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PRIVATE BUSINESS IN DEVELOPING COUNTRIES: IMPROVED PROSPECTS

BY GUY P. PFEFFERMANN

Following the deterioration in world economic situation since 1981, many countries have evolved policies aimed at enhancing their domestic output and trade, and consequently improving their balance of payments position. Many developing countries have carried out structural economic reforms that incorporate a number of incentives to attract much needed fresh funds from external sources and also to obtain relief from their debt burden. The IFC discussion paper analysed the prospects for private business in developing countries in the next 2 to 3 years under the growing structural reforms with special attention paid to recent trends in foreign direct investment and privatisation efforts in developing countries.

The paper is divided into five sections as follows: Background, Growth prospects, Prospects for the Private sector in Developing countries, Privatisation, and Foreign Direct Investment. The background section appraised some of the economic policies pursued and developments in developing countries in the last 2 decades. The section emphasised the existence of interdependence of the effect of economic policies and conditions of the developed and developing countries. For instance, the author stressed that the recent slow-down of growth in the developing countries has been one of the factors holding back the growth of output in the OECD countries.

The author identified three groups of developing countries whose economies experienced the worst slow-down of growth. They are the oil exporters, the heavily-indebted and the sub-saharan African countries with some countries falling into more than one group e.g. Mexico, Venezuela and Nigeria are oil exporters and also heavily-indebted countries. Guy Pfeffermann's findings revealed that while the economies of some of these countries have fared relatively well since 1980 (mostly middle income exporters of manufactured goods who did not borrow excessively), most of the heavily-indebted countries have been virtually stagnant. Faced with these problems, many developing countries have embarked on adjustment programmes. However, the author noted that adjustment problems have been aggravated by the high cost of borrowing coupled with deterioration in terms of trade for developing countries.

In section II of the paper, the author examined the growth prospects of the developing countries. The author recognised the remarkable progress that have been made by the middle-income countries in the last two decades. He stressed that the most important external determinant of growth in the developing countries as a whole, is the level of economic activity in the industrialised countries especially the OECD countries. With rising tide of protectionism in the developed countries coupled with declining international demand for primary produce, it is reasonable to expect the economies of developing countries that diversified their exports including services to fare better than those dependent on primary products for the bulk of their foreign exchange earnings. He envisaged moderate growth in world production and growth in the next 2 years. He however cautioned that "the possibility of the external environment providing any fresh stimulus to the expansion of the developing countires' economies appears for the moment to be fairly remote".

Section III of the paper focussed on the prospects for the private sector in developing countries. Some structural adjustment tools like real devaluation, trade liberalization and deregulation were used to assess the challenges and future opportunities for the private sector. Under the orthodox SAP, devaluation is expected to make exports and import substitution more profitable, while trade liberalisation is expected to offer the ready availability of imported inputs and make many firms to expand exports. Examples of countries that had experienced export boom through devaluation like Mexico, and Chile in Latin America were cited. He also noted the opportunities that have opened up for the private sector in some African countries like Ghana and Nigeria following devaluation of their local currency. The author argued that many firms in the private sector have taken advantage of the new business environment under the structural adjustment programmes. The author concluded that the Asian countries provide a promising business prospect due to more favourable outlook for most countries in that region.

Section IV of the paper dealt with privatisation which is now widely accepted as a potential instrument for economic change. The issues addressed in this section range from problems militating against privatisation, to the implication of privatisation for the private sector and foreign direct investment. The author, armed with some empirical data stressed that the success story of privatisation has spawned a great deal of rhetorics. Political economy consideration, high cost of transaction and other practical problems like valuation difficulties, weak capital market (especially in smaller African countries) and weak private sectors, were identified as problems militating against privatisation in many developing countries. Strong financial incentives, strong political will and a pragmatic approach to tackle implementation problems of privatisation were identified as features of successful privatisation as evidenced from lessons from few successful experiences. Mr. Pfeffermann had high hopes on the success of privatisation efforts in the developing countries as reinforced by his statement that "a Second Phase in the privatisation process is within sight in which less will be said and more will be done about privatisation through pragmatic approaches on a case-by-case basis but building upon recent experience. Assisting this process promises to be one of the important challenges facing donor countries in the coming years".

The final section of the paper dealt extensively with efforts made by developing countries in attracting foreign direct investment (FDI). The author attributed the growing introduction of FDI promotional policies in developing countries to the severe limitations on the availability of foreign capital through commercial lending and reduction in domestic investment resulting from recessions and structural adjustments. Mr. Pfeffermann, concluded with a suggestion that developing countries should continue with their policy liberalisation which many have just started as well as introduce new measures and mechanisms for attracting flow of foreign direct investment.

The above provides a brief summary of major issues raised by the author. The paper, which is the IFC report on business outlook in developing countries is an empirically detailed and theoretically informed work which contributes greatly to knowledge about the experiences, successes, failures and growth prospects of developing countries in their efforts to restructure their economies. While the paper will be of interest to policy makers, private investors in developing countries, the academics and the general reader interested in the business outlook of developing countries, it is necessary to caution on the conclusions arrived at by the author. The author's generalisation with respect to growth prospects, export diversification, effects of devaluation and the impact of privatisation and commercialisation on investment generally should be viewed against the economic background and economic structure and peculiarities of each developing country. This is because a wholehearted acceptance of the conclusions of the author may be misleading in view of the heterogeneous nature of these economies and the response to particular set of policy measures in each country.

There are some issues which the author cannot consider in detail as they apply to a specific country, for example, Nigeria. I will like to review Mr. Pfeffermann's paper based on Nigeria's experience. The following issues will form the basis of my review:

(1) Growth Prospects,
(2) Export Diversification,
(3) Effects of devaluation on developing countries and
(4) Impact of privatisation and commercialisation on investment in developing countries.

Growth prospects in the developing countries depend on new investments in these countries. This is affected by the amount of foreign exchange earned and the price of foreign exchange since developing countries do not produce the capital goods required for the investment. The crucial role of exchange rate in investment is connected with the cost of investment projects. A highly depreciated currency results in higher costs of investment and reduced rate of return. The paper could be reduced to an assessment of SAP on private business in developing countries. In this connection, the role played by interest rate deregulation on investment should be mentioned. In Nigeria, banks who have been entrusted with the determination of interest rate have marked up lending rate to the extent that new investment in manufacturing has been jeopardised.

On the issue of diversification of exports in its usual sense, this means widening the range of exports to include both manufactures and primary commodities. However, for a developing country like Nigeria where production of manufactured goods for exports has been rendered difficult by the lack of resources to divert to such activity, export diversification narrows down to expansion of the range of primary products whose prospects are declining in the international market. In fact, prospects for these commodities will continue to be bleak as the developing countries are making the same export diversification efforts at the same time thus increasing the chance of a glut of the commodities in the international market when they simultaneously produce the commodities. Moreover, even if developing countries manufacture exportable products, they still have to face the protectionist policies of the industrialised countries.

The next issue of interest is the effect of devaluation on developing countries. Developing countries export primary commodities whose prices are determined abroad. For devaluation to increase their export revenue, the demand for their exports should be sufficiently elastic. However, since the prices of primary products produced by developing countries are exogenously determined, devaluation seems to be neutral to their export earnings.

For devaluation to produce the effect mentioned by the author, resources within a developing country should be able to move to the export sector for export manufacturing. The required resources are not available within the domestic economies of developing countries and experience has shown that devaluation has not produced the desired shift of resources.

Lastly, I will like to comment on the impact of privatisation and commercialisation on investment in a developing country. Privatisation connotes an economic philosophy which emphasises the role of the private sector. It is a means of getting the government out of the non-strategic areas of the ceconomy and reduce its involvement in direct investment in business enterprises. In a paper titled "The rationale for privatisation and commercialisation", Mr. F.K. Bajomo noted that "privatisation and commercialisation can be referred to as a reward system involving a move towards the pursuit of efficiency and effectiveness in the attainment of objectives, through the adoption of management styles that take profit-making as one of its major goals"[1]. Despite the fact that there are a lot of benefits derivable from privatisation and commercialisation, they can lead to some socially and economically unpalatable consequences for the nation if caution is not exercised in the implementation process. When the policy action affects the prices of industrial inputs it jeopardises new investment and reduces output. The effect of the reduction of subsidy on electricity, petroleum products, as well as the introduction of commercial rate charges by the Nigerian Telecommunications Limited (NITEL) in Nigeria on prices is no more news.

The review has shown that while some developing countries that adopted SAP could have benefited as mentioned by the author, this favourable experience cannot be generalised.

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[1]Bullion, *Central Bank of Nigeria*, Lagos; Volume 12, No. 3, July/ Sept., 1988. p. 37.