations. This would achieve, in theory at least, one of the main objects of privatization: the wider distribution of wealth and a broadly based ownership of capital. It would help to surmount one of the main dangers to the LDC privatization, which is that it might be done corruptly, with state assets ending up in the hands of the cronies and families of political leaders.

Free distribution of stock would certainly spread ownership of capital, at least in the short term, but it does present some practical problems. It has been done successfully in a very few cases in advanced countries, notably Canada, and has been advocated by commentators ranging from Dr. David Owen, leader of the Social Democratic Party, to Samuel Brittan, Deputy Editor of the Financial Times.

The fairest method, that of equal distribution to the entire population, places stocks of little value into the hands of people who might have no idea of what to do with them.

One alternative might have the development agencies buying stocks at the market rate, but then putting them on sale to the indigenous population at one half or one third of that price. In order to achieve the objective of a broadly based ownership, an upper limit would restrict the number purchased by any one person or institution. This would prevent a few rich individuals snapping up the cut priced stocks.

Similar limits were placed on the initial allocation of shares in British Telecom to the general public. The sale was structured so that only small applicants were satisfied, forcing big buyers to enter the market and push up the price of the shares bought by small investors. The result was not only to spread ownership, but to nearly double the value of the shares as soon as dealing opened.

Another expedient pioneered in the flotation of Telecom was the use of highly visible advertising to promote the shares. This extensive campaign was very successful at attracting first time share buyers, and could serve as the model for achieving similar results in LDCs. There is a need there for programmes of education and information to inform the public about the stock market and share purchase as a form of investment. The development agencies have a role here, in advising how such campaigns could be carried out, and in providing some of the funds to pay for them.

Employee Buyout

An even more appropriate privatization model to adopt might be that of the employee takeover or buyout. In this case we have UK experience of inestimable value to LDCs, in that it is applicable there to a greater extent than is the conventional model. In the case of a worker/management buyout, ownership is transferred into the hands of many people with little wealth or knowledge of stock markets. It is a form of privatization popular with the employees of state-owned concerns, and thus politically attractive.

The National Freight Corporation takeover serves as a useful model. The workers invested some £6.2 million, about £700 each, and the banks contributed the remainder of the £53.5 million to finance a buyout of the firm. The workers own 83%, and the banks own the rest. Employee productivity is up by 30%, and each £1 of stock originally bought is now worth £10, making many of the worker owners considerably richer than they were.

Other employee buyouts in Britain have included the Swan Hunter warship yard, the Vosper, Grangemouth and Tyne ship repair yard, Vickers, and the Victualic plastics firm. Worker takeovers have been invited for the subsidiary companies of the National Bus Company, and about 20 of them have notified intent to do so, and have enlisted the help of accountancy and venture capital firms.

The government itself has asked the UK subsidiary of Bankers Trust to study the feasibility of multiple buyouts financed through loans from financial institutions.

The Vickers case has many of the factors significant for the use of buyouts in developing countries. The management had to launch education programmes to inform the workforce about stock owning. They had to make the case that the pension scheme of a privatized yard would be as good as the previous one. Loans had to be arranged which could be repaid out of wage packets.¹⁹

To each employee interested in buying stock, £500 interest free is to be offered for purchase of shares. Preferential loans of up to £5,000 will be made available at market interest rates, but with repayments of capital deferred for two years. The workers' consortium will buy stock at a preferential rate of £1, whereas financial institutions, pension funds and banks will expect to pay 5 times this rate. No single shareholder will control more than 15% of the company.

Significantly, the British government announced acceptance of the £60m buyout on March 7th 1986, even though it was not the best offer received in strict cash terms. This is a point developing countries should take on board. In some cases it is more acceptable for social and political reasons to accept an offer involving the employees and management, in preference to one which does not.

The parallels should be noted. The workers are not wealthy. They know little about buying stocks. Not only do they need to be educated in such matters, they may require loans for the purchase of shares. The amount of money they need to put forward can be as little as 10% of its value; and they can buy shares at a preferential rate, with financial institutions putting up the rest of the money.

It will probably turn out, yet again, that a company in which the workforce has a major stake is more likely to be a successful company and, indeed, a happy one.

None of the above factors would be difficult to organize in many developing countries. Development agencies could help to train management and employees in the skills of mounting buyouts. They could educate the workers about stocks and shares. They might provide loan facilities to promote workforce purchase of shares, allowing repayment out of subsequent wages. Finally, they might put up the bulk of the funding needed to finance purchase of the operation from the government concerned.

PATTERNS OF ASSISTANCE

The Private Sector

Given encouragement and incentives by western governments, and welcomed by governments in the less developed countries, the private sector in the west could perform a much more significant role in encouraging and helping privatization in developing countries.

The first and most obvious role for the west's private sector is to assist in the actual process of privatization. Western investment banks, accountancy firms, and advertising agencies have both expertise and experience in handling privatization operations, and could apply both of these to programmes within developing countries.

Western investment banks should handle LDC privatization stock issues, and do the underwriting. Management consultancy and accountancy firms should help prepare the state enterprises for privatization; and advertising agencies should conduct the publicity campaigns necessary to interest the public within the developing country in buying shares. Some western firms are already active in this field, and need only a little encouragement to increase their commitment.

Western private investment in privatized companies should be encouraged by the creation of appropriate tax advantages. These could apply in particular to unit trusts which specialize in the privatized equity of third world nations. Indeed, the formation of unit trusts which would invest in LDC privatization projects should be deliberately encouraged.

The creation of such capital pools to promote third world privatization would be a very useful policy innovation. These unit trusts could combine their resources on occasions to actually achieve privatization in the third world. Their roving brief would be to identify and develop profitable privatization opportunities in developing countries. The tax advantages to them could be justified on the grounds of the economic and social benefits their activities would bring in the third world, and on the high risk nature of the investments. The tax benefits might take the form of making these funds a shelter from some of the taxes which fall on capital and its transfer.²⁰

The private sector should be encouraged to lend against equity held in third world privatized companies by investors within the LDCs. In other words, such equity should be treated as security for loans, enabling LDC entrepreneurs to commit their funds to privatization projects, while retaining liquidity. Governments might act to encourage this practice by standing as secondary guarantor.

Banks should be encouraged to convert part of their debt owed by LDCs into equity,²¹ and western governments might provide

measures for this. LDC governments could reduce their debt service and interest payments by exchanging debt for equity in companies being privatized. The stock given to banks in this way could have conditions attached, such as the requirement for resale to indigenous investors within 10-15 years. Such a policy would also give western banks a major interest in ensuring the success and profitability of the companies concerned.

Financial institutions should be encouraged to provide facilities to enable LDC investors to buy shares in privatized companies on credit. Such facilities were made available to investors in British Telecom when it was privatized. They were permitted to pay in three installments over an 18 month period. Similar methods would greatly increase opportunities for investors within the developing countries to participate in state sales.

Governments of Developing Countries

The most important role which LDC governments themselves can play in promoting privatization is that of creating a climate which encourages investment.²² This involves guarantees for property rights and contract protection, and having an impartial system of adjudication for property and contract disputes. Investors must be free from the fear of expropriation. The rule of law must be there to regulate transactions, and there must be general confidence that the government itself respects the law.

In practice it also means having a tax structure which does not militate against achievement and success, but which allows people to garner and retain the rewards of taking risks and engaging in enterprising activity. Tax rates must be low, on corporate as well as personal incomes, and such taxes as are necessary should fall more heavily on consumption than on sources of investment.

The financial rules of the developing nations should be such as to allow mobility of capital in and out of the country. Foreign investment is attracted by circumstances which make it easy to move and recover capital, as well as to invest it. Free trade is important, without tariff barriers to regulate or pre-select the types of activity which take place. The need is to discover and exploit comparative advantage, rather than to have developing nations producing expensively behind tariff walls those things which can already be produced more cheaply elsewhere.

It is important that privatization should be understood by the governments of LDCs as a creative process whose aim is to shift whole areas of economic activity, together with dependent interest groups, out of the public sector. It moves them away from the politicized, non-commercial state sector, and towards the consumer-responsive, profit making private sector.

Privatization is not merely a means of raising some funds quickly by selling off a few state assets, or a means of granting favours to a few individuals or companies by allowing them to buy these assets at low prices. Properly done, it should involve a wide

section of the population, and should take as many people as possible into the wealth-creating process.

There are cases in which governments of developing countries wish to achieve the benefits of privatization, but are reluctant to experiment with major decontrol of the economy. One option which is possible for such cases is the use of special development zones within which there is protection for investment and enterprise. Even if the deregulation has to be confined initially to special zones, there is every prospect that development within those areas will encourage the LDC government to extend them, and eventually to permit their benefits to spill over more broadly into society at large.

NEW BRITISH AID POLICIES

The British government could make a serious effort to promote privatization in developing countries. In some cases developing countries have already started down the privatization road, and require extra support and advice. In other cases countries are actively considering privatization and need encouragement. Some countries, meanwhile, require to be persuaded of the necessity of privatizing in the first place.

A variety of new policies is needed. There is a great number of new initiatives which could form the basis of a comprehensive programme to boost privatization and economic growth in the third world. Britain could undertake all of them, and could achieve a major acceleration in third world development by doing so.

The Proposals:

1. A unit should be established within the Overseas Development Administration with specific responsibility for encouraging privatization in the developing world. A number of outside experts should be brought in to help staff this unit, to augment in-house expertise. The unit should co-ordinate the various policies instituted to promote privatization.

2. A number of specialist teams is needed to provide advice on privatization to developing countries. These teams should be made up of officials with privatization experience from various government departments, managers seconded from newly privatized companies, and experienced individuals seconded from the city.

The ODA already funds a programme called the British Executive Service Overseas (BESO), which sends experienced businessmen to advise governments and businesses in developing countries. BESO sent over 100 executives to 60 developing countries in 1984. The private sector part of the proposed privatization advisory teams could be organized through an expansion of this programme.

3. A series of conferences on privatization should be initiated in Asia, Africa, and Latin America, in which British and other specialists could outline their views and experience and attempt to assess third world problems and perspectives with regard to privatization.

4. A data bank on privatization experience both in Britain and other parts of the world should be set up. It should gather information not only on recent privatization successes but also on public services which have been privately provided for some time. Publication of the information in a series of reports would make this available to interested governments and individuals. The production of a series of 'blue book' privatization manuals would also be of great assistance.

5. Government ministers should take a more active role in putting the case for privatization when visiting other countries. Trade

and industry ministers in particular, who travel more regularly than other ministers, could be more forceful in pointing out the benefits of privatization in terms of increased economic activity and trade.

6. Delegations of third world officials should be funded to visit Britain for the purpose of gathering information on privatization. Their visits should include meeting with public officials and with private businessmen who have been involved in the process.

7. Third world officials should be seconded to UK government departments overseeing the privatization of parts of the public sector, in order that they might gain direct experience.

8. Developing countries should be helped to set up special development zones. These can act as a focus for investment and private sector development, attracting and building up private companies which can provide the capital required for successful privatization. The provision of tax incentives for British companies investing in these zones might be a useful part of this policy.

Freeports are already proving a useful innovation in the developing world and their number has increased dramatically in recent years. British experience of freeports is recent, and the government might wish to set up a private sector team to draw lessons from freeports around the world, and advise third world governments accordingly.

9. Monetary aid to each and every country should be conditional on its economic policies. The adoption of sensible economic policies, including progress on privatization, should be sought.

10. Capital should be made available for privatization of third world public sector entities by purchase of equity shares in the new company. This is a much more productive method of giving aid than the direct government-to-government aid which it would to some extent supersede.

The problem with direct aid is that it can be counter productive. It promotes state spending by the LDCs, and leads to their people of talent looking to government as the source of all wealth and power, and thus never developing into the entrepreneurial class needed for economic growth. While direct aid distorts the economic priorities of the LDCs, often shutting out opportunities, capital for privatization equity would at least foster some growth in private sector activity.

Governments of developing countries are often hindered in their desire to privatize by a reluctance to sell to foreigners, despite a lack of domestic capital. The method of introducing foreign capital described above should be much more palatable to them, as it is designed to end in local ownership. This policy, together with the two suggested immediately below, could surmount

the most important political objections to privatization in these countries.

11. The British government should assist privatization in developing countries by lending money to private companies there who wish to invest in privatization offers. The arguments for this action are similar to those for the above proposal. Given that the government is already in the lending business, it is preferable that such lending should actually achieve something useful. Again, firm restrictions on the extent of lending will be required. It might be best to encourage private British financial institutions to put forward the money with appropriate government guarantees.

12. A major problem associated with the privatization of public sector entities in the third world is the need to dispense with the overmanning levels which characterize state operations, and which provide opportunities for politicians to reward their friends and supporters.

The British government should help to make funds available to governments of developing countries for the provision of suitably generous voluntary redundancy payments whenever these circumstances arise.

13. Private sector involvement should be urged in development projects, and insofar as it is possible, made a condition of development aid. For example, aid to construct irrigation networks, roads, or electricity generation facilities could be given on the condition that these were privately built and operated. British companies might be encouraged to become involved in these projects as partners with local companies.

14. British representatives in international agencies concerned with development, such as the World Bank and the IMF, should press for similar policies to be adopted by those agencies. They should also attempt to persuade EEC partners, many of whom are now beginning privatization programmes of their own, to adopt a similar approach, both individually and through the EEC.

15. Economic development through privatization should be made a key feature of British work in the Commonwealth, with Commonwealth bodies being involved in this work. Regular conferences and seminars should be held under Commonwealth auspices to spread information about privatization and to encourage involvement and participation by all members.

FOOTNOTES

1. Ivan Fallon, 'A Development Success: Hong Kong and Singapore' in 'Aid By Enterprise,' Adam Smith Institute 1984.

2. Ibid.

3. 'British Overseas Aid 1982,' Overseas Development Administration, London 1983.
4. Figures taken from 'British Overseas Aid 1984,' Overseas Development Administration, London 1985.
5. Washington Times, July 16th 1985.
6. Pratap Bhogilal, Journal of the Indian Merchants' Chamber, May/June 1985.
7. The Times, October 26th 1985.
8. Financial Times, November 4th 1985.
9. 'British Overseas Aid 1984,' Overseas Development Administration, London 1985.
10. 'Private Provision of Public Services in LDCs,' a 1985 paper by Gabriel Roth of the Economic Development Institute of the World Bank.
11. Washington Post, October 10th 1984.
12. 'The Role of the Private Sector in Providing Water in Developing Countries,' by Gabriel Roth in the Natural Resources Forum of the United Nations, New York 1985.
13. Gabriel Roth, 'Private Provision' (10)
14. Ibid.
15. Gabriel Roth and Anthony Shephard, 'Wheels Within Cities,' Adam Smith Institute 1984.
16. Michael Forsyth, 'Reservicing Health' 1982, and 'The Myths of Privatization' 1983, Adam Smith Institute.
17. Eamonn Butler and Madsen Pirie, 'Freeports,' Adam Smith Institute 1983.
18. Rodney Atkinson, 'From Less Debt to More Equity,' in 'Aid By Enterprise,' Adam Smith Institute 1984.
19. The Times, March 8th 1986.
20. Madsen Pirie, 'The New Aid Paradigm,' in 'Aid By Enterprise,' Adam Smith Institute 1984.
21. Rodney Atkinson, Ibid.
22. Madsen Pirie, Ibid.