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DEVELOPMENT OF THE PRIVATE SECTOR AND ACCELERATION OF GROWTH IN THE LEAST DEVELOPED COUNTRIES POLICIES AND INSTITUTIONAL SUPPORT*

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* The view expressed in this document are those of the author and do not necessarily reflect the view of the Secretariat of UNIDO. This document is a translation of an unedited orginal.

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Summary

The policies applied in the least developed countries have been important contributors to the stagnation of private industry in those countries since the end of the 1970s. By helping to create a favourable environment for business, which includes putting public enterprises into order, by stabilizing macroeconomic conditions and by improving the framework of laws and regulations, the authorities can relieve the private sector of severe restraints on its development. Certain other reforms directed towards a more active policy, e.g. promoting foreign investment, providing non-financial assistance and implementing environment policies, are also necessary to ensure swift and sustainable growth of the private sector.

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INTRODUCTION

0.0.1 One of the most striking features of the world economy in recent years, i.e. roughly since the beginning of the 1980s, has been the deteriorating situation of the least developed countries[1] (LDCs). For these countries, the convergence of incomes between South and North that had been forecast by development theory of the 1960s and 1970s did not materialize. On the contrary, between 1985 and 1990, while per capita GDP in the industrial countries rose at the rate of 2.5 per cent per annum, the LDCs were only able to achieve a rate of 0.7 per cent. In 1990, per capita GDP in the LDCs was US$ 240 per annum, compared with US$ 11,000 in the industrial countries.

0.0.2 Within this generally depressed situation, private sector growth was particularly slow from the beginning of the 1970s to the middle of the 1980s; the private share of total investment, which is a key indicator of the relative weight of the private and public sectors, fell from 64 per cent to 55 per cent. This compares with a fairly stable figure of around 83 per cent in OECD countries during the same period.

0.0.3 There is no simple explanation for the stagnation and decline of the economies in the LDCs. It is true that these countries suffered from the impact of adverse external factors, such as the drop in commodity prices, but there is also no doubt that the economic policies put into effect more or less at the same time in a great number of countries were largely responsible for the lack of enterprise and diversification that was to be seen. Typical features of the economies in the LDCs were inflated exchange rates and budget deficits incompatible with sustainable growth; an onerous tradition of protectionism, which continued to distort resource allocation and stifled exports; and the predominance of public enterprises in industry, which helped to keep the private sector out of activities in which it normally plays a vital part.

0.0.4 Since the mid-1980s, reforms (often described as structural adjustment) have been introduced by the LDCs so as to restore private industry to its role of engine for growth. The aim of this report, which is the first of three, is to assess what progress these reforms have made and indicate directions for their further development. It should be noted that the study only concerns industry, seen from the perspective of promoting the private sector. Some aspects of policy, particularly education and infrastructure, are not dealt with, even though they are important for the private sector. These are subjects of a complex nature that encompass aspects related not only to the private sector; they are usually matters for specific study.

0.0.5 Other factors, such as export financing and promotion, which are at the core of policies to develop the private sector, are dealt with in the two other reports in this series. The policy issues taken up in this report are: privatization; macroeconomic conditions and foreign trade policy; laws and regulations; incentives for foreign investment; non-financial assistance; industrial restructuring; environment policy. These topics were chosen because they lend themselves, to some extent, to specific analysis. In the light of the progress achieved and the difficulties encountered, recommendations will be made for each of these fields, in which, despite the diversity of situations, problems common to a majority of LDCs can be distinguished. The policy of import substitution, for example, has been followed to varying degrees in a large number of countries, with much the same results. Also, the development of private enterprise has very often been held back by the domination of public industrial corporations in most LDCs. Finally, it must be said that a report as brief as this on a subject so vast can obviously make no claim to be exhaustive; the aspects presented here are therefore only the most crucial ones, i.e. those that gave rise to the greatest difficulties in the past.

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[1] There are 47 LDCs, 29 of which are in sub-Saharan Africa: (i) Africa: Benin, Botswana, Burkina Faso, Burundi, Cape Verde, Central African Republic, Chad, the Comoros, Djibouti, Equatorial Guinea, Ethiopia, Gambia, Guinea, Guinea-Bissau, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Rwanda, São Tome and Principe, Sierra Leone, Somalia, Sudan, Togo, Uganda, the United Republic of Tanzania, Zambia; (ii) Middle East: Yemen; (iii) Asia-Pacific: Afghanistan, Bangladesh, Bhutan, Cambodia, Kiribati, Lao People's Democratic Republic, Maldives, Myanmar, Nepal, Samoa, Solomon Islands, Tuvalu, Vanuatu; (iv) Latin America and Caribbean: Haiti.

Definition of LDC

In 1971, the United Nations defined LDC according to the following three criteria:

- Per capita GDP (at current market prices, in US dollars)
- Share of manufacturing in GDP
- Literacy rate of the adult population.

In 1991, the following criteria were added:

- Life expectancy at birth
- Per capita calorie intake
- Primary and secondary school enrolment rate
- Percentage employment in industry
- Per capita electricity consumption
- Export concentration rate.

In 1994, the per capita GDP ceiling was set at US$ 567.

Box 1

0.0.6 At the end of chapter 2 there is a section which attempts to provide some basic criteria for the formulation of an integrated policy. While private-sector promotion policy is easier to analyse when broken down into the topics indicated above, this has the disadvantage of masking the fact that these various aspects are in fact strongly interlinked. An overall reform plan is therefore needed, and the content of the plan will no longer be common to the majority of LDCs, but will depend rather on each specific situation.

CHAPTER 1. CHARACTERISTICS OF INDUSTRIAL DEVELOPMENT IN THE LEAST DEVELOPED COUNTRIES

1.1 INDUSTRIAL DEVELOPMENT AT A STANDSTILL

1.1.1 Table 1 presents the data available on growth in the LDCs and the rest of the world. As can be seen, the LDCs have fallen much further behind in terms of per capita GDP and the forecasts for the year 2000 do not hold out any hope of improvement, assuming current trends continue. These figures conceal a great deal of disparity and situations that are even worse in certain cases; as table 2 shows, some LDCs have seen their per capita income decline and in all probability the number of poor increase, while others enjoyed satisfactory growth. These more recent data do not cover all of the LDCs but they do show that the trend observed up to 1990 has not changed. In order to bring home the significance of this stagnation and, in some cases, decline, comparisons are often made between the LDCs and other developing countries, especially the famously successful countries of South-East Asia. Between 1960 and 1985, for example, Singapore registered a growth rate in terms of per capita GDP of 7.5 per cent, Hong Kong 6.5 per cent, and the Republic of Korea and Taiwan Province of China 5.5 per cent.

Table 1: Per capita GDP levels and growth rates by economic groupings, 1985-2000

Country or economic grouping	Growth rate				Per capita GDP	
	GDP		Per capita GDP			
	1985-1990	1990-2000	1985-1990	1990-2000	1985	2000
World	3.3	3.5	1.6	1.8	2 700	3 580
Developed countries	3.0	3.1	2.5	2.6	11 100	16 130
Eastern Europe and USSR	2.7	3.6	1.9	3.0	9 150	14 200
China	8.0	5.6	6.6	4.2	430	900
Developing countries	3.4	4.3	1.0	2.0	920	1 200
LDCs	3.5	3.1	0.7	0.2	240	270

Source: UNIDO, 1993.

1.1.2 Industry has an important role to play in the development of the LDCs because it provides a path to rapid growth of per capita production, i.e. productivity, which is the basis of per capita income, and is thus a major contributor to improving the well-being of the population. It is no surprise, therefore, to observe that behind the stagnation of GDP in the LDCs lies a halt in industrial development combined with inadequate diversification of production, especially for export. The LDCs have a very weak manufacturing base; while they accounted for 14.2 per cent of the population of all developing countries in 1988, they contributed only 1.4 per cent of the manufacturing value added (UNIDO, 1993). The underutilization of capacity in the manufacturing sector is another indicator of the great difficulties faced by industry in the LDCs. According to a study of 20 LDCs[2] carried out in 1991 (UNIDO, 1993), in nine countries the utilization rate was lower than 20 per cent; in five countries it was from 20 to 40 per cent; and in only two countries (Ethiopia and Malawi) was it higher than 60 per cent. As the share of manufacturing is explicitly included in the definition of LDC (see box 1), it is logical that the statistics should reveal their industrial weakness. A weak industrial sector (representing less than 10 per cent of GDP in the case of the LDCs) is regarded as a characteristic of an incompletely developed economy, vulnerable to internal and external shocks and dependent on special efforts at national and international level for its survival and growth.

1.1.3 Most LDCs have not been able to diversify their exports and, especially in Africa, have often continued to depend on a few export commodities. In the mid-1980s, commodities accounted for 80 per cent of exports from sub-Saharan Africa, roughly the same percentage as in 1960, while exports of manufactures were significant only in a rare number of countries. Moreover, agricultural exports became more and more concentrated in a few products: nine commodities made up 76 per cent of African exports, compared with 70 per cent in the 1960s (World Bank, 1994a). The other developing countries, on the other hand, generally diversified their exports widely.

[2] Afghanistan, Bangladesh, Burkina Faso, Burundi, Comoros, Djibouti, Ethiopia, Haiti, Guinea, Malawi, Maldives, Myanmar, Samoa, Sierra Leone, Sudan, Togo, Tuvalu, United Republic of Tanzania, Yemen.

Table 2: Per capita GNP of certain LDCs: average annual growth rate 1980-1992 (percentages)

Niger	-4.3
Mozambique	-3.6
Sao Tome and Principe	-3.0
Mali	-2.7
Madagascar	-2.4
Haiti	-2.4
Ethiopia	-1.9
Zaire	-1.8
Togo	-1.8
Central African Republic	-1.5
Sierra Leone	-1.4
Comoros	-1.3
Mauritania	-0.8
Benin	-0.7
Rwanda	-0.6
Lesotho	-0.5
Gambia	-0.4
Malawi	-0.1
Burkina Faso	1.0
Burundi	1.3
Guinea-Bissau	1.6
Bangladesh	1.8
Nepal	2.0
Cape Verde	3.0
Chad	3.4
Bhutan	6.3
Maldives	6.8

Source: World Bank, 1994b.

1.1.4 It is often claimed that the change in the terms of trade between the LDCs and the rest of the world affected their growth potential. For sub-Saharan Africa, for example (with the exception of Nigeria, which benefited greatly from the petroleum price rise in the 1970s), the deterioration in the terms of trade, i.e. essentially the drop in commodity prices, entailed a fall in external income of 5.4 per cent of GDP between the period 1971-1973 and 1981-1986. Although this is a substantial fall, however, it still represents an impact of 0.3 per cent per year. Generally speaking, recent studies (Easterly, 1993) show that the decline in the terms of trade is probably responsible for no more than 10 per cent of the fall in the growth rate between the beginning of the 1970s and the middle of the 1980s. Transfers from abroad in the form of grants or loans increased, moreover, and almost wholly made up for the loss of income resulting from the drop in commodity prices. Many indicators show, for example, that sub-Saharan Africa received more assistance than the other developing countries: during the period 1987-1991, excluding Nigeria, it received an amount of aid equivalent to 24.65 per cent of its GDP, whereas the corresponding figure was only 4.01 per cent for a selection of other developing countries. All in all, it would seem that adverse external factors were only a subsidiary cause of the deteriorating situation in the LDCs. Internal factors certainly played a more important part. (This report covers only the internal factors connected with economic policies).

1.2 INTERNAL CAUSES OF STAGNATION

Inflated development of the public sector

1.2.1 It is now considered that, although the public sector expansion observed in the LDCs helped bring about a first phase of industrialization in the 1960s and 1970s, it later became a severe handicap. State intervention in fields where market mechanisms operate reasonably well, such as the production of private goods and credit allocation, led to mediocre performance in these sectors and to an eviction of the private sector that was partial in some branches and total in others. In addition, with a substantial part of their financial and administrative resources occupied for this purpose, governments neglected certain functions that were crucial to the development of industry and for which their contribution is indispensable, most of all the provision of a physical and institutional infrastructure.

1.2.2 The LDCs originally founded public enterprises (PE) for many reasons: to substitute a weak and lethargic private sector with the State, to achieve high investment rates quickly, to create jobs, to develop a technological independence that was regarded as a strategic need, and to provide certain goods at a lower cost than the market would have provided. Numerous public enterprises obtained the results expected of them. Much more numerous, however, were the public enterprises that were unprofitable and inefficient, as well as being disproportionately high consumers of the available credit.

1.2.3 *A sizeable, uncontrolled cost.* The burden placed by the PE on national budgets rapidly became a major worry for Governments. In Guinea, for example, State transfers to the PE in connection with those enterprises' explicit and implicit losses represented more than 5 per cent of GNP in 1990. In the United Republic of Tanzania, during the 1980s, half of the State enterprises made losses that were covered by the budget. In Ghana, transfers from the State to public enterprises between 1985 and 1989 represented an average of 2 per cent of GNP. The lack of thoroughness in monitoring public enterprises' results — particularly when they had a social role to fulfil — generally prevented Governments from evaluating returns on investment correctly, while the opportunity costs of subsidies and equity participation was very high. An illustration of this is provided by Guinea, where 70 per cent of the State's transfers to the PE sector was of an implicit nature — tax exemptions, subsidized interest rates, preferential exchange rates, services of public officials provided free, etc. — i.e. transfers that were difficult to quantify and hence even more difficult to control.

1.2.4 *Eviction of the private sector.* With public enterprises omnipresent and the financial sector itself often dominated by the State, the flow of credit available to the private sector, particularly in the form of long-term loans, dried up. Exact data are rare, because the statistics do not usually indicate whether the borrowers are public or private. It is worth noting, however, that in Burundi, Chad, Guinea-Bissau and Zimbabwe, the amount of loans to the PE was on average as high as, or higher than, that of loans to the private sector. In the United Republic of Tanzania in 1988, fewer than 20 public enterprises accounted for three quarters of the loans of more than US$ 100,000 from the National Bank of Commerce (World Bank, 1994a). In Guinea, the PE represented only 25 per cent of GNP but received 90 per cent of official bank credit.

1.2.5 In order to improve the financial position of the public sector, Governments have generally given the PE numerous special advantages such as tariff and non-tariff barriers, preferential access to foreign exchange, awarding of public contracts without tendering, authorized delays in payments to tax authorities or other PEs, and finally the establishment of legal monopolies over activities concerning private goods. A case in point is provided by Mali, where the company SOMIEX had a monopoly over wholesale imports, particularly of food grains and building materials. In 1982 in Togo, the small and medium-sized private enterprises stated that one of the major obstacles to their development was competition from public enterprises, particularly in the oil-mill, fruit juice and sawmill sectors, which are precisely those sectors where the export potential is greatest and market mechanisms most efficient, and where private interest is therefore high.

Unsatisfactory macroeconomic conditions

1.2.6 In the early 1980s, the macroeconomic situation of the LDCs, particularly of those in Africa, was one of grave crisis. Currencies were greatly overevaluated, with differences between the official rate and the black market rate of as much as 100 per cent or more in some countries. Balance-of-payments deficits grew. It is estimated that the budget deficits of sub-Saharan African countries amounted to 7 per cent of GNP on average (see table 5). For economies operating on a floating rate, the existence of an overevaluated exchange rate, and hence of a parallel market undercutting the official rate significantly, was cumulated with the need to ration foreign exchange so as to protect the country's foreign reserves. Apart from the tax on exports which the overevaluation of the exchange rate implies, the latter has thus had the further disadvantage of complicating considerably what is for the private sector a vital dimension of its activities, namely, administrative tasks (this type of constraint, where the arbitrary nature of the administration comes into play, often being regarded as a major constraint by companies, as indicated below). The situation of LDCs within the CFA zone, which had opted for a fixed exchange-rate system based on the French franc, was however a special one; they too experienced current account and budget deficits but never had to limit the convertibility of the CFA franc, which was guaranteed by France. This, together with the fixed exchange rate, enabled them to quell inflationary pressures. As from the mid-1980s, however, the appreciation of the French franc against the dollar, coupled with the fall in commodity prices, markedly curtailed the competitiveness and export market shares of the CFA countries; their growth was then slower than that of other African countries.

Protectionism and import substitutes

1.2.7 The decline in LDC growth as well as the low utilization rate of installed capacity observed at the beginning of the 1980's cast protectionism as a way of ensuring sustainable growth into question and showed that it did not improve the resistance of economies to external and internal shocks. Contrary to the intentions behind import substitution policies, dependency on such substitutes has often risen rather than fallen, for two main reasons: the protected industries were generally dependent on imported capital goods and commodities; since these policies took the shape of public support for industry at the expense of agriculture, food product imports also rose since agricultural investment was neglected as protection shifted to industries. The case of Zambia, among so many other LDCs illustrates the impact of these policies. Zambia's second plan (1972-1976) foresaw 15 per cent growth in manufacturing value added, based mainly on import subsidies for, i.e. dairy products, textiles, and chemical products. Actually, industrial production started to fall in 1974. Domestic demand and consumption advanced at a much slower pace than in other comparable countries, Kenya for example, which adopted strategies where exports were given more emphasis. The most serious (and least quantifiable) damage that these policies may inflict on the LDCs stems from improper resource allocation: when physical and human capital[3] as well as labour are not applied to activities resulting in optimal long-term profitability, where countries have a dynamic lead, a loss of earnings is incurred and amplifies as long as resources are not rechannelled.

Legal and regulatory conditions offering few incentives

1.2.8 The policy of restrictive State intervention in resource allocation and, more generally speaking, in all decisions concerning business was a fundamental reason for the weaknesses of private initiative in the LDCs. Moreover, LDC policies have often been particularly discouraging towards a key economic sub-category: that of the small- and medium-sized enterprises (SME). Growth incentives were offered to the largest enterprises as a matter of priority, and very often to the SMEs, which remained overshadowed by both the PEs as well as by the largest private enterprises. For example, in West Africa, in the 1970's, the large

[3] Human capital, comprising all the qualifications available in the economy (measured, for example, in the total number of years of study), is considered as distinct from labour, which is the application of work to economic activities (measured, for example, in the number of hours worked).

subsidies paid to long-established enterprises discouraged potential competitors: hence, concentration built up while the small enterprises lost their share of the market. In the financial field (not covered by the present study) suffice it to say that the SMEs were particularly disadvantaged when it came to credit access. Laws and regulations on the establishment and liquidation of enterprises, fiscal matters, labour regulations, price controls, the legal conditions governing private ownership and the performance of the judiciary continued to be crucial problems for the development of private enterprises.

CHAPTER 2. ELEMENTS FOR A PRIVATE SECTOR DEVELOPMENT POLICY

2.0.1 It is possible to break down government action in favour of the private sector into two categories: (i) reforms directed towards the improvement of the business environment to make it compatible with sustainable growth, in particular as concerns macroeconomic stability, legal and fiscal conditions and credit availability; (ii) specific policies to promote the private sector, for example the promotion of foreign investment and non-financial assistance programmes for private enterprises. The latter type of measure recognizes that when the economy has been dominated by the public sector, market mechanisms may well be unable to swiftly supply the private sector with certain factors of production necessary for its growth, particularly human and physical capital and technology. Certain crucial policy elements span these two categories: privatization programmes may, for example, be viewed as an improvement of the business environment, since an extended public sector often inhibits private enterprises, and as an opportunity to attract private capital and technology. The advantage of the distinction made however, is to emphasize that the latter type of measure is no longer warranted in principle if market mechanisms are able to meet the requirements of enterprises. By way of illustration, subsequently it will be seen that the success of non-financial assistance to enterprises should be reflected in, and gauged by, their gradual take-over by the market, that is by State divestiture of these programmes.

Table 3: Privatization in the African LDCs

Percentage of enterprises divested	Number of enterprises before State disinvestiture			
	0-50	51-100	101-200	Over 200
0-10	The Gambia Mauritania Rwanda Sierra Leone	Burkina Faso Uganda Zambia	Malawi[4]	Tanzania
11-25	Chad	Burundi Central African Republic	Madagascar	Mozambique
26-40	Niger		Guinea	
41-60	Guinea-Bissau	Benin Mali Togo		

Note: Divestitures include partial sales but not management contracts or leases.
Source: World Bank, 1994a.

[4] Total number of PEs includes 121 statutory bodies and 18 commercial parastatals.

2.0.2 Creating an appropriate business environment comprises:

- Privatization
- Macroeconomic policy and foreign trade policy
- Legal and regulatory conditions.

Compensating for market shortcomings comprises:

- Promotion of foreign investment
- Non-financial assistance
- Industrial restructuring
- Environment policy.

2.1 PRIVATIZATION

The result of privatization efforts

2.1.1 *Under-performance.* Data on privatizations in the LDCs, unfortunately rare and heterogeneous, indicate that the results of enterprise reforms have up until now been disappointing. For the African LDCs, the number of PEs has not significantly dropped: the financial results of the PE sector continue to prove unsatisfactory and the enterprises concerned continue to perform inadequately both in terms of cost and quality. As for company size, privatizations have especially focused on small- and medium-sized enterprises, and the large enterprises, representing most of the assets of the public sector – airline companies, railroads, mines, and the public service sector – have been much less affected by the reforms. Exceptions to this are to be noted in Benin, Guinea and Laos, where between 5 to 20 per cent of the public assets were privatized.

2.1.2 The unreliability of the data makes analysis of results difficult. For example, enterprises merely up for sale, for which the legal winding up process had commenced but where activity had not been interrupted and where employees continued to be paid just as before, were frequently excluded from the PE lists. In other cases, companies were considered as having been privatized when actually they had been sold to other PEs.

2.1.3 Though certain LDCs have been able to improve the profitability of key enterprises, by dint of privatization or PE reforms, generally the data available indicate that financial transfers between the States and the PEs have not significantly dropped. Burundi or Guinea, for which there are relatively recent data, are probably indicative of a general trend. In Guinea, where an ambitious privatization programme was introduced in the beginning of the 1980s, direct and indirect transfers towards the PEs continue to be disproportionate. In Burundi, it is estimated that in 1989, transfers to PEs accounted for 25 per cent of the budgetary resources, or one and a half times the budget earmarked for education (World Bank, 1994a).

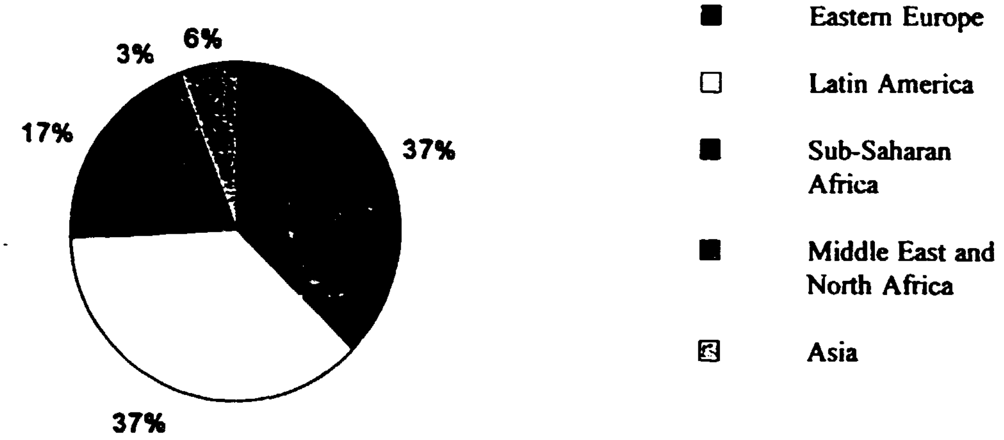

Figure 1. Number of privatized PEs in the developing countries, 1980-1991 (Kineni, 1992).

Public enterprises in Nepal

Much of the national production comes from 64 PEs, of which 28 belong to the manufacturing sector. Manufacturing sector PEs account for 36 per cent of the capitalization and 29 per cent of the value added in the sector. Apart from their monopoly over the infrastructure, the PEs dominate the production of cement, fertilizer, and sugar as well as the chemical product trade. PE losses were US$ 376 million in 1991 and US$ 200 million in 1992. The seventh plan (1985-1995) states that public enterprise reform is one of its principal objectives. However, implementation of this plan was delayed until 1991, when a privatization agency was established by the Government and a privatization bill passed. In 1992, three companies were privatized: the Brick and Tile Factory, the Bhrikuti Paper Mills and the Bansbari Leather and Shoe Factory. Fourteen privatizations were scheduled for 1993/94. Illustrating a trait common to many LDC privatizations, the Nepalese programme concentrated up until now on small and medium-sized enterprises, and in the three operations already having taken place, there was a transfer in majority under PE authority. The Government considers that the success of small and medium-sized enterprise privatizations will allow a gradual move towards the transfer of large enterprises.

Source: UNIDO, 1994.

Box 2

2.1.4 What with all the difficulties and holdups in privatization in the LDCs, many observers have questioned whether privatizations really are the best way to reform the PE sector. Given the obstacles observed, they argue, in particular, the absence of political will, the lack of interest on the part of investors and the weakness of institutions, it would be a more realistic policy to impose rigid financial constraints on the PEs while encouraging competition with the private sector. Thus the PEs would be subjected to stricter budget and regulatory control, especially in the case of "natural" monopolies, i.e. ports or power distribution, and whenever possible, placed on the same commercial and legal footing as the private sector. Though such an option is certainly a valid short-term objective, the history of relations between Governments and PEs seems to indicate that it is the change in capital ownership that best ensures effective management. It was actually observed that PE reforms without transfer of ownership very often resulted in an incomplete solution. For example, Governments often used performance contracts in order to set goals for the PEs, which enable them to better ensure proper management control. Since these were tried in Africa in the beginning of the

1980s (initially in Senegal) it is possible to assess their medium-term impact. It appears that performance contracts were indeed useful to determine PE goals and provide incentives for better management, but that they did not significantly enhance the performance of key enterprises. All told, it is most improbable that any real reform of the PE sector, so crucial for the development of the private sector, can take place without a real privatization programme.

Determining the goals of privatization

2.1.5 In designing a privatization programme it is useful to determine the goals pursued by the Government, which is both the PE owner and also conducting the reform. The main goal of privatizations should be the improvement of the effectiveness of enterprises. Selling the PEs for as much income as possible can be only a secondary goal. To split the aims like this is necessary because very often these two criteria are in conflict. In particular, rapid privatizations are not always compatible with optimized privatization income for the State, and yet it is a crucial factor for private sector development. In other words, one cannot regard privatization-generated budget income as the only factor contributing to a general improvement of the economy. In this regard it is interesting to mention the many coupon programmes launched in the countries of the former Communist bloc, where State revenue was cut down to zero in order to hasten the transfer of PEs to the private sector and thereby turn effectiveness of market mechanisms to advantage as quickly as possible. It is preferable to rapidly do away with PE monopolies and to unleash market forces, rather than to make significant gains in selling a private quasi-monopoly.

2.1.6 Privatizations can help create capital markets, but this should not be one of the primary aims. When capital markets have restricted investment capacity to draw upon, the launching of a great number of privatizations can actually hamper private sector issues. For example in Nigeria, where offerings on the stock market totalled 800 million Nairas in 1989, the privatization programme intended to raise almost 3 billion Nairas between 1990 and 1991 (World Bank, 1992b). However, because privatization expands the ownership of productive efforts, it naturally promotes the emergence of organized financial markets.

Planning privatizations

2.1.7 One of the most difficult choices for the Government is deciding which enterprises to privatize and in what order. Most of the Governments, for example, those of Chile, Jamaica, Mexico, the Philippines, Laos, Poland, Togo and the United Kingdom launched their divestiture programme by giving pride of place to the privatization of small- and medium-sized enterprises working in competitive sectors. These enterprises are relatively easy to swiftly privatize: they require little or no prior restructuring, involve little political risk, are easily absorbed by the local investment capability and thereby enable the sometimes sensitive issue of foreign participation to be bypassed. The prime justification of this approach is that it is rapid, enabling marketing effectiveness to be turned to profit as quickly as possible. Furthermore, it is often noted that when such privatizations are conducted at the start, this allows know-how which will be used in subsequent operations with the larger PEs to be developed progressively and with limited risk.

2.1.8 Some Governments, i.e. those of Brazil and Argentina, started off their privatization programme with large enterprises. These operations are a different type — they are complex, all the more so since they can affect public services. They involve the development of an appropriate regulatory framework, necessitate sophisticated financial engineering techniques, involve greater political risk, especially in terms of employment and of foreign participation, which can no longer be avoided. And yet this strategy, as the success of Argentina and Brazil has shown, can be extremely effective. For a start, the political opportunity to privatize can last a very short period of time. A recently elected Government can act energetically during the period of consensus that immediately follows its election. In doing this, it sends a very clear message on privatization and thereby reinforces the confidence of investors and of financial markets. Furthermore, if large enterprises are properly privatized this can result in immediate and substantial benefit for the entire economy. In Argentina telecommunications services improved rapidly after the privatization of ENTEL, the PE in telecommunications. Secondarily, the privatization of some major areas of loss can rapidly bring relief to public finances, again the case in Argentina, which apart from ENTEL, also privatized the railroads and the oil sector, which together accounted for 50 per cent of the operational deficit in the PE sector. At the end of the 1980s, Brazil privatized its steel sector, comprising very large enterprises, and their profitability improved significantly since then.

Table 4: Privatized enterprises in certain LDCs

	Period	No. of privatized PEs
The Gambia	1982-89	28
Guinea	1983-90	28
Mozambique	1987-93	216
Mali	1987-90	4
Tanzania	1985-91	20
Togo	1984-90	18
Zaire	1992-93	9
Zambia	1992	21
Laos	1990-93	28
Bangladesh	1976-84	approx. 600
Nepal	1992	3

Source: UNIDO, 1994; IDC, 1991

2.1.9 It is generally during the planning phase that the Government chooses a privatization method for each enterprise. Owing sometimes to the political and social dimensions of reforms (in particular if an over-concentration of capital is feared) and lack of investor interest, and in order to instil some degree of private know-how into PE management, LDC Governments have not privatized by sale of capital alone. In particular, the following alternatives have been used:

- Management contracts, in which the public authorities pay fees to a private firm to manage the PE. This type of arrangement has been extensively used in the hotel and air transport sectors, for which standard procedures and contracts have been drawn up. For industry, such contracts have been rather less usual, mainly because there is no incentive for managers to ensure proper maintenance of facilities.

- Leases, an improvement from this point of view, since the leaseholder pays a fixed rent to the State and has an incentive to cut the operating costs since he shoulders the commercial risk of the business. However, even if the contract is long-term and renewable, it is not necessarily in the interest of the leaseholder to keep up the value of the assets, particularly if the business experiences problems.

In some cases such contracts have constituted an improvement compared to a purely public management scheme, but in industry they are generally speaking worse than a complete privatization, because they do not provide managers with enough of an incentive to improve productivity.

2.1.10 Privatization priorities are specific to each country and are determined in particular by the interest of the private sector, the Government's administrative capability and identification of the sectors which most sorely need to improve their effectiveness, *inter alia*, with new investments. The two characteristics referred to below have nevertheless been observed in most of the LDCs and have generally been reasons for deviation from privatization programme goals:

- At the start of the privatization process, most of the LDCs divided up the PEs into two groups: The "strategic" enterprises, which could not be privatized and the non-strategic enterprises, which could in principle be privatized. The strategic PEs were often the largest, notably including public service suppliers. In the light of experience, it seems appropriate not to exclude public services and other large PEs from privatization at the outset, especially since this group of enterprises in the LDCs generally suffers from an acute lack of investment, offers good prospects of improving its effectiveness and is crucial for the rest of the economy.

- The lists of PEs to be privatized often have been published well in advance of actual privatization, when it does take place. One of the very negative effects of this method is that it demotivates staff, who are confronted with an uncertain situation, blocks any new investment and generally speeds up PE deterioration to a large extent. One clear lesson to be drawn from such experience is that there should be as little time as possible elapsing between the official or unofficial announcement and the actual privatization.

Should enterprises be restructured before they are privatized?

2.1.11 A distinction should be made between legal, financial and possibly managerial restructuring from the kind of physical restructuring which require new investments. As a rule, the former may be necessary for proper privatization, but experience shows that it is doubtful whether any physical reform conducted by the Government is better than that which would have been performed by a private entity taking over the business.

2.1.12 The privatizations of small companies generally do not call for prior reform of any sort. Their small size makes the fixed costs of restructuring excessive, in particular in terms of the time involved for planning, execution and administration. Furthermore, there are private national stakes since, given the relatively low price of the enterprise (as long as it is intrinsically profitable), the Government can rapidly turn market mechanisms to account. If the enterprise is not profitable, liquidation may be the best way of divesting. Many countries have gone ahead with the privatization of small PEs without any restructuring, in particular Chile, Jamaica, Mexico, Czechoslovakia, East Germany, and generally with success.

2.1.13 For large enterprises, a certain type of restructuring may well be a prerequisite to privatization. There are three different sorts of reforms:

- Legal and organizational changes. Very often, in particular in countries with a past experience of planned economy, a changeover in the legal status for a type of company with limited capital and responsibility (sometimes referred to as "corporatization" or "commercialization") may be necessary. This may be done concurrently with a break-up of the PEs into sub-units which are easier to transfer. In Argentina for example, the telecommunications company was broken up into two companies, each sold to separate entities. Another frequently mentioned example is that of East Germany where the Government very often split companies up before transferring them.

- Financial restructuring. An excessive debt burden may make the privatization of a PE difficult, even if the latter is intrinsically profitable, that is generating an attractive amount of operational cash flow. On the one hand, private investors tend to be interested in takeovers where the balance sheet would enable them to obtain additional financing, and on the other hand to shun factors diminishing the value of the enterprise. Thus the policy of Governments throughout the world has often been to discharge all or part of the PE liabilities before privatizing them. In Cameroon for example, with the support of financial backers, the Government cancelled a major part of the debts of several large enterprises in the transport sector, prior to their privatization. In Ghana, the Government assumed US$ 6.3 million in PE financial debts and unpaid taxes. An extreme example is provided by East Germany where up until December 1991, the Government assumed 70 per cent of the debts of the 4,500 privatized enterprises.

- Dismissals. Though there are many cases of privatization which resulted in jobs created, in particular in Chile and in the United Kingdom, working towards better PE productivity usually implies cutting down on the number of jobs. In Guinea, Mali, Argentina, Japan, Togo and Tunisia, privatizations went hand-in-hand with dismissals. Given the opposition of trade unions, the acute visibility of this type of issue and the significant delays that can be incurred, usually private takeover entities are not particularly anxious to start cutting wage and salary costs themselves. Governments are in a much better position to draw up social requalification and reclassification plans, as was done for example in Mali, Guinea and Tunisia. Besides, severance pay is not the only way that the Government can improve the position of the wage-earners undergoing privatization. Employee capital-sharing plans, where the Government reserves part of the shares for the staff, are a particularly widely used and effective method, for example in Chile, Nigeria and Pakistan, to associate workers in the spin-off benefits of privatization.

2.1.14 As a rule, Governments should not make new physical investments if they intend to subsequently privatize. LDC experience in PE management indicates that Governments are generally not best qualified for this type of investment decision, which is actually one of the major reasons for privatization. Furthermore, these operations are risky and costly, both in terms of time and money. Consequently, it is only in very rare instances that Governments have preferred to physically reform an enterprise before privatizing it.

Using valuations

2.1.15 Generally Governments run valuations of the PEs slated for privatization in order to set a minimum price for the transaction and to be able subsequently to assess the success of the privatization programme by comparing the prices obtained to the valuation set.[5] However, it would seem that Governments have sometimes attached too much importance to valuations. Even in countries where capital markets are well developed, valuations are only estimates and frequently not confirmed by the market; indeed, over-valuations have been very common in privatizations in the developing countries. In these cases, sometimes considerable delays have been noted. In Costa Rica for example, the ALUMASA aluminium furnace was evaluated at US$ 52 million whereas the final price at which it was sold was only US$ 4 million. In Jamaica, a tendency to over-value also delayed privatizations — it is estimated that these delays alone resulted in a 20 per cent loss of the value that could have been obtained, because of the deterioration that took place during this lapse of time. When shares are placed on the financial markets, over-valuation can result in failure of the offering, as was the case in Sri Lanka when 65 per cent of the shares of United Motors were not picked up, thereby shaking the confidence of small investors as to the remaining privatization programme. The lesson to be drawn from all these cases seems to be that PE valuation should be conducted with the utmost of prudence and that whenever possible it is useful to provide for a certain flexibility in the use of reserve prices.

Mobilizing funds

2.1.16 It is often considered that one of the major difficulties in LDC privatizations is the absence of developed financial markets and generally the lack of private capital. There are very few African countries in which stock markets have existed for some time (Nigeria, Kenya, Zimbabwe); in a few others they have more recently appeared (Botswana, Mauritius, Namibia). Furthermore, in the cases of Mozambique and of Guinea (IDC, 1993a and 1993b), it was observed that private and public enterprises do not have their own funds. However, LDCs have various ways of attracting the necessary capital.

[5] Three main methods are used, often in combination: updated cash flow (which is most appropriate if the PE is being sold as a whole), price earning ratios (with reference to similar transfers), and net assets (most adapted to a sale with broken up assets).

2.1.17 The *participation of foreign investors* has been one of the politically difficult elements in privatization programmes in the developing countries. Governments are very often hesitant to yield control over certain assets, sometimes labelled "strategic", to foreigners and have frequently imposed restrictions on their participation in the State's disvestiture. A survey of 40 developing countries (IFC, 1994) shows that foreign investment in 1993 accounted for only 10 per cent of the sum total of investments in the developing countries, which would seem to indicate that foreign participation in privatization remains marginal. At the same time, a growing number of countries considers (see section 2.4) quite rightly that foreign investment is one of the essential components of a private sector promotion policy. Many developing countries such as India and Mexico, aware of the fact that restrictions on foreign capital turn away a significant source of funds, have in recent years lifted barriers to foreign participation. "Golden shares" can, when they are used in the exceptional cases of large enterprises of national interest, allow Governments to settle for a political compromise which still allows for some foreign capital. Apart from this, the capital funds of nationals or of the emigrant community can usually be relatively easily mobilized.

2.1.18 *Credit payments* for privatizations have often been used by LDC Governments in response to the scarcity of national capital. However, as privatizations in Ghana, Guinea and Mali have shown, this approach can give rise to significant non-payment, and has the added disadvantage of not cutting the bonds between the State and the privatized enterprise clearly and definitively. For this reason, paid down cash is to be preferred over a deferred-payment sale, even if the actual amount paid is nominally less.

Administering privatizations

2.1.19 Privatizations must be administered in a rapid and transparent fashion. In Laos for example, the effective launching of privatizations in 1990 was seriously delayed because there was no single institution with the necessary prerogatives. In Turkey as well, the institutional weakness of the programme resulted in significant delays. The experience of industrial and developing countries indicates that great attention must be paid to the following points:

2.1.20 *Centralizing responsibility.* In order to avoid the dilution of responsibility and the many associated possible blockages, particularly harmful in the case of politically sensitive issues such as privatizations, and where swiftness is one of the keys to success, it is recommended that the body entrusted with privatizations be given a very high-level institutional link. The body should have access to the highest governmental authorities and should not depend on sectoral ministries, which are often tempted to defend their particular interests. The responsibility of the State concerning important decisions relating to the programme, in particular the planning of privatizations and the concluding of the largest transactions, should all be entrusted to the specialized body, which must have clear terms of reference. Since privatizations are technically difficult, it is also recommended that this body be given a status enabling it to recruit high-level professionals at levels of remuneration competitive to those of the private sector.

2.1.21 The privatization body should supervise the entire programme and be involved in its most important decisions; as for the most repetitive tasks, such as valuation and the execution of sales, the body would usually do well to *subcontract* out to the private sector (consultancy experts, banks) or to another part of government.

Legal aspects of privatizations

2.1.22 Legal issues arise throughout the privatization process. Before launching the programme, the Government should make sure that the legal framework is appropriate, in particular as concerns abolishing monopolies, regulating certain sectors and of course organizing the privatizations themselves. Also worth mentioning is an issue crucial to many LDCs, i.e. the rights of ownership, in particular the ownership of land. In Laos for example, it is legally impossible for alien natural or legal persons to own land and this has caused considerable delays.

2.1.23 In executing transactions, legal assistance is often necessary to draw up the contracts and to advise the various parties. The follow-up to the execution of commitments taken over of course also entails a significant legal dimension. All in all, given the technical nature of these issues, it is generally recommended that specialized and independent lawyers be called upon.

2.2 THE MACROECONOMIC AND POLITICAL FRAMEWORK OF FOREIGN TRADE

The need for stable macroeconomic conditions

2.2.1 As the experience of the 1970s and 1980s has shown, there can be no sustainable growth without macroeconomic stability. Inflation is detrimental to investment and thus to the improvement of productivity: an inflated exchange rate hinders exports. A country experiencing serious imbalances either internally (budget deficit) or externally (deficit in the balance of payments) is in the long term running the risk of an adjustment which will be all the more painful for having been delayed: in almost all instances, these countries must finally decide to credibly cut their budget deficit to control inflation and to introduce an adequate exchange rate to reduce the deficit in the balance of payments. Macroeconomic stability must have priority.

2.2.2 *Budgetary and monetary policy.* Prudent budgetary policy is the pillar of macroeconomic stability. Inflation can be directly affected by the mode of fiscal deficit financing chosen by the State, which has both fiscal power and a monopoly on printing money. Given the weaknesses of capital markets in the LDCs, monetary policy there is very often indissociably linked to budget policy. Since the States cannot finance their deficits by making an offering, they fall back on printing money; if the increase in money supply is greater than demand for it, this generates inflation. Even when countries do have the possibility of financing their deficit by issuing a domestic loan, budget deficits have negative impact on growth, since when the public offering is greater than demand, interest rates will tend to rise, affecting investment and aggravating the budget deficit (since there will be more debt to service). In the case of a foreign loan, the effect on the deficit will often prove similar. Furthermore, if such a policy is pursued over too long a period, the market will reject new security issues and the Government will be forced to opt for either a spending cut or an increase of taxes, without which monetary and inflationist deficit financing would become inevitable.

2.2.3 *The impact of inflation.* Even though countries with a variety of inflation rates have continuously grown over a long period of time, a constant rise in prices almost always hinders economic activity. High inflation is unstable inflation. Price volatility makes it very difficult to draw up medium-term plans, and that affects industrial investment, the profitability period of which is often greater than the horizon that is foreseeable during a period of high inflation. Under such conditions relative prices (the differences between the prices of various goods and services) cannot be read clearly and directly, when in fact these prices are essential "signals" in a market economy — they guide resource allocation, i.e. investment decisions, recruitment, the savings and consumption of economic entities. Furthermore, a permanent rise in prices, which can veer quite unpredictably, results in a non-productive absorption of resources. Inflation forces enterprises to devote precious time to very short-term financial decisions, because any error here can have very onerous repercussions. Financial sectors grow to meet the demand for financial products which enable protection against monetary erosion. In Brazil for example, between 1975 and 1987, the share of the GDP for the financial sector doubled, which is a waste of resources since the demand for financial services existed only because of inflation.

2.2.4 *The exchange rate policy.* A real[6] competitive exchange rate is necessary for export growth and forestalls the appearance of deficits in the balance of payments. The experience of the 1980s, particularly in the African LDCs, has shown that countries that had allowed their exchange rate to rise excessively in value

[6] The real exchange rate is usually defined as being $e = EP^*/P$ where E is the nominal exchange rate, P^* is the level of prices abroad and P that of national prices.

had export growth slow down and capital funds leave the country. Over-valued currency halted their growth and contributed to the setback in agricultural production and the deterioration of foreign accounts. Let us, however, stress that the exchange rate equilibrium is not set once and for all and that it depends in particular on the terms of trade, on the differential between domestic and foreign interest rates, on tariff barriers on imports and on the free circulation of capital funds. It is also to be noted that, though any nominal devaluation is in the short term essentially a devaluation in real terms, measures to reduce the budget deficit are generally necessary to guarantee the long-term effects of devaluation. It has often been observed that the beneficial effect of a devaluation on exports can be a very short-lived one when such a measure is taken in an inflationist environment. A rise in prices, helped along with a higher price tag on imports, can make up for devaluation; this is why, when planning any devaluation, it is of vital importance to bear in mind the two other facets of macroeconomic policy, i.e. fiscal and monetary measures. An aborted devaluation is unfortunately more than just a loss of administrative resources; it is also an erosion of the Government's credibility, the importance of which cannot be over-estimated if macroeconomic reforms are to succeed.

2.2.5 *A feeble reduction in budget deficits.* As table 5 shows, most of the African LDCs have been able to substantially cut their budget deficits over the last years. However, on the one hand this trend is feeble since the overall deficit level remains high (4.6 per cent of the GNP for the countries reviewed) and since, on the other hand, this movement is very non-uniform; some countries such as Niger, Mozambique, Zambia and Sierra Leone continue to show fiscal deficit rates that are incompatible with sustainable growth. Moreover, this improvement was essentially obtained by cutting expenditure, investment expenditure at that. Ideally, a reduction in deficit should result from an increase of revenue; however, in many LDCs, in Africa in particular, revenue remained stable or declined. In Madagascar, Uganda and Zambia for example, real fiscal revenue dropped due to high inflation rates and shortcomings of mechanisms for adjusting taxes to rises in prices.

2.2.6 *An acceptable monetary policy.* The principal parameters of monetary policy are inflation and real interest rates, which should encourage savings while not hampering investment. For the African LDCs, on the whole inflation remained relatively low and even dropped in certain countries (see table 6), with the exception in Africa, of Tanzania, Sierra Leone and Zambia. But interest rates have sometimes run too high, as in Niger, the Central African Republic and Benin. High real interest rates (see table 7) may be the sign of a restrictive monetary policy, intended to avoid the over-heating of the economy and to contain inflationary pressures and the flight of capital funds. It may also be interpreted as the eviction of the private sector by the public sector (crowding-out),[7] which finances its deficits by raising rates. All in all, given that inflation is under control, the monetary situation at present is acceptable in most of the LDCs, all things considered.

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[7] See D.A. Currie, 1981.

Table 5: Budgetary indicators (percentage of GNP) in certain African LDCs

	Overall budgetary surplus/ deficit, including grants		Capital expenditure	
	1981-1986	1990-1991	1981-1986	1990-1991
Surplus or small deficit				
The Gambia	-4.7	2.7	12.4	9.2
Mauritania	-4.3	-0.9	2.5	5.4
Tanzania	-8.5	-0.9	6.8	3.9
Moderate deficit				
Malawi	-8.4	-2.5	8.7	6.1
Burundi	-8.5	-3.3	13.7	13.3
Togo	-3.6	-3.3	10.7	6.2
Burkina Faso	-9.4	-3.4	15.7	7.5
Large deficit				
Uganda	-5.2	-4.1	2.2	6.4
Madagascar	-5.8	-5.1	6.6	7.1
Mali	-7.7	-5.3	10.5	11.5
Benin	-8.5	-6.3	11.0	5.6
Central African Republic	-4.3	-6.5	6.9	11.2
Rwanda	-3.7	-7.0	8.2	7.5
Very large deficit				
Niger	-4.9	-7.2	8.7	8.3
Sierra Leone	-12.0	-7.7	4.3	3.8
Zambia	-14.4	-8.5	4.9	7.5
Mozambique	-13.7	-8.9	13.7	13.8
Average	-7.5	-4.6	8.7	7.9

Source: World Bank, 1994a.

Table 6: Inflation in certain African LDCs

(Variation in percentage of the index of retail prices)

	1981-1986	1990-1991
Tanzania	30.6	21.0
Sierra Leone	57.1	106.8
Zambia	26.21	101.8
Benin	4.3	0.1
Gambia	20.7	10.4
Madagascar	19.4	6.5
Togo	6.5	6.6
Mauritania	10.3	6.6
Malawi	13.3	12.2
Rwanda	5.3	11.9
Burkina Faso	6.2	1.9
Mali	6.0	3.3
Central African Republic	9.6	0.3
Niger	6.0	-4.3

Source: World Bank, 1994a.

Table 7: Real interest rates for deposits in certain African LDCs

	1981-1986	1990-1991
Niger	6.3	16.0[a]
Central African Republic	1.9	6.8[a]
Benin	4.8	6.6[a]
Togo	4.0	5.9[b]
Chad	3.9	5.2[b]
Gambia	-9.8	3.2[a]
Mali	2.4	2.8[a]
Burkina Faso	2.7	2.6[a]
Malawi	-3.7	-0.3[a]
Uganda	-38.6	-2.9[a,c]

Notes: [a] The real interest rate for 1991 was calculated using the 1991 inflation rate.
[b] The real interest rate for 1990 and 1991 was calculated using the 1990 inflation rate.
[c] The inflation rate was based on the annual change in the consumer price index and on the implicit GDP deflator.

Source: World Bank, 1994a.

2.2.7 *Progress in the exchange rate policy*. As already noted, the LDCs had started the preceding decade with generally inflated exchange rates which inhibited private investment. Real progress was accomplished in this field, both for countries with the floating exchange rate as well as those in the CFA franc zone. Fortunately most of the African LDCs were able to significantly reduce the premium between the official rate and the parallel market rate. For the African countries undergoing structural adjustment, this premium ranged from an average of 52.8 per cent for the period 1981-1986, to 9.9 per cent for the period 1990-1991. However, additional progress is possible since roughly one-third of them maintained a premium equal to or higher than 30 per cent. For the CFA franc countries (which include eight LDCs), the turning point in the exchange rate policy took place in January 1994, when the CFA franc lost 50 per cent of its value against the French franc. Justified by the loss of competitiveness of the CFA franc during the second half of the 1980s, this measure was accompanied by a support plan on the part of financial backers to absorb a part of the short-term cost of this measure. Almost one year down the road, it appears that the impact of devaluation was not uniform for all of the countries concerned. Inflation could have made inroads on the benefits thereof, but was contained to an average of 35 to 40 per cent and seems to be clearly dropping. But this rate was over the 50 per cent mark in Chad, for example; Niger (where the public sector deficit greatly increased) and the Central African Republic also did not turn the devaluation to very good account, in terms of macroeconomic stabilization.[8] However, the LDCs exchange rate policies on the whole took the form of real exchange rate devaluations which brought them nearer to the equilibrium rates at which exports are not penalized.

Foreign trade policy

2.2.8 With regard to foreign trade, the attitude of the LDCs followed the general evolution of government policies tending towards less State intervention in resource allocation decisions taken by the private sector. After having been protectionist in the 1960s and 1970s, over the 1980s the majority of the LDCs went from a growth model centring around import substitutes and the protection of emerging industries to the recognition that exports are very major stakes for the environment.

2.2.9 *The dangers of import substitution policies*. Import substitution policy, for a long time one of the spearheads of the industrial policies of the LDCs, was justified in the famous emerging-industry line of argument proposed by John Stuart Mill.[9] Let us stress the two conditions which are prerequisites to the success of an import restriction policy as it is presented by Mill and confirmed by economic history: (i) in the activity promoted, the country must have an intrinsic advantage enabling it to be competitive on the international market once it has acquired experience and qualifications; (ii) consequently, protection must only be temporary — otherwise it prompts improper resource allocation. These two prerequisites, as shown by the difficulties in the LDCs, and particularly in sub-Saharan Africa, as regards import subsidies, have only rarely been met in the policies of these countries.

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[8] *The Economist*, 14 January 1995.

[9] Excerpt from *The Principles of Political Economy* by J.S. Mill: "The only case in which, on mere principles of political economy, protecting duties can be defensible, is when they are imposed temporarily (especially in a young and rising nation) in hopes of naturalizing a foreign industry, in itself perfectly suitable to the circumstances of the country. There may be no inherent advantage on one part, or disadvantage on the other, but only a present superiority of acquired skill and experience. A country which has this skill and experience yet to acquire, may in other respects be better adapted to the production than those which were earlier in the field... But it cannot be expected that individuals should, at their own risk, or rather to their certain loss, introduce a new manufacture, and bear the burden of carrying it on until the producers have been educated up to the level of those with whom the process are traditional. A protecting duty, continued for a reasonable time, might sometimes be the least inconvenient mode in which a nation can tax itself for the support of such an argument."

2.2.10 As Stiglitz (1992) shows, it is not the static but rather the dynamic advantage which should be considered by Governments; in other words, not the lead that countries presently have, but that which could emerge in the long-term. What constitutes the elements that determine industrial success is rather more often within the field of institutions, of human capital and technology, rather than within the field of natural resources or geographical situation. Stiglitz gives the example of the Swiss watch-making industry's success; there was nothing to start off with that gave that country a head-start in comparison with other industrial countries. A leading edge was nevertheless achieved through a complex process of the accumulation of know-how in a very close-knit industrial fabric generating external effects.[10] Making an estimate of the static advantages of a country is extremely difficult; making an estimate of the dynamic advantages, if that were at all possible, is an even more perilous exercise.

2.2.11 Another serious problem with import substitution policies relates to the way in which the above second condition is met in practice. Once the protective barriers had been set up, whatever the failure or the costs incurred for the whole group of developed industries may have been, it appeared politically and socially difficult to do away with customs barriers, as these policies would actually have it. Usually Governments when introducing barriers forgot to set an exact schedule for dismantling them.

2.2.12 *Reform of foreign trade policy.* Import restrictions in the LDCs have taken a variety of forms: as has been seen above, inflated exchange rates unduly benefited importers at the expense of exporters; short-term import control measures (for example, through systems of import licences and foreign exchange rationing) have occasionally been used to maintain the balance of payments; tariff and non-tariff measures have been imposed in a permanent fashion. This wide range of instruments makes any evaluation of the reforms of foreign trade policy difficult, for one parameter may improve as another policy aspect worsens. Moreover, one must not forget that the impact of reforms must be examined with due account taken of the flourishing import markets operating in parallel, in other words the prevalence of contraband activities, particularly in the African LDCs. In Togo for example, a 1982 study (FRIDA, 1982) shows that competition from low-priced contraband in Nigeria and Ghana was one of the major problems of private enterprises.

2.2.13 As for foreign exchange rationing, which only concerns the countries with a flexible exchange rate, the devaluations in certain LDCs allowed for State control to be relaxed, for example in Uganda, Tanzania, Madagascar and Zambia. Unfortunately, these reforms are, alas, fragile in the latter three countries, because they are threatened by precarious balances of payments. A positive sign was noted, however, in most of the African LDCs: discretionary controls on the part of the Government has often been replaced by automatic rules.

2.2.14 Import licence systems have also become more liberalized. There was often transition from a system where all goods require licences to a system of negative lists, in other words lists of controlled goods. Some countries such as Tanzania and Zambia for example (World Bank, 1994a) even eliminated import licences, though maintaining lists of goods it is strictly prohibited to import. On the whole, progress in this respect seems hesitant and a significant number of LDCs continue to require administrative licences for a major portion of their imports.

2.2.15 In most of the LDCs an initial wave of reform focused on customs duties, harmonizing tariffs by doing away with a certain number of ad hoc exceptions, cutting down on the number of applicable tariff rates and correcting certain anomalies attributable to the historical accumulation over time of various changes in customs regulations. It had been frequently the case that raw materials would be taxed more than the corresponding finished products (for example, specialized chemical products and paint; spare parts and bicycles), which usually worked against the goal of protecting local industries. Secondly, various LDCs

[10] External effect refers to the benefits, often by way of an increase in productivity, derived by an enterprise from its environment. For example, a company in Silicon Valley reaps the benefit of the know-how in that environment. Clusters of firms or stores in a given area are explained by such external effects.

initiated a narrowing of tariff dispersion. This measure is important because it tends to reduce the distortions among sectors of activity. Furthermore, cutting back the highest rates can have a certain psychological impact, for they offer very strong incentives for smuggling. Mali, Burkina Faso and Togo reduced the number and scope of their customs tariffs. And finally, no doubt because of the importance of gate-way taxes in national budgets (for the sub-Saharan African countries customs duties account for some 20 per cent of total budget revenue), the overall-level of customs duties was not significantly reduced. Quite to the contrary, in certain LDCs, for example in Madagascar, Malawi and Uganda, because of the exigencies of the budget austerity these countries had opted for, the percentage of customs duties levied on the total value of imports went up.

2.2.16 It may be added that in the countries where exchange rates were flexible, reforms lowering import barriers generally had limited impact on the cost of imports, in particular since flourishing parallel markets very often were able to circumvent customs barriers. However, the reforms were positive after all because the "private income" from import restrictions that benefited certain interest groups dropped. For example, public enterprises often had privileged access to key imports and/or foreign exchange; the officials of customs and other services involved in import control were also among the beneficiaries of such official protectionist barriers.

Pursuing and strengthening reforms

2.2.17 *Achieving macroeconomic stabilization.* As we have seen, the improvement of budget policies is fragile and incomplete. Two possible paths of direction may be identified:

- More cuts in government spending, after the efforts already made by many countries, might well have only marginal effect and also come up against strong political resistance and compromise the State's investment. Thus it seems that fiscal reform is a priority for many LDCs, in particular in terms of tax harmonization, improvement of tax collection and tax evasion measures.

- Another important aspect of macroeconomic reforms is maintaining realistic exchange rates.

2.2.18 As concerns the *foreign trade policy*, the general lifting of protective barriers must continue to be considered as the main medium-term objective of reform efforts. However, though one may be justified in analysing protectionist policies as being on the whole less than ideal, the resulting industrial situation must be taken into account necessarily. Because of the very narrow margin for fiscal manoeuvring that LDCs have presently, it is generally felt that at this point in the reforms an overall down-sizing in customs duties is not a priority. Such a measure would actually have strong and immediate impact on budget equilibrium, before extremely useful reforms such as the rationalization of tariff rates and the reduction of their dispersion have run their full course and while their effect on the budget is still comparatively weak. In addition to this, a rapid reduction of customs duties could have a very intense and probably undesirable effect in terms of jobs and production in certain countries. All in all, a possible agenda for the reform of foreign trade policy could be the following:

- *Transforming non-tariff obstacles into tariff provisions*; the former (for example, import licences and other regulatory hindrances) have the serious disadvantage of not being transparent in the price distortions they create; additionally, because non-tariff barriers are often used for the benefit of certain groups of enterprises (particularly when a quota import licence system is used), they restrict competition on the national market.

- *Establishing and issuing a calendar of gradual customs duties reduction.* Prior announcement of a reduction of duties is important to allow the rapid play of market mechanisms in resource allocation: industrial investments, the profitability of which is on a medium-term basis, will rely on this calendar; the protected industries will be able to plan productivity gains more easily. There are various ways of reducing customs duties, but one of the most effective ones seems to be the "concertina method" (MICHEALY 1987). Instead of a uniformly proportional drop in duties for all goods and a reduction of the same number of points, according to this method all the duties are initially brought down to a set ceiling. In a second phase, a new and lower ceiling is chosen, and so on. Let us note that this method goes along with the recommendations made earlier on — and with many reforms already initiated — in cutting down the number and the range of applicable rates. Finally, factors such as the significance of employment in the various sectors should not be left unconsidered when establishing the tariff rate reduction programme.

2.3 REGULATORY AND LEGAL CONDITIONS

Obstacles to setting up a business

2.3.1 The administrative hassles that remain to be faced by entrepreneurs in the LDCs when they are setting up a business significantly hamper the development of the structured private development sector. The law stipulates what constitutes a company; but is it easy to set one up? In Colombia where the registration of new businesses is very efficient, a company can be set up in 12-15 minutes. In Poland, the same operation takes three months. There are so many LDCs where just registering a company is still too time-consuming. Let us take the case of Mali, for example, where many entrepreneurs complain how administratively long and difficult it is to set up an enterprise, even an individual one (IDC, 1991). What is even worse, LDC Governments have often discouraged private initiative by requiring that authorization be obtained for private investments. In Mali yet again, authorization is required for any investment in the tourism, construction and civil engineering sectors, as well as stock breeding and communications. This system of authorizations, which appears in varying forms in so many other LDCs, has serious disadvantages:

- On the whole, checking the entrance of new competitors onto a given market restricts competition.

- The private sector was often kept out of the most promising branches of the economy, such as industry based on national inputs. In Togo, Mali and Guinea, for example, agro-industrial activities based on local raw materials were reserved for public enterprises up until the 1980s.

- Private companies were viewed with a certain amount of mistrust or even hostility on the part of the Governments of many LDCs (in particular during the period following independence), and therefore were placed under the control of an administration with high discretionary powers. The authorization system, just as the other regulatory constraints reviewed in this section, resulted in rampant corruption.

- The administrative slowness and complexity of authorizations put off entrepreneurs and promoted the emergence of the informal sector.

2.3.2 To facilitate the registration of companies, "single counter" arrangements were set up in some of the LDCs for that purpose. Just as for similar institutions designed for foreign investors (see section 2.4), the objective here is to group together all the formalities stipulated by the law. Up until now, results have been mixed: in some countries, Guinea for example, they did allow faster and easier registration. In this country, where the establishment of a "single counter" arrangement was accompanied by real reform of the law of enterprises and of associated procedures, the main impact of the measures focused on the sector of individual entrepreneurs and micro-enterprises, which had hitherto been relegated to the informal sector. This was a very positive contribution. But in other LDCs, the "single counter" arrangement was just a new way of dressing up old procedures, since company laws and investment codes had not been reformed. Moreover, the "single counters" were often up against government services (sectoral ministries, the tax administration, social security and pension offices, etc.) that staunchly defended their prerogatives.

Authorizations and price controls in Bangladesh

In the years following independence, private investment in industry was officially discouraged in Bangladesh, except for small rural industry. From 1970 onwards, the field open to private enterprises was made progressively broader by extending the authorized branches of activity and by raising the investment ceiling. In 1976, except for certain sectors which were still reserved for public enterprises, private investment became possible in many fields but remained subject to a system of authorizations (the "Industrial Investment Schedule"). This system provided for investment amounts per subsector of activity in order to "guide" and sanction the private sector. Subsequently, certain "free" sectors were able to accede to an automatic authorization system for which the unique pre-condition was that the entrepreneur should possess the necessary foreign exchange to import equipment, either in the form of salaries earned abroad or foreign investment not subject to repatriation. Authorizations were granted by the Ministry of Finance.

Bangladesh created a very broad system of price controls on inputs and finished products. Cost variation needed to be justified in order to obtain an authorization to raise prices. These applications were also examined by the sectoral Ministry and the Ministry of Finances in order to evaluate their macroeconomic and fiscal impact.

Source: World Bank, 1992.

Box 3

2.3.3 *Reforms* relating to the setting up of businesses depend on the conditions specific to each country and in particular on the state of the legislation, the administrative capability of Government and the stage of development of the private sector. However, the experience of reforms initiated in the 1980s seems to indicate certain directions which would apply for most of the LDCs:

- *Restrict the field of authorizations*. The restriction of private activities can only be economically valid (i) in the infrastructure services sector;[11] (ii) where, because of negative external effects, quality control is better run by the Government than by the private sector itself, in particular in the health and education sectors. Other sectors should be freely open to the private sector. Monopolies which the PEs traditionally benefited from are one of the most serious obstacles to the expansion of the private sector Privatization may offer an effective way to allow the rapid involvement of the private sector in hitherto protected sectors (see 1.2.1). Simply abolishing the legal monopoly of PEs, when it is accompanied by measures allowing for fair competition with the private sector (see 2.6.5), can also be an acceptable solution, especially when privatization is otherwise difficult.

- *"Single counter" arrangements* cannot ensure lasting improvement unless they are supported by legal reform vesting them with the authority necessary to accomplish their mission. Moreover it may be useful to proceed with reforms gradually, at first giving the "single counter" the simplest legal entities to work on, such as individual enterprises. This method, which produced good results in Guinea, allows rapid effect on the informal sector.

[11] For certain utilities such as telecommunications and power, many developing countries opt for the active participation of the private sector, i.e. in power production or telephones. In these cases, which are "natural" monopolies, the need for regulation remains.

Taxation

2.3.4 *High rates of taxation.* All countries must seek to strike a balance between the need to collect sufficient revenue and the need to provide enough incentive for work, investment and savings. Moreover, Governments must make sure that they distribute the tax burden fairly and avoid distortions in the net return on various economic activities. On the whole, the LDCs have not been able to conciliate these two goals. The tax rate on company profits is often higher than in the industrial countries, which has resulted in considerable distortion of economic activity. In Mali for example, in 1991 company profits were taxed five times in various ways. The personal income rates of taxation are also clearly higher than in the rest of the world. The marginal taxation rates on revenue were 85 per cent in Tanzania and 60 per cent in Ghana up until 1991. Unduly high rates of taxation usually have three kinds of negative effect:

- Heavy taxation of the private sector, amounting almost to confiscation, has limited the investment capability of enterprises.

- Even more significantly, high rates of taxation have prompted entrepreneurs to remain within the informal sector, where revenues can be concealed more easily.

- High taxation rates have encouraged corruption of tax authority officials.

2.3.5 *Tax relief is effective* because it tends to eliminate those disadvantages. Just like many industrial countries, the majority of the LDCs introduced special tax breaks for new enterprises. In Botswana for example, new companies were able to benefit from a total income tax exemption over the first year or two (depending on whether the area of investment is urban or not), and then a degressive tax for subsequent years. An IFC survey (IFC, 1990) showed that this policy, along with other government incentives substantially helped enterprises to take hold.

2.3.6 Although incentives are generally recognized as being effective, the greatest of care must be taken with the criteria for attributing tax breaks, which have often been a source of distortion in the measures of encouragement. Any system of incentives must keep to a minimum any arbitrary decisions that public authorities can make, and must set criteria that can easily be applied in order to ensure automatic attribution of incentives. Moreover, these criteria should be chosen in such a way as to avoid certain undesirable side effects. The criteria of enterprise size, whether it be expressed in terms of assets, capital or number of staff, may give rise to particularly damaging distortions. In Morocco for example, a complex combination of investment-based criteria placed small and medium-sized enterprises in a situation of disadvantage compared to larger firms, and since the small and medium-sized enterprises are the most labour-intensive (DFC, 1983) this had a detrimental effect on jobs — the Government's main interest. And conversely, granting small and medium-sized enterprises tax breaks can encourage these companies either to remain small or else to go against the spirit of the law by making use of other legal loopholes to hide their growth, as has been the case in Mali for example. All in all, in order to ensure that this runs in a foreseeable, simple and neutral way, it is often recommended that use be made of degressive tax breaks applied as from the date the company is set up, whatever its sector or its size. The only other criterion not subject to much criticism is that of enterprise location, for land-use planning purposes.

2.3.7 The recent experience of developing countries, for example Colombia, Korea, Indonesia, Malawi and Mexico, shows that tax distortions may be reduced while meeting revenue goals as well as being fair and economically efficient, if a *systemic approach* to tax and tariff reforms is adopted. A reduction of import duties in order to improve the efficiency of the economy is a more realistic measure when domestic tax assessment is broadened at the same time. Thus, the elements essential to an effective tax reform are as follows: the improvement of the internal revenue administration, the reduction of tax breaks for the non-poor and the simplification of the tax structure.

Improvement of work regulations

2.3.8 The legal rigidities of recruitment and dismissal procedures, as well as constraints relating to salaries swelled production costs and in the long run were detrimental to investment and employment. Significant inequalities appeared between the minority of workers within the formal sector, protected by labour regulations, and those of the informal sector. The effects of labour regulations vary greatly from one country to another. In certain LDCs, the legislation is not really applied, because it would be so costly; only large formal sector enterprises, because they are the most visible, are really subject to legislation, which is therefore an incentive not to grow. Moreover, labour regulations, such as laws relating to security of employment, may steer employers away from taking on permanent staff. In Senegal, for example, the laws on dismissals are practically tantamount to a guarantee of employment; consequently, workers are not very motivated and enterprises hesitate to take them on. In certain LDCs, such as Mali, in order to control employment the State went so far as to create a recruitment monopoly for structured enterprises, including private ones: accordingly, any enterprise wishing to hire necessarily had to go through this Government agency.

2.3.9 In order to improve the competitiveness of enterprises and to accelerate growth, certain developing countries over the last years have launched reforms to liberalize the labour market by doing away with certain restrictions relating to recruitment, salary determination and dismissal. Mali, for example, introduced reforms in 1992 allowing for much more flexibility in the labour market. In 1987 Senegal abolished the government agency exercising a monopoly on recruitment for enterprises. Côte d'Ivoire did likewise in 1992. Mass redundancies can henceforth go into effect more easily in Côte d'Ivoire and Senegal; Senegal has also made it easier to freely set wages by negotiation between the parties concerned. Much still remains to be improved, but these few examples show that the reform of work regulations is possible and is a major concern on the part of entrepreneurs. Reform of work regulation could take the following three directions:

- Facilitating the free recruitment of staff. State monopolies on recruitment are harmful to the private sector. On the other hand, the information and guidance functions that government recruitment agencies also usually play, are useful in that they make it easier for supply to meet demand.

- Limiting intervention in the fixing of salaries. It is understandable that for social reasons the public authorities would sometimes wish to set a minimum wage, but the latter must be kept at a realistic level. In Bangladesh, for example, it was noted that enterprises on the average paid salaries 30 to 60 per cent higher than the minimum legal wage, indicating that the latter is not really in the way of market mechanisms.[12]

- Allowing dismissals. On the whole, it is extremely counterproductive in the medium term to prevent dismissals. The State may quite rightly require that compensation be paid to wage-earners upon dismissal, but this must be computed with full recognition of the indirect cost implications in terms of recruitment.

Eliminating price controls

2.3.10 Though in the case of natural monopolies they can be justified, price controls in general are a major constraint on private initiative. Occasionally there is a very long lag-time between applications for increases and the administration's decision. In Burkina Faso for example, a bicycle manufacturer had to wait 18 months before being able to raise his prices; the cost of imported parts climbed considerably in the meantime (Marden and Belot, 1987). Even worse than the time factor, the discretionary nature of decisions

[12] One could argue that the minimum wage is therefore useless. However, apart from certain obvious political situations, when the formal sector provides for most of the jobs, as is the case in Bangladesh, the minimum wage can protect certain portions of the population where the labour market is distorted by elements such as ethnic or gender discrimination.

may prove to be the most serious obstacle to private investment; planning and implementation of certain projects within a medium-term horizon can be greatly affected by price uncertainty. Moreover, the application of price controls requires government effort to be mustered, which is very costly given the limited resources of the LDCs. In Ethiopia for example, the price controls department was as much as 800 strong, and that was still considered as being insufficient. On the whole, one cannot overestimate the importance of real prices in guiding investment towards the most promising sectors through the play of market mechanisms.

2.3.11 Many LDCs have already eliminated most price controls. In the African countries, this trend has been particularly clear (see table 8) but it is also to be observed in Asia. In Sri Lanka, India, Bangladesh and the Philippines, price controls now affect a list of goods and services which is much shorter than before. However, both in Africa as well as in Asia, price controls have not generally been done away with in the petroleum sector which supplies a substantial part of the energy and represents, directly or indirectly, a high proportion of production costs. Mali is among the few countries to have completely eliminated price controls on petroleum products. Rwanda, Uganda and recently Madagascar have introduced procedures for automatic price adjustment as a function of import costs. Burundi, Malawi, Mozambique, Niger and Togo are regularly updating their prices though they do not have automatic procedures for this.

Table 8: Price controls on goods in Africa

Country	Before reforms	Since 1992
Benin	•	■
Burkina Faso	•	•
Burundi	•	○
Central African Republic	•	■
Chad	■	■
Congo	•	■
Côte d'Ivoire	•	●
Gambia	•	○
Guinea	•	■
Guinea-Bissau	•	○
Madagascar	•	●
Malawi	•	■
Mali	•	○
Mauritania	•	○
Mozambique	•	•
Niger	•	■
Nigeria	•	■
Rwanda	•	■
Sierra Leone	•	○
Tanzania	•	■
Togo	•	■
Uganda	•	○
Zambia	•	○

- • Extensive controls (on 36 products or more).
- ● Limited controls (on 10-25 products).
- ■ Few controls (on less than 10 products).
- ○ No controls.

N.B. Price controls on refined petroleum products were excluded from consideration.

Source: World Bank, 1994a.

2.3.12 The directly identifiable impact of reforms has been to improve incentives to agricultural production (with an effect on agro-industry), as well as to make certain inputs more readily available. Let us note that the strongest impact of the reforms overall, though it is not always possible to identify it clearly and specifically, remains greater market effectiveness and better resource allocation.

Contract enforcement

2.3.13 Contracts, which mark each and every purchase-sale and recruitment operation, whether or not there is any written expression of agreement between the parties, are one of the legal bases of the market economy, and an indispensable instrument of everyday business. In the LDCs, two major problems often have been observed (IFC 1990, World Bank 1994d, IDC 1991a):

- Does the law allow for sufficient flexibility in the drawing up of contracts between two private parties? For example, if two enterprises consider that it is appropriate to provide for a procedure of arbitration that is distinct from the procedures provided for by law, will the former have priority? It goes without saying that each country must strike a balance between protection of the rights of economic partners, on the one hand, and market efficiency, on the other; however, in many LDCs, it would seem that this balance has not been struck, in that legal restrictions have often hampered the operation of market mechanisms, without any significant gain in fairness.

- Secondly, what is the cost of contract enforcement? In certain countries, the delays inherent in the judiciary make it well-nigh incompatible with the requirements of enterprises. The slowness and, in certain cases, the arbitrary nature of the decisions handed down, inflates the cost of contract enforcement to such an extent that they are no longer applicable in practice.

2.3.14 Thus, two types of reform are often necessary: legal reform, where the advantages of the greater flexibility of contract law should be considered, and institutional reform, where the judiciary in particular should be reviewed, especially in order to speed it up and make it more independent of the executive.

Property rights

2.3.15 The uncertainty of persons as to the legal recognition of their ownership is a very significant obstacle to the growth of the private sector. In many developing countries, this uncertainty appeared for the following reasons:

- The public authorities were able to prohibit or severely restrict the legal ownership of assets, of land in particular. In the case of Laos, this type of provision had a non-negligible effect on privatizations and foreign investment (see 2.1.22, 2.4.22).

- In the legal framework there may be satisfactory provision made for private property but, because of a perceived threat of expropriation, investors consider ownership as being uncertain. Countries where in the past nationalizations considered to be abusive by investors have taken place often elicit this type of uncertainty.

- The administrative departments in the LDCs in charge of registration of property and, in particular, transfers thereof, are often ill-prepared and ill-equipped to properly perform their duties.

- Finally, the legislation may sometimes not be in complete alignment with customary law, which may have precedence in transactions between private persons.

Whatever the causes for uncertainty relating to ownership may be, the effect generally is to inhibit the accumulation of capital, since those involved will of course seek a higher yield from their investment, sometimes over a shorter period of time, as compensation for the risk perceived.

2.3.16 The directions to follow are directly prompted by the causes of uncertainty. When there are political difficulties with reforms, long-term and renewable leases may improve a situation of major uncertainty. Just as for contract performance, reforms must have a legal and institutional dimension.

2.4 ENCOURAGING DIRECT FOREIGN INVESTMENT[13]

2.4.1 After several decades of scepticism, most of the Governments of the LDCs have taken a stand in favour of foreign investment, recognized today as an important factor in speeding up economic growth. Although numerous programmes encouraging foreign investment have been launched since the middle of the 1980s, it is only in a limited number of cases that these policies have made it possible to gain optimally from the national advantages by attracting quality investors.

Legal framework

2.4.2 The focal point of legislation governing foreign investment is the *investment code*, which is a law aimed at presenting in a single text the basic provisions relating to investment in the country concerned. The prime objective of investment codes is usually to promote or facilitate foreign investment. They usually contain assurances by the State, among others, on expropriation and repatriation of profits and capital, tax advantages and other inducements, as well as procedures for requesting approval.

2.4.3 *The arbitrary administrative situation* devolving from the investment codes is one of the problems frequently quoted by foreign investors. Out of 48 investment codes in the developing countries, a study made (World Bank, 1992b) concludes that the majority of texts reviewed provide for a discretionary decision, i.e. one which does not have to be justified to the applicants, either for the concession of tax or other benefits. In particular, most of the sub-Saharan African countries exercise a major discretionary power in the granting of the tax benefits provided for in the investment codes. Finally, among the 48 countries studied, it is interesting to see that the countries with the greatest income are also those which enjoy the least discretionary power.

2.4.4 The principal disadvantages of the administration's discretionary power are as follows:

- Each time that an investment code fails to provide for the nature and scope of the benefits in accordance with fixed criteria, the investors are liable to be afraid that their competitors will be granted benefits greater than those they receive themselves in the long run. In numerous LDCs, for example Togo, Senegal and Congo, studies show (for example, DFC 1983) that this risk frequently materializes and therefore creates a situation that leaves much to be desired in competition among foreign investors – and possibly local investors – working in the same sector.

- The discretionary power of the administration and the negotiations usually entered into between the host country and the investor appreciably step up the costs of the approach stage. The effect has the disadvantage of totally penalizing small investors who often do not have sufficient financial resources to cope with a schedule involving very uncertain discussions and a great deal of moving about.

2.4.5 *Regulatory and legal framework*. Tax incentives and other benefits are not usually enough to motivate a quality investor. One cannot stress too much the importance of the view that the latter has the soundness of the regulatory and legal framework behind him, including in the legal follow-ups. The inducements offered

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[13] In this section the terms direct foreign investment and foreign investment are used equally and mean any investment made by a company or individual in an enterprise in another country where the investor exercises influence on the management of the enterprise.

to foreign investors are not genuinely attractive unless they are supported by a complete range of laws and legal, financial and administrative institutions in the host country. As we have seen above, this is a central point for which much remains to be done in most of the countries concerned.

2.4.6 *The constraints on the repatriation of capital and profits* are another legal barrier currently perceived as a major hindrance for the foreign investor. Out of the 48 investment codes studied, only two made provision for unconditional transfer of capital and profits. Most of the codes include a guarantee of the repatriation of funds, but subject it to the regulations governing the exchange rates and the tax legislation. In a limited number of countries (Egypt, Guinea-Bissau, Madagascar, Namibia and Somalia), the investment code even stipulates a minimum time-limit, following the completion of the investment, for the transfer of benefits or capital. It is to be noted that among a selection of investment codes in industrialized countries[14] it is only Spain and France who restrict the transfer of foreign investment funds.

2.4.7 The first disadvantage of these provisions is that the perception of the risk country by foreign observers is thereby degraded, especially since the regulations governing the exchanges to which the transfers are subjected are themselves often restrictive and do not allow the exporters as a whole to preserve their foreign currency. Furthermore, this type of legal constraint tends to encourage a special class of foreign investor. The investment projects which provide for the import of inputs from the investor's country of origin, especially if the investor is himself to be the supplier, offer in effect a convenient means of repatriating all or part of the profit made in the host country. A particularly revealing case of this mechanism is provided by the automobile assembly projects: since the original products are sold by the investor to his own branch, it is possible for the transfer price to include the benefits gained in the host country. In practice, these implicit dividends are extremely difficult to detect. Conversely, the projects using mainly inputs available in the host country, whether raw materials or manpower, cannot get past the provisions of the investment code. It is to be noted that these projects are exactly the ones whose contribution to the trade balance is strongest.

2.4.8 For information purposes let us quote the question of *expropriation and associated compensation*. Most of the investment codes stipulate that the investors may be expropriated, in the public interest, in accordance with the law and against payment of compensation. We should note that most of the industrialized countries have made similar provisions. These legal provisions, it seems, do not represent in themselves a major problem for the investors since the latter frequently regard the expropriation risk as part of a much bigger political risk, which in any way cannot be reduced significantly by improving the legal texts.

Institutional framework

2.4.9 *Limited efficiency of the "single counter" arrangement in the selection of projects.* Since the investment codes mostly envisage a case-by-case approach, the Governments have set up specialized institutions for the selection of investors. During the last few years, often at the instigation of the sponsors, these institutions have frequently taken the form of "single counters". Although varying considerably in its prerogatives and institutional affiliations from one country to another, the ambition of the single counter is to offer the foreign investor a single point of contact where he can request the necessary information for the preparation of the project and, first and foremost, all the authorizations demanded by law. From the host country's point of view, the single counter has a dual objective: (i) to improve the quality of the investment by centralizing government expertise at one single institution and therefore making possible better selection and a better standard of negotiation; (ii) to increase the amount of investment by simplifying and curtailing the selection process. However, the "single counters" in most of the LDCs, and generally speaking in the developing countries, have been disappointing as far as their performance is concerned and have not, among other things, made it possible to cut down the time limits for approval.

[14] Australia, Canada, Japan, New Zealand, Spain, France, United States and Great Britain.

2.4.10 The principal explanation for this performance is the separation between the administration in charge of the approval procedure (carried out by the "single counter") and the actual decision-making (which often continues to be the prerogative of other administrations). In certain extreme cases, the "single counter" is hardly more than a post box responsible for transmitting the investor's requests to the relevant quarter. Hence there is a risk that the "single counter", instead of speeding up the selection procedures, stretches them out instead by introducing an additional link into the administrative chain. The persistence of the separation between the functions of administration and decision-making can be regarded as a consequence of the existence of several different interest groups each wishing one to maintain a certain influence on the influx of foreign investment. We should quote, among others, the administrations whose activity is directly affected by the foreign investment, such as the central bank, the Ministry for Immigration and the Ministry for Finance, or again the sectoral ministries and the representatives of the local private sector. Because of these multiple pressures and without strong political will on the part of the Government, the "single counter" is often nothing more than the result of an incomplete institutional reform where only the administrative tasks are centralized, while the decisions remain the domain of the departments concerned; it is these decisions which are so often the cause of the delay and not the administrative treatment of the applications.

2.4.11 *Inadequacy of the economic analyses.* Despite the considerable aid granted for almost 25 years by the sponsors for economic analysis of investment projects, it would seem that the analyses made by the administrations responsible for selection are still today based more on the economic interest of the project for the investor than on its net contribution to the economy. In other terms, the criteria employed are often those of the financial viability of the project, more especially its capacity to repay the contracted loans, and not those of a cost/benefit analysis. For example, none of the countries reviewed by Wells (1991) ponders in any serious way on the need to grant the tax benefits provided for in the investment code. Although the tax benefits were not needed to attract the investors, they should then consider them as a project cost. The difference between the financial profitability of a project and its economic impact is particularly important in the case of high customs protection. Sufficiently high customs dues may in effect enable an investor to make large profits without the net benefit for the national economy being clearly positive, especially in terms of resource allocation. Even when the agency responsible applies criteria such as foreign currency savings, job creation or the development of a certain region, the implicit costs of the project, like the taxes and dues that are exempt, continue to be omitted.

2.4.12 *Limited efficiency of the "single counter" arrangement in the provision of services.* The Governments of the LDCs have also assigned to the "single counters" — sometimes different from those responsible for selection — the task of providing in foreign investors with certain information services, advice and assistance regarded as a factor that could improve the investment climate. A major part of these services is to assist investors to obtain different permits and licences necessary for starting up and continuing with a project. It should be noted that these permits are different from the initial approval for the project; for example, this could be a building permit, an import licence or a registration with the central bank with the aim of being able to repatriate dividends. Just as in the situation observed for a selection of projects, the "single counters" providing services suffer from an insufficient investment of authority by the competent administrations. The result has been that the delays in obtaining permits have still not been significantly reduced.

Table 9: Institutional approaches for the selection of foreign investment projects

Country	Responsible for organization		Type of structure
	Administration	Decision-making	
Brazil	Central Bank, National Institute for Industrial Property (INPI), Special Secretariat for Informatics (SEI)	Ministries concerned	Decentralized administration and decision-making at the same time (diffuse)
Dominican Republic	Investment Promotion (IPC)	Industrial Investment Committee (CII)	Centralized administration; decision-making coordinated by BII
Ghana	Ghana Centre (GIC)	GIC	Centralized administration; decision-making partly centralized, but coordinated mainly by the Centre
Kenya	Investment Promotion Centre (IPC)	Investment Facilitating Committee (IFC)	Centralized administration; decentralized decision-making
Republic of Korea	Foreign Investment Policy Division (FIPD)	Ministries concerned	Centralized administration; decentralized decision-making
Mexico	Directorate General for Foreign Investment (DGIE)	DGIE/National Foreign Investment Commission (CNIE)	Centralized administration; basically centralized decision-making, partly coordinated
Philippines	Board of Investment (BOI)	BOI	Centralized administration; decision-making coordinated by the Committee
Singapore	Economic Development Board (EDB)	EDB	Centralized administration and decision-making
Thailand	Office of the Board of Investment (OBOI)	Board of Investment (BOI)	Centralized administration; decision-making partly centralized, but coordinated basically by the Committee
Turkey	Foreign Investment Department (FID)	Council of Ministers	Centralized administration; principally centralized decision-making, partly coordinated

Source: World Bank, 1994c.

"Selling" a country

2.4.13 Numerous countries, whether industrialized or developing, have adopted programmes for actively promoting their countries among foreign investors. These activities, which are based on the marketing techniques used in the private sector, include the creation of a suitable image of the country abroad, direct contacts with potential investors and services intended for appreciation of the "prospects" for their project (arrangement of visits, provision of specific information etc.). There are numerous indications that these programmes are effective, provided that two conditions are met:

- The "product" should be marketable; in other words, it is useless to try to promote a country whose policy and legal and institutional environment is not attractive to foreign investors. Conversely, the existence of tax benefits and other direct incentives does not seem to be a component part of the choice of investors, whose approach is usually based on the intrinsic advantages of the country, including therefore its legal and institutional framework. Studies suggest that the direct benefits granted to investors, costly in terms of lost income, could be replaced by promotional programmes, often less costly and having effects, if correctly designed and put into practice, that are longer lasting.

- The experience of the past promotion programmes shows that they must comply with the following rules which are gone into further on: (i) the programme has to be carefully "targeted"; (ii) there has to be adequate apportioning of the different activities between the two main categories, in other words the creation of an image and the direct generation of investment; (iii) finally, the competence of the agency responsible for introducing the programme is a key factor.

2.4.14 Prior to enlarging upon the three points above, we should point out that the LDCs, with a few rare exceptions (see boxes 2 and 4 on Laos), have not been present in this movement. However, it appears that changes in policy and institutional reforms alone have little chance of rapidly generating significant flows of foreign investment. Countries hardly known in the international business community and with a tarnished reputation or far away from the principal investment sources will probably not stand a chance of attracting substantial investments without a promotion programme.

2.4.15 *"Targeting" the promotion programme.* Promotion should be directed towards investors likely to be really influenced in their decision on localization, and not simply firms with an interest in the country considered. *Inter alia,* the exporters of consumer goods or capital to the host country do not usually provide more than a feeble response to promotion. Indeed, these enterprises are themselves well informed of the opportunity whether to invest or not in the host country by the direct contacts that they maintain there, for example, their representative or their distributor. The decision to invest in a country to which one wishes to export is often due solely to increasing difficulty in preserving the market, especially because of the raising of entry barriers. It can therefore be seen that promotion can only have a marginal impact on this type of prospect.

2.4.16 The preferred target of promotion should be the enterprises seeking to export from the host country, especially by relocating their production. The last decade has seen a vast production relocation movement towards the developing countries, the driving force for this type of decision not being the previous existence of a flow of business between the host country and the investor, but rather a search for lower costs of production associated with the right business environment. For this type of decision the investor is often faced by a very open choice where promotion may swing the balance.

2.4.17 It is also important to make the best use of the resources invested in promotion by targeting the investors' countries of origin. This choice can be made by following a simple rule: strengthen existing relations. If there are already investments there from the given country, it will be easier to canvass the enterprises of the same country by referring to projects under way. It goes without saying that the geographical, linguistic or cultural proximities are also important criteria in the choice of the target countries. Boxes 2 and 4 for Laos are illustrations in this respect.

2.4.18 Following the same logic, it may be advisable to target the programme per sector. If, for example, referring again to Laos, the host country has received investments in the area of textiles (mainly from Thailand), promotion geared to the textile sector of other countries has a good chance of being profitable.

2.4.19 *The choice of activities.* The activities involved in creating an image include publicity in the international media, the organization or attendance of international fora, investment missions, seminars abroad and so on. Experience shows that these activities alone do not lead directly to investments, but help to make potential investors aware of the interest of the host country. As a result, it is felt (Wells, 1991) that one of the problems affecting the promotion programmes of developing countries is the undue stress placed on these image-building techniques to the detriment of the direct generation of investment. Furthermore, it can be claimed that by virtue of their general stage of development the LDCs will probably have difficulties in competing with the industrialized countries or countries with intermediate revenue. Consequently, a more "targeted" programme in terms of country or sector probably improves the chances of success for the LDCs.

Targeted promotion in Laos

Under a project for privatization and encouragement of foreign investment supported by the World Bank and UNDP, since 1990 Laos has set up a foreign investment promotion programme, the salient points of which have been:

- The organization of several high-level seminars in countries previously interested in Laos: Australia (150 people, with 100 Pacific Asian firms) and Thailand; the mailing of 3,500 letters to European firms selected per sector;

- Promotion activities targeted sectorally, which include international seminars organized in Laos for the mining, agro-food and tourism sectors;

- The launching of a review ("Investment Opportunities") on a biannual basis.

This promotion has been accompanied by a reform of the investment code and of the main texts governing private activities and the construction of institutions already in charge of the programme following the departure of the international advisers. Although it may be difficult to tie the investment encouragement activities to genuine flows, we should note that during the two previous years before the beginning of the programme, in January 1991, 94 foreign firms had been approved, totalling 142 million US dollars in capital; between the launching of the programme and December 1993, 250 new investments had been recorded (an increase of 266 per cent), amounting to 392 million US dollars of capital (an increase of 267 per cent).

Source: IDC 1991c and 1992.

Box 4

2.4.20 Activities which generate investment combine the techniques of a direct approach to investors, firm by firm or sector by sector. Along the lines of the private marketing activities, one of the most effective techniques is direct and personalized sale. The promotion agencies with the greatest success are those that have selected beforehand the potentially interested enterprises in the host country and have contacted them directly. For example, in Singapore, the Economic Development Board contacted Apple Computers on its own initiative before the latter set up its relocation projects.

2.4.21 *Institutional organization and promotion.* In the past it was, as a general rule, the government agencies traditionally responsible for selecting investors which put the promotion programmes into effect. However, the conversion of a public entity into an activity fundamentally geared to the market proved to be extremely difficult. The rigid scales of remuneration of the officials made the job of marketing and vending professional rather difficult since the professionals were often interested in the results produced. As a consequence the government agencies had a tendency to confine themselves to these image-building activities to the detriment of direct-marketing activities.

2.4.22 Other countries adopted a radically different approach by entrusting the promotion programmes to a private organization. Other problems, sometimes the opposite of the previous ones, then have to be coped with. Firstly, the problem of financing a private organization cannot be settled without the support of sponsors, via the Government. When this is possible, as has been done in Costa Rica with the aid of USAID, close attention has to be paid to the independence of the private agency so that the public funding received by it does not destroy indirectly the advantage linked to its belonging to the private sector. Likewise, a private agency may lack the government contacts necessary to support the investors, especially in arranging visits and obtaining preliminary authorizations (visas etc.).

2.4.23 A medium-term solution seems to be an autonomous government agency, free from the constraints of salary scales and authorized to subcontract to the private sector some of the functions for which it is normally better qualified. As a government body, the agency preserves in principle the support of the administrations for obtaining the various permits requested by the investor.

2.5 NON-FINANCIAL ASSISTANCE

2.5.1 Foreign investment (see section 2.4) is the preferred instrument for transfers of technology. This section deals only with non-financial assistance to enterprises, especially the small-size ones, the majority capital of which is held by nationals.

2.5.2 Factors external to the enterprises are not the only ones to limit their growth. Most of the studies on the private sector in the LDCs show that the limited managerial ability and inadequate command of technology slow down entrepreneurs to a considerable extent. In Mali, for example, shortcomings in management (preparation of financial documents, management of cash flow, cost auditing etc.) have acted as the first constraint on private enterprises, followed by technological problems (selection and maintenance of equipment, organization of production etc.) (IDC, 1991). A similar finding has been obtained in Guinea (IDC, 1993a). Similarly, it has often been observed that the difficulties encountered by the private sector of the LDCs (particularly the micro-enterprises) in access to credit do not usually involve so much a lack of liquidity on the part of the banks as the lack of quality, not necessarily of the products themselves, but of the applications for credit.

2.5.3 In the light of the recent experience of the African LDCs, corroborated by certain advances made in the theory of development (for example, Romer 1990), it is reasonable to believe that because of the small scale of the national economies and the poor stock of human capital actually available in each country, investment in the qualifications of the private sector makes it possible to speed up economic growth. By qualifications is meant all the qualifications available in the economy, including those offered by the network of consultancy firms and private consultants.[15]

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[15] Human capital is taken to mean the sum of the qualifications of the entire active population actually available in each country.

Public support institutions which are not very efficient

2.5.4 The idea is not new, but rather the application of it is. Traditionally the role of public information, training, and consultancy has been largely entrusted to the chambers of commerce and industry, and to the State institutions specializing in certain functions (for example, management training, preparation of feasibility studies) or certain branches of the economy. In a number of LDCs the chambers of commerce and industry have been entirely governmental institutions. These bodies have not, in the global sense, made a satisfactory contribution.

2.5.5 Since they are products of the State, these structures have not usually had the benefit of a clear understanding of the problems of the private sector and have only rarely had the abilities necessary to remedy the situation; this is essentially for two reasons. First, in terms of human resources, the officials running these institutions have often had only a very indirect idea of the needs of the enterprises. Second, as extensions of the State, the support structures have experienced the shortcomings frequently observed in the public administration of the LDCs, namely lack of motivation among the personnel, non-continuity of services, vote catching and in a general way unequal quality.

2.5.6 The demand for services is extremely varied and variable. In Mali, for example, if we consider only the issues relating to management, requirements cover, among other fields: the introduction of computerized accounting systems, the preparation of financing schedules and marketing for export. Furthermore, there is no reason to think that these requirements remain stable with time, especially in the case of success of the aid programmes. On the contrary, the experience of the industrial and other developing countries shows that the requirements of the enterprises evolve as a function of their stage of development, both individually and collectively. The public entities of the LDCs have not been able to cope with the diversity of the demands and have concentrated on certain segments, for example, feasibility studies or information on external markets.

2.5.7 By dint of the attitude displayed for some time by the public authorities towards the entrepreneurs, the latter have come to regard State institutions with a certain distrust, including those whose mission was to support them. For example, the chambers of commerce, being often public (especially in Africa), have fulfilled their role of representing the private sector to the authorities only very imperfectly; the entrepreneurs — most of the time and with good reason — have been afraid that the public project offices may have been communicating to the tax authorities the financial data used as a basis for feasibility studies (in particular for extension projects).

2.5.8 When the programmes have been supported by donors, they have often been promoted by expatriate technical assistants making a direct contribution to the provision of services to the enterprises. Although this approach may have brought good results in the short term, it has not on the whole ensured a true transfer of competence in the country. Let us quote, for example, the programme of aid for redundant civil servants to set up enterprises. Apart from the theory, which has shown itself to be largely unrealistic, that experts spending their entire career in public administration represent people well suited to setting up an enterprise, this programme has suffered from the poor employment in the private sector of the capability of the foreign experts, who have basically taken away their abilities with them at the time of their departure. Similarly, with regard to the "integrated"[16] projects of sponsors in favour of certain sectors or certain regions, although able to make an immediate improvement to private investment, they have had the defect of offering a precarious solution; indeed, they do not encourage the creation of a private institutional fabric (credit organizations and consultants), but may even inhibit it since they replace it under strongly subsidized conditions.

[16] This refers to the assistance programmes for enterprises, especially micro-enterprises, in the rural environment, which offer credit and non-financial support at the same time.

Non-financial aid to Mali

In 1992, with the support of the World Bank, the Government of Mali set up a non-financial assistance agency, the main characteristics of which are as follows:

- The agency is a private association, the main founder members of which are the credit organizations, while the other support institutions and organizations represent the private sector.
- A convention was signed with the State for obtaining funds. The agency preserves its entire independence and is governed by a professional officer recruited in the private sector.
- The agency, the staff of which is small since no service is provided directly, has drawn up a long list of private, national and foreign consultants. The capability available covers a broad range of advisory and training services in the area of management and technology.
- The enterprises are selected according to the hoped-for profitability of the assistance requested. They take over a substantial share of the cost. The number of interventions subsidized for a given enterprise is limited with the aim of promoting the emergence of an autonomous request for services. In other words, it is felt that if an enterprise considers the aid received to be worthwhile, and if as a result it wishes to benefit from such again, it must be ready to take on a growing share of the cost.
- A tripartite contract has been concluded between the supplier of the services, the beneficiary and the agency. The latter inspects the implementation of the contract.

Source: IDC, 1990-1991

Box 5

Privatization of aid

2.5.9 Certain programmes launched towards the middle of the 1980s, usually as one of the components of a broader reform, have opened up a promising path. They are of a different type in that they are based on the provision of assistance by the private sector. Their double objective is (i) in the short term, to cater for the needs of private enterprises by offering them varied and worthwhile assistance in management and technology, both in terms of consultancy and training; (ii) in the medium term, to help to reinforce a fabric of consultantancy firms and private consultants. These two objectives will be pursued with all the more success if certain conditions are complied with.

2.5.10 *Provision of services by the private sector.* In order to ensure rapid response to the variety of the requests for assistance and to play the role of catalyst in increasing the human capital, the support programmes in the LDCs should not themselves in principle provide services to beneficiaries, but rather subcontract them to the private sector; the latter, especially at the beginning of the programmes, should include foreign consultants so as to promote transfers of know-how and to provide an adequate response to certain specialized needs. Since the equality of the services is a key point in the success of the aid, national private consultants (firms or individuals) should themselves be, as members of the private sector, the preferred beneficiaries of the assistance. For example, in Mali, the Malian Agency for Support to Enterprises set up according to these principles, should not itself provide any aid to the enterprises and has drawn up a long list of local and foreign consultants who supply the enterprises with consultancy and training services in the area of management and technology.

2.5.11 *Make the beneficiaries pay.* The market mechanisms may be used to ensure an economically effective distribution of the assistance. A significant contribution by the beneficiaries to the direct cost of aid makes it possible (i) to do away with the enterprises that are not really motivated or qualified and which, it is feared, will not use the assistance placed at their disposal to the optimum extent; (ii) to strengthen the demands of the enterprises with respect to the services received, which helps to improve the quality of the assistance; (iii) to guarantee that the type of assistance offered is genuinely requested by the enterprises (which has not always been the case with the public support structures). The African Project Development Facility, of which the IFC is one of the reference shareholders and which helps African entrepreneurs with the preparation of investment projects, demands that 50 per cent of the costs be covered by the beneficiaries, in addition to a substantial fixed payment (of the order of US$ 1,000) and a success fee. Let us add that the non-paying programmes, including those organized in the industrial countries, have often run into difficulties directly associated with the free nature of the services. For example, the partner-finding programme promoted by the French Ministry of Cooperation in the African LDCs have been faced with a lack of motivation on the part of the beneficiaries in pursuing contacts with selected European companies.

2.5.12 *The institutional attachment* of the institution responsible for managing these programmes is of crucial importance:

- Experience shows that these programmes must remain *independent of the State*. Although this objective does not always seem to come by itself, especially when the support of the sponsors is given through loans or gifts to the State, it is important to ensure that these programmes avoid the difficulties of their public predecessors, of which a good number stemmed from their belonging to the Administration. A solution often applied is that of a non-profit-making association, which can then conclude a financing agreement with the State;

- The above legal arrangement makes it possible to fulfil another important objective, i.e. that of equitably representing the private sector, more especially the credit establishments.

2.5.13 Another key point in the programmes is the *coordination of non-financial assistance with the provision of credit*. The impact of such programmes on private investment might be considerably cushioned if the enterprises with access to non-financial assistance do not have access to credit, and vice versa. This quite clearly does not mean that an enterprise benefiting from non-financial assistance should automatically regard itself as eligible for financing by credit establishments. The latter, as well as the institution responsible for managing the assistance, desire to and must preserve the independence of their decision-making. However, coordination can be achieved by the following means:

- As stated, one should always consider direct involvement by the banks in the programme-managing institutions; as has been done in certain countries, a representative of the credit establishments can equally participate in the decisions to render assistance and thus form a prompt channel of information for the banks. On a reciprocal basis, the latter can undertake to inform the assistance programme managers of credit agreements;

- Generally speaking, the assistance should help to improve the quality of investment projects and to enable banks to make an easier assessment of credit requests.

2.5.14 To sum up, the privatization of non-financial assistance, when correctly implemented, presents a number of desirable features:

- *Versatility and adaptability.* A broad and flexible range of advisory and training services may be offered promptly to the enterprises. For qualifications which are not available locally, foreign consultants (who may to their advantage replace costly expatriate technical assistants usually available in other types of programmes) may act for the enterprises and, first and foremost, set up local consultancy offices.

- *Use of market mechanisms.* Although it starts from a situation of failure by the market, where the latter cannot manage to provide, initially, the qualifications that are nevertheless necessary, this type of scheme helps it to function by making it solvent through the introduction of a subsidy. Since the enterprises assume a significant part of the cost, there are strong incentives for constant improvement of the quality of the services. The type of services furnished is requested, of necessity, by the enterprises.

- *Transfer of know-how.* Since the recipients of the activity of foreign consultants are the national consultancy offices in the same way as the enterprises, the chances of a transfer of know-how being able to survive at the end of the programme are improved. Furthermore, what is perhaps more important still, the competition between the suppliers of services, fostered and organized by the programme, induces the latter to constantly improve their qualifications.

2.6 INDUSTRIAL RESTRUCTURING

2.6.1 The development of technologies, the changes in consumer preferences, the liberalization of international trade, and the legacy of past policies are factors which make necessary industrial restructuring. One can envisage the restructuring, in a competitive environment, as a response by the market to these different impulses; this response includes modification of productivity and the relative size of the enterprises or sectors; the start-up, closing down or expansion of the enterprises; alteration of the mixture of products and technologies, and exogenous alterations to the balance of the enterprises.

2.6.2 It is important to adopt a clear position, consistent with the other policy lines, as to the role of the State in the administration of enterprises. As we have seen, one of the lessons of the economic history of the LDCs is that the Governments are less qualified than the private investors with regard to the allocation of industrial resources. This finding implies that direct intervention by the State in the restructuring of private enterprises should in principle be eliminated. This does not mean, however, that the State should be inactive in this area; far from it. Most of the sponsors and without doubt a large number of LDC Governments agree in considering that the public authorities should play the following role in the restructuring:

- Even if the privatization is an appropriate long-term objective, a certain number of public enterprises remain and will still remain for many years to come in the public sector; even when their privatization has been decided on, a certain type of prior restructuring may be useful (2.1.11).

- In the case of the restructuring of private enterprises, certain activities by the State may be necessary to accompany and facilitate the industrial changes, more especially in the area of training, public information on the employment market and responsibility for part of the social cost of restructuring. These accompanying measures will often have a sectoral dimension.

2.6.3 We should point out that the instruments of policy described in this report (macroeconomic stability, legal and regulatory framework, privatization, encouragement of foreign investment, non-financial assistance and, to a lesser extent, environmental policy), together with access to credit and export promotion, are primarily aimed at the success of the industrial restructuring. This section only covers government activities, which are not discussed in the previous sections, first mentioning the restructuring of the public enterprises, and then the social treatment of the restructuring, which concerns both the public enterprises and the private sector.

Restructuring of public enterprises

2.6.4 Although the restructuring of public enterprises is not normally treated as one of the components in the promotion of the private sector, it is useful to mention it since, as we have seen, the special links existing between the public enterprises and the State have been one of the strongest factors in the ousting of the private sector. Public enterprises placed on an equal footing with the private sector and better managed are elements favourable to the development of the latter; it is therefore first and foremost from the standpoint of the normalization of relations between the public authorities and the public enterprises that the subject will be dealt with.

2.6.5 *Restoring relations with the State.* The restructuring should be envisaged against the background of complex relations, sometimes escaping competitive logic, which the public enterprises maintain with their principal shareholder, the State. First, the public enterprises often enjoy substantial advantages, more especially, easier and cheaper access to credit and to currency; direct transfers, sometimes in the form of contributions to the capital; protection against local and foreign competition; purchasing or selling arrangements with other public enterprises, and tax benefits. Second, the management of the public enterprises is affected by certain constraints imposed by the public authorities, for example: obligation to employ; political appointment of the senior staff and, in a general sense, political interference in strategic decisions, often tainted by corruption; rigidity of selling prices, and the obligation to maintain non-profitable services. To reduce these imbalances is one of the most important objectives of the restructuring.

2.6.6 The subsidies and indirect transfers, whether they intervene in the direction State-public enterprise or public enterprise-State, since they are difficult to identify and quantify, make it difficult to assess performance and, finally, provide the public enterprises with an incentive to mediocre efficiency. Indirect subsidies in the direction State-public enterprise (for example, financing with subsidized interest rate) are often regarded as being justified by the services mutually rendered to the State, such as the maintenance of non-profitable social activity (for example, the operation of telephone lines in rural regions). If it is part of the prerogatives of the State to adopt redistributive measures, the latter should be put into effect in such a way as to control the cost and impact of them. As far as the public enterprises are concerned, restructuring should consist in:

- Identifying and eliminating indirect transfers by aligning, under conditions granted to the private sector, the financial and commercial relations between the State and the public enterprises. Only direct subsidies should exist.

- Each time that it is possible, separating the redistributive activities of the State from the other public enterprises activities. A special legal channel should be used for social activities, which would be the recipient of direct subsidies explicitly allocated for this purpose. For example, in the case of the electrification of poorly populated areas, a typically non-profitable activity, special legal entities could be used to control the assets and liabilities, as has been done in certain African countries. Another often quoted example is that of separating the post offices, a social activity, from the telecommunications, a potentially very profitable activity.

2.6.7 In the special case of the suppliers of infrastructural services (water, energy, transport, communications etc.), the restructuring should also reflect these principles, namely that the public enterprises should be authorized to raise their prices according to the trend in costs; when the State wishes to subsidize the prices, as is often the case with water, this should be done in an explicit manner, preferably through a specific legal instrument in which the costs, income and subsidies are accounted for.[17]

2.6.8 *Physical restructuring* includes the upgrading or replacement of obsolete factories and equipment, the introduction of new technologies, and investments aimed at improving the overall use of capacities and energy. The physical restructuring of the public enterprises should not in essence differ from the restructuring practised in the private sector, namely the decisions to invest should be based on profitability estimates worked out on the basis of a commercial strategy, market assessment and costs.

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[17] It is often observed that subsidies on products of prime necessity are not always the most efficient way to ensure the minimum well-being of the poorest segments of the population, since the subsidies are also of benefit in this case to wealthier people, who consume these products just as much as the poor people.

2.6.9 Most of the problems encountered in this type of operation have not usually involved the quality of the design of the physical restructuring programme, but are rather linked to the inadequacy of the additional changes in the organizational and managerial side of the public enterprises (see table 10). In effect, it is to be noted that the major difficulty of the public enterprises and their chief shareholder, through the supervisory ministries or occasionally by State holding companies, is to adopt a competitive attitude and to adopt a style of commerce aimed at winning shares in the market and the satisfaction of the clientele. However, this question is not exclusive to the LDCs and has not always been resolved in a fully satisfactory manner by the industrial countries, for example France and Britain; in those countries it has been a weighty argument in favour of privatization. Hence priority should be accorded to the changes described in table 10, without which physical investments might be doomed to failure.

2.6.10 Let us note that certain methods of reform, classed above as privatization, such as management contracts and long-term leasing may be elements of the restructuring (see 2.1.9).

2.6.11 *Financial restructuring.* This operation consists basically in settlement by the State of the debts incurred by the public enterprises. It can be justified in cases where, for different reasons (among others, the payment of excessive commissions at the time of acquiring equipment), the servicing of the debt stifles the cash flow of the public enterprises, but where the cost of liquidation of the assets is way below the current value of the operational cash flow. It is conceivable that the State, which in the general sense has given its guarantee on the loans, is then interested in balancing the liabilities of the public enterprise in such a way as to keep it active, rather than liquidate it for a negligible yield from the transfer and with the same amount of debt. This restructuring can be partial, for example with rescheduling of the debts, or else total. In Cameroon, the Government has recently carried out restructuring of the debt in the transport sector for the case of several public enterprises whose financial situation was of this kind.

Table 10: Organizational and managerial aspects of the restructuring of public enterprises

Market product and positioning. Change of product, market or positioning; transition from local to export markets; reform of selling and distribution capacity.
Reorganization. Decentralization, creation of cost and profit centres; development of marketing and international sales division; elimination of public enterprise monopolies.
Staff reduction. Elaboration of social plans, including retraining and redeployment of redundancies.
Improvement in management control. More reliable, targeted and rapidly available information on the main financial and physical indicators enabling the main managerial decisions to be made.
Autonomy of the enterprise. Review of the composition and authority of the administrative board, the appointment of competent senior officials and increase in personal responsibility; minimization of government interference.
Management training. Development of the management skills of the executives.
Plans for participation in the results. In accordance with the legal opportunities, involvement of the staff in results, bonuses.
Joint ventures, marketing agreements and investment by foreign companies. This approach can help to infuse the desired managerial know-how.

Source: Ira Lieberman, 1990.

The social dimension

2.6.12 The restructuring of public and private enterprises, since it is aimed at greater efficiency, is often accompanied by redundancies. It is important to give the greatest attention to the social cost of these operations for the market is often shown to be of limited efficiency in retraining redundant workers in order to give them better qualifications and the resistance of the groups of workers involved, together with the political resistance in the broader sense, must be taken into account from the beginning of the operations. The tools facilitating social treatment of restructuring are as follows:

- The payment of *redundancy grants* may represent compensation for the loss of a job. The amount of it, in the absence of legal criteria, or in order to help to define the latter, can be calculated by estimating the average time during which the redundant workers will remain unemployed. In the case of allowances payable at the time of voluntary discharge, one of the difficulties is to keep the highest qualified employees, whose loss often has very unfortunate consequences for the enterprise. One solution is to incorporate into the restructuring programme pay rises for skilled workers as well as a system of performance bonuses.

- *Replacement assistance*. The State may provide redundant workers with job-finding services, guidance and relocation bonuses. With regard to the question of assistance for starting up an enterprise, there are examples (see 2.5.8) where this has only met with limited success in terms of costs and benefits, especially when the recipients of redundancy grants have been the subject of a special follow-up programme, including advice and training. One possible interpretation of this fact is that the start-up of an enterprise, in the LDCs and elsewhere, calls for special skills, which the majority of individuals do not have. As a result, it might be more efficient to refer the true entrepreneurs to the general support structures (see 2.5.1), rather than work out costly programmes, specific to the redundant staff, for assistance in starting up enterprises.

- The *requalification* programmes are undoubtedly one of the most important points of social support for restructuring. These programmes, which may be intended for various educational levels, cover both the provision of skills required immediately by future employers and more fundamental and more general requalification. In this area, as in the non-financial assistance for enterprises, the involvement of the private sector as the supplier of the skills is a success factor for the programmes. For example, this could be training periods in enterprises, apprenticeship contracts, and involvement of private technical schools, or possibly sectoral schools.

2.7 INDUSTRY AND ENVIRONMENT

2.7.1 During the last 10 years the Governments of the LDCs and the sponsors with capital have placed the environment in the forefront of development policies. They have recognized that there are two sorts of relationship between economic development and environmental protection. First, the quality of the natural environment, for example the cleanness of the air or the non-pollution of the water, makes a big contribution to the welfare of the people and deserves to be by itself one of the initial development objectives; although the benefits of an increase in the available income are overshadowed by a decline in health and in the quality of life, it can be stated that the ultimate aim of growth — the well-being of the population — has not been attained. Second, the damage inflicted on the environment may conflict with the increase in the productivity of the LDCs, which is the main driving force for economic growth. The intensive exploitation of natural resources (soils, fishing reserves, forests etc.) with the aim of stepping up short-term income may threaten the viability of economic activity in the long term. In certain situations, the protection of the environment and the economic efficiency are convergent, including in the short term. This is often the case, for example, with the small-scale agriculture where granting clear-cut property rights to peasants may at the same time encourage them to respond better to the signals from the markets and to manage the soil more effectively;

a suitable tax on hydrocarbons could contribute to better management of energy resources and to a reduction in the releases into the atmosphere.

Industrial development and pollution

2.7.2 As the industries of the developing countries gradually catch up their competitors in the wealthier countries, there tends to be an increase in pollution through the greater use of energy and a rise in production and waste. The releases from traditional industrial activities increase with the volume of the latter; industrial towns grow bigger, more people are exposed to pollution; the restructuring of industry takes place at the expense of moderately polluting activities such as textiles and agro-industry and to the benefit of industries more injurious to the environment, for example, the metalworking, chemical and paper industries.

2.7.3 It is foreseen that the consumption of energy in the developing countries, which goes together with their industrial development, will soon dominate the world energy market. Despite several oil crises and repeated financial difficulties, the developing countries consumed three times more energy in 1990 than in 1970. Conversely, it is predicted that the energy requirement per head in the OECD countries should stabilize by the end of this century, and then decline. This phenomenon can be explained by the fact that the basis of the growth of the wealthy countries comes from an increase in value-added industries, which generally consume less energy, and from the tertiary sector.

2.7.4 A distinction should be drawn between two types of pollution associated with the use of energy. Firstly, the pollution is local and linked to releases of particulate matter; the use of fuel containing lead; the impurity of air within a closed space on account of the combustion of the biomass (especially cooking with wood). It is industrial activity which is often the cause of this type of pollution through its releases and wastes, which become more numerous and poisonous with the progress of industrialization. Secondly, pollution can be global with the emission of CFCs and the gases contributing to the greenhouse effect. In the 1980s, electricity production rose 60 per cent in the industrial countries and more than 110 per cent in the developing countries. More than half the world coal consumption and a third of the fossil fuel consumption is accounted for by power generation. An extrapolation of the present trend, i.e. without the pollution reduction techniques being further developed, results in a fourfold increase in pollution associated with power production within 10 years.

2.7.5 Besides energy production, certain industrial activities dominated by the larger production units, such as ferrous and non-ferrous metallurgy, industrial chemistry, the paper industry, cement plants and mines, are giving off substances which, uncontrolled, effect the health of the neighbouring populations, reduce the scale of agriculture and other industries, and tend to damage the infrastructure. The SMEs, which provide an essential part of the employment and growth in the LDCs, are not exempt as polluters; they are particularly liable to discharge organic effluents into waterways and other hazardous wastes that have not been properly treated.

2.7.6 The challenge of environmental policies in the LDCs in face of the necessary expansion of industry is to minimize the highly polluting stage that the developed countries went through during the initial period of their industrial development. The wealthy countries, because they are wealthy, are ready to sacrifice a part (and probably a modest part, moreover, if we bear in mind the long-term cost of the deterioration of the environment) of their prosperity in order to gain a better environment. For example, the regulatory framework of the OECD countries is more restraining with regard to contaminating activities than is that of the LDCs, and is basically applied; technologies for treating industrial wastes have been developed; production technologies have been improved in order to reduce the output of wastes, including those associated with the production and consumption of energy. For example, pollution of the air by some industries such as mines and cement plants is primarily due to dust particles, which can be monitored by suitable systems; effluents discharged into waterways by the chemical or paper industries can be treated if the biodegradable and non-biodegradable substances are properly separated; pollution caused by coal in the production of steel can be reduced by using natural gas or by electrification of the processes. The LDCs therefore possess the advantage of size in antipollution measures: they can benefit from the experience and the technological advances of the industrial countries. We should also note that since a large share of the industrial growth takes the form of the construction of new production units, the previous polluting technologies of the wealthy countries could be more easily avoided.

2.7.7 Although the appropriate technologies exist, their costs are generally high and particularly burdensome for the SMEs. At the end of the 1970s and beginning of the 1980s, investment in the reduction of pollution in Germany, Japan and the United States was nearly 5 per cent of the total industrial investment. However, in the LDCs the cost of combating pollution is in all probability not so high, since the initial measures are often the least costly; it is estimated that up to 60 per cent of the pollution in the developing countries could be avoided at minimum cost. In the industrialized countries, which began policies benefiting the environment before the developing countries, each new advance, according to the economic principle of diminishing returns, has a relatively higher cost. Furthermore, as has been said, as opposed to the industries of the wealthy countries, where the existing production units often need to be modified, a large share of the future capacities of the LDCs will stem from entirely new installations, for which the anti-pollution measures are comparatively cheaper.

Environmental policies

2.7.8 The standards and regulations in force in the industrialized countries can be a long-term objective of value for the developing countries. In the short term, however, there are few LDCs which possess the means, or even the needs — in view of their industrial advancement — for such policies. Because of the limited resources of the LDCs in financial terms, though also in administrative terms, it will therefore be necessary to try to introduce reforms wherever the benefits will be greater, i.e. in the most polluting activities. Furthermore, we should point out another reason for carefully targeting policies: non-applied regulations and non-paid fines are more costly than a simple loss of administrative resources, since the confidence felt by the enterprises in the effective application of any new regulation may then be affected; they will then have a tendency, in order not to compromise their competitive position, to systematically try to get round the government measures.

2.7.9 The behaviour of the industries and consumers can be changed in two ways: by adopting coercive regulatory measures and standards or by introducing market incentives, either by increasing the cost of certain resources and/or the pollution itself. The first approach has so far dominated the environmental policies of the industrialized countries. However, renewed interest in the second type of action has found justification in certain pioneering measures adopted, for instance, in Germany and the Netherlands regarding the cost of water pollution. Finally, one measure having greatest impact in the short term is the elimination of cost imbalances which, instead of reducing the incentive to the consumption of pollutant or rare resources, conversely increase it.

2.7.10 *Reduce subsidies for consumption of resources.* Subsidies promoting the consumption of electricity, fossil fuels, pesticides and irrigation waters constitute a threat to the environment and high fiscal cost. Their reduction is not politically an easy task since their official aim is often to promote industrial development or self-sufficiency in food and, moreover, they usually benefit powerful interest groups. However, these subsidies, which are indirect in the sense that they are introduced through import prices and not by explicit transfers to recipients, make for a strong bias against the protection of the natural environment and are a heavy burden on budgets. For example, it is reckoned that the elimination of energy subsidies in Poland would by itself bring about a 30 per cent drop in the release of sulphuric oxide particles within six years. In Brazil, the reduction in tax incentives and credit intended for extensive agriculture has made it possible to save some 300 million US dollars per year and has slowed down the destruction of the forests.

2.7.11 *Incentives.* Measures based on increasing the cost of pollution offer the considerable advantage of benefiting from market mechanisms and therefore fit especially well into a development policy for the private sector. Normally, these measures comprise taxes or charges imposed, first, on the consumption of rare and/or polluting resources (for example, taxes on hydrocarbons) or, second, on the charges imposed on the volume of the pollution itself. This system therefore encourages all polluters and users of resources to modify their cost structure, most often by adopting, on their own initiative, technologies more friendly to the environment. Let us point out that the enterprises have a constant incentive to improve their technology, whereas in the case of the regulatory type of measure, they will go no further than the prescribed standards. However, the efficiency of this type of activity depends largely on the existence of a competitive market. Indeed, enterprises will respond to incentives to the extent that the increase in production cost penalizes them *vis-à-vis* their competitors. For example, countries like India or Thailand, whose oil industry is basically in the hands of public enterprises, would only make a small gain by imposing an additional cost on lead-containing petrol. In a more general sense, the enterprises benefiting from a form of monopoly or oligopoly on their production, will be less sensitive to a change in the price structure of their inputs. An example the other way round is provided by Malaysia, where charges are imposed on palm oil producers for releasing effluents into the waterways. This measure made it possible to reduce biological oxygen discharges by this industry to the extent of almost 90 per cent between 1982 and 1987.

2.7.12 One difficulty of this type of action is that the enterprises may be incapable of investing in the new technologies stemming from it, even in a situation of free competition. In this way, Governments have sometimes subsidized technological changes by taking on part of the cost of the investments or by providing credits under concessionary terms. But, it is usually observed that these interventions contradict the principle according to which the polluter should pay the cost of the pollution.[18] For this reason, this assistance may run counter to the objective of protecting the environment in the long term and should be targeted and supervised with the greatest care.

2.7.13 *Regulations and standards.* The degradation of the environment may also be prevented by adopting measures compelling enterprises to behave in a certain way. These policies, which are broadly applied both in the developing and industrial countries, are suitable in situations where we find a limited number of public enterprises dominating certain sectors where there is limited competition in the private sector. Furthermore, in cases of highly virulent pollution hazardous to the population, the incentives are often insufficient in themselves to produce a rapid improvement. For example, in the case of toxic wastes, the Government's role is to define the safety standards and supervisory procedures; incentives in the form of dues to be paid for this type of pollution are in practice easily got round by the secret dumping of waste.

2.7.14 Governments may also fix quantitative standards, to be attained gradually and in accordance with a fixed schedule. This method has been adopted by the United States to regulate the lead content of petrol; in such a case the Government has established standards by considering the public health benefits to be gained from this measure. However, it is not always easy to identify or quantify exactly the damage done by pollution; fixing quantitative standards therefore gives rise to great difficulty.

2.7.15 Policies which regulate the quantities of resources that may be consumed can be suitable when it is very important that certain thresholds are not exceeded for important public health reasons, such as for radioactive emissions and, as we have seen, toxic wastes or for the conservation of unique natural resources, the excessive exploitation of which may have irreparable consequences (marshland, coasts etc.).

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[18] The principle of the polluter paying the cost of the pollution was adopted in 1972 by the OECD and stipulates that "the polluter should bear the cost of measures to reduce pollution decided upon by public authorities to ensure that the environment is in an acceptable state."

Table 11: Examples of environmental policies

	Affected variable		
Type of policy	Price	Quantity	Technology
Incentive:			
Direct	Charges for effluent releases into waterways (Netherlands, China) Stumpage fees (Canada, United States) Deposit refund (beverage containers, Northern Europe)	Tradable emission permits (United States) Tradable fishing permits (New Zealand) Tradable input or production permits (United States)	Technological taxes based on presumed emissions (water pollution control, France, Germany)
Indirect	Fuel taxes (Sweden, Netherlands, France)		Subsidies for research and development and efficiency of fuels (catalytic converters, United States, Japan, European Union)
Regulations:			
Direct	-	Emission standards (United States, China) Logging bans and quotas (wood, Thailand)	Mandated standards (catalytic converters, United States, Japan, European Union)
Indirect	-	Bans and quotas for inputs and products (Brazil)	Efficiency standards for inputs and processes (fuel, United States)

Source: World Bank, 1992a.

Continuation of reforms

2.7.16 Environmental policy in the LDCs, as in all developing and industrialized countries, has placed emphasis on regimentation to the detriment of direct and indirect incentives. However, it has been observed, particularly in the industrial countries, where the data is abundant, that objectives such as the purity of the air and the watercourses could have been pursued with an efficiency at least equal and at less cost by incentive-creating measures. In the developing countries, the high preference accorded to regulation has often come up against inadequate administrative capacity and few policies, despite the at times ambitious objectives, have been essentially put into effect. Sometimes, the impact of the measures in terms of redistribution of income and wealth (for example in the case of public enterprises) has been a major political obstacle to their effective introduction.

2.7.17 In all, two lines of reform, often absent today from the environmental policies of the LDCs, could be considered:

- There should be elimination of market distortions which induce the enterprises to create more pollution; subsidies for the consumption of energy or other rare or polluting resources should be carefully reviewed.

- The policies should be based more on incentive measures. Putting a price on damage inflicted on the natural environment would make it possible to gain more advantage from the market mechanisms — especially since the market exists in reasonable conditions of competition.

2.8 DETERMINING AN INTEGRATED POLICY

Principal criteria

2.8.1 An integrated development policy for the private sector should be based on the specific nature of the country considered. It determines an order of priority for the measures to be adopted and provides the planning details for them.

2.8.2 Possible criteria for determining a policy for the benefit of the private sector are as follows:

- Allocating financial and administrative resources at points where the impact will be most effective in terms of private sector growth, i.e. at points where constraints on growth are today the strongest. Certain measures, for example the reform of property rights are low in cost and have an effect which is often substantial in the medium term.

- Watching out for inconsistencies. It frequently happens that the lack of an overall reform programme or else the inadequacy of subsequent coordination leads to certain contradictions. For example, it has often been noted that the effect of considerable efforts invested in encouraging foreign investment may be strongly weakened by the inadequacy of company rights or the insufficiency of the legal apparatus.

- Stimulating market mechanisms. As was stated in section 2.0.1, certain measures are aimed at bringing the environment of the LDC private sector nearer to a market economy; others are of a slightly different nature in that they constitute an attempt to compensate for certain shortcomings of the market linked to the present state of the economy. This latter type of measure should in principle be aimed at encouraging the operation of market mechanisms and in certain cases should have a limited lifetime, since in the event of success, the market could replace the intervention. A good example is provided by the non-financial assistance programmes.

Taking into account the specific nature of each country

2.8.3 The diversity of the environment of private enterprises in the LDCs cannot be overestimated. The order in which the seriousness of each constraint is established varies considerably from one country to another. For example, we have seen that in Mali the greatest impediment to the development of enterprises was managerial ability and the command of technology. In Togo, the domination of the public enterprises in the most important sectors of the economy, associated with a feebly stimulating legal and regulatory environment, has been the main difficulty for the private sector. In the Asian LDCs the impediments in the private sector probably emerge in an order as a whole unlike that of the African LDCs; more especially, the restrictive attitude of the Governments has often been felt there as a major constraint.

2.8.4 *Direct surveys* of a sample of enterprises are a valuable tool for adopting the viewpoint of the private sector. This method has yielded good results in numerous LDCs and has often made it possible to justify or refute the initial ideas that the Governments and sponsors of funds may have had regarding the best way of assisting the enterprise.

2.8.5 These surveys, essential as they are, cannot, however, provide the only basis for a promotion programme for the private sector. The enterprises are not always in the best position to identify the real reasons for certain unfortunate effects they experience. For example, it is customary for enterprises to complain of the lack of working capital; but the latter devolves as a whole from the unduly low profitability of the enterprise, which in turn is subject to causes which may range from the inadequacy of the management to competition by subsidized public enterprises. In the same way, the macroeconomic framework, probably because of the technical difficulties involved in its analysis, has only rarely been quoted by the enterprises as a constraint, although it does often represent an important factor, for example in the case of overestimated exchange rates.

2.8.6 Still more important is the fact that these surveys generally only touch on the enterprises that are active. This means that the information gathered is of limited interest in understanding the absence of private enterprises in this or that sector of a priori importance, or even identifying the general causes of failure. For this purpose it would be ideal to question the potentially interested entrepreneurs in the sectors concerned (and ascertain why they have given up their projects), as well as the entrepreneurs whose enterprises have ceased working. These two types of party are often impossible to identify.

2.8.7 Overall knowledge of the economy considered is therefore needed in order to correctly interpret the enterprises' point of view. Surveys at enterprises will therefore be usefully supplemented by a separate analysis of the factors recognized as liable to stand in the way of private growth, for example, those which are described in the three reports of this series.

2.8.8 Taking into account the specific nature of the conditions for each country also means estimating the administrative capacities of the institutions responsible for applying the policy. Given equal impact on the constraint that it is wished to reduce, some measures can be preferred to others by virtue of their greater ease of implementation. As we have seen all through this report, the administrative and institutional practice of the reforms is one of the key aspects of their success.

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