Private Investment in Developing Countries

by Mark Pargeter

Introduction

The debate on aid to less-developed countries has recently been concentrated in the fields of private charity and government contribution. In the field of private charity there has been an extension of the 1 per cent idea, and schemes have proliferated—Third World First, 1 per cent Group, Good Friday appeal, St Andrewstide appeal. These are all designed to overcome one of the main disadvantages of appealing for money from the individual—the enormous cost of collection. In the field of government contribution the debate has settled in the field of multilateral *v.* bilateral aiding. The important point at issue here is to ensure that the aid does not become a political football.

Difficulties of the Capitalist System

The debate as it has been conducted, chiefly by men of good will of left-wing persuasions, has left aside the question of how private investment could be integrated or used for the development of the less-developed countries. The words that go round are those of moral obligation and what is right rather than the efficiency and profitability of the products of the development process. There is a lack of trust in the products of the capitalist system, a feeling that it cannot work fast enough or fairly enough to be able to augment the direct efforts that can be undertaken by direct transfer without receiving anything back. In part this is a natural reaction to the hard words of G. Kennan who in his Reith lectures, *Russia, the Atom and the West*, said:

> I must also reject the suggestion that our generation in the West has some sort of cosmic guilt or obligation *vis-à-vis* the underdeveloped parts of the world. The fact that certain portions of the globe were developed sooner than others is one for which I, as an American of this day, cannot accept the faintest moral responsibility.[1]

This comment was wholly rejected by the late President Kennedy in his inaugural address in January, 1961, when he said:

> To those people in the huts and villages of half the globe struggling to break the bonds of mass misery, we pledge our best efforts to help them help themselves, for whatever period is required—not because the communists may be doing it, not because we seek their votes, but because it is right.[2]

[1]*Russia, the Atom and the West*, London 1958, p. 76.
[2]*Inaugural Address*, 20th January, 1961.

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The lack of trust is in part justified. Everywhere capitalists can be seen ensuring that alternative sources of supply can be found, that prices shall be as low as possible in the realm of raw materials, that substitutes shall be found for raw materials, or that as little raw material as possible shall be used in the manufacturing process. Efficiency, security and exploitation seem to be the keynotes of capitalist economic policy. The aim of security, of making the system function regardless of the people in it, has been world-wide from the beginning of time. The exigencies of war ensured that sugar beet should find a permanent place in Europe, that rubber should be manufactured synthetically; political disturbance ensures that oil shall be refined in Europe, and that Alaska's reserves shall be used instead of the supplies from the politically unstable Middle East or Africa. Instability requires that products shall not come from one area. This doctrine is not confined to relationships between rich and poor countries—the recent nickel strike and its effect on companies prospecting for nickel in Australia such as Poseidon have shown us that.

But there is a deep underlying feeling in the present debate that this situation is not right. It has strong intellectual backing:

> An increasing supply of primary products, resulting from investment several years ago, is being confronted by a stagnant demand from the industrial nations; . . . It is not always realized that a comparatively small fall in commodity prices is equivalent in its effects to a cut of billions of dollars in aid to under-developed countries.[1]

This quotation from a letter in the *The Times* of 29th October, 1957, signed by twelve eminent economists from Oxford and Cambridge, was followed *not* by a plea to do something about the *structure of the economy* but for the rich nations to be charitable:

> the richer countries of the Atlantic community should make a grant of, say, 1 per cent of their national incomes to an international fund for the economic development of the under-developed countries.[2]

The emphasis on transfers has meant that investment by private individuals has become something of a back number, if not a dirty word for the activists. But perhaps the important thing to remember is that however the money is passed between the rich and the poor, investment decisions are needed to ensure that it is wisely and, dare I say it, profitably used. It is these investment decisions which have led to the chronic instability of many commodity markets because investors have hedged their bets by investing in two schemes where one would do. They have done this on two counts: one, that a

[1] *The Times* (London) 29th October, 1957. The letter was signed by Professor R. F. Kahn, Professor E. A. G. Robinson, Professor R. Stone, N. Kaldor, W. B. Reddaway, T. Balogh, F. A. Burchardt, Colin Clark, R. F. Harrod, E. F. Jackson, Sir Donald MacDougall and G. D. N. Worswick.

[2] *The Times* (London) 30th October, 1957. Letter from Professor J. E. Meade.

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scheme can fail for many reasons, political, lack of market, lack of expertise in running the industry, lack of good labour relations; or two, that the investor is incorrigibly optimistic about the probable sales outturn.

Problems of Aid Giving

There seems, however, to be something in the investor's gambling instinct which could in principle be used in the fight for development. In the transfer of charity there is too much at stake to risk wasting resources. A charitable organization is forever looking over its shoulder at its projects to see whether the money which has been so painfully collected is yielding solid results. Oxfam has recently been hauled over the coals by the gutter press for throwing away some new but absolutely useless shoes. Aid programmes from governments come under fire when no clear-cut results are seen. President Johnson in his message to Congress of 8th February, 1968, said (of aid):

> It was valid in 1948 when we helped Greece and Turkey maintain their independence. It was valid in the early fifties when the Marshall Plan helped rebuild a ruined Western Europe into a showcase of freedom. It was valid in the sixties when we helped Taiwan and Iran and Israel take their places in the ranks of free nations able to defend their own independence, and moving towards prosperity of their own.

But such a result does not come in a few years. The examples of aid at work are palpably misleading if put against the needs of the developing world, and the failure to achieve similar successes where there is a crying need for managerial and entrepreneurial skills to turn cash into investment decisions which show results has resulted in Congress passing the lowest aid commitment for many years.

Although the British see the provision of aid in moral terms 'to help developing countries raise living standards . . . to promote social and economic development'[1] they see it also 'to raise incomes in the developing countries . . . provide expanding markets for our exports and safeguard the supply of our imports and the return on our investment',[2] the Estimates Committee of the House of Commons say:

> One of the points which Your Committee have had to consider is the suggestion made by some witnesses that too much stress has been laid on the moral purpose of the aid programme at the expense of British trade interests.[3]

The charge of 'toothless bulldog' is also one that does not encourage a substantial increase in the aid programme, and it has been the

[1]7th Report of the Estimates Committee (Overseas Aid), H. of C. Papers 442, 23rd October, 1968. §8, Quotation from White Paper 'Overseas Development: The work in Hand' (Cmnd 2736), August 1965.

[2]*op. cit.*

[3]*op. cit.*, §10.

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aim of many to ensure that British aid does not go to those who 'spit in our face'.

The Basis of Private Investment

Private capital is not governed by these constraints. An investor can be bold, he does not have to look over his shoulder to his constituents to answer charges of wasting money. He does not have to justify the employment of top administrators at competitive salaries to manage his funds in the way that charitable organizations must do. He does not have to take note of the timing of elections in the time-scale of his operations. A lengthy pay-off cycle may be necessary for the success of a venture—to take an example very near home, our own electricity industry has invested its resources diligently over the last twenty years with slender profitability and at the butt-end of everyone's jokes but now the pay-off is beginning to show with greater profitability, falling electricity prices and greater security of supply. In aid terms twenty years seems too long a time to wait for something to happen; in private investment terms it may be possible—the railway investors of the nineteenth century bought and speculated in shares which operated on a much longer time-scale with even less return than might be expected from a steel mill in India.

One of the main reasons why there is antipathy to private investment is the consideration that investment is for a return. Professor Streeten advances a thesis that the existence of a flow back to the investor automatically ensures that the interests of the country in which the investment is made—the people, and the plant—are subordinated to the interests of the investing agent. Geoffrey Chandler in an article in *Economic Age* (November-December 1969) dispels this by arguing that the primary duty of a company is to be efficient, and that if it is not efficient, wherever it may be, or under whatever pressures it may be working, then it is failing in its duty. The myth of subordination of interests is a form of modern scapegoatism of the same order as the myth that the British economy is subordinated to the gnomes of Zurich.[1] On the other hand it is well to realize that there are tensions involved in overall planning and that in some cases very short time-scales conflict with the necessary long time-scale for the good working of a project. This may happen both on the investors' side *and* on the side of the country in which the investment is made. For example, if the investor thinks that there will be a political upheaval in the country in which he wishes to place his money, he will consider how long he thinks it will be before this upheaval takes place and will aim to have made a return equal to his original investment by that time. On the other hand, the country in which investment is made may consider that it is in

[1]Richard Bailey, 'Joint Ventures and Development: the Economic Alternative', in *Economic Age*, I, 6, 1969, and Geoffrey Chandler, 'Private Investment and the Developing Countries', in *Economic Age*, II, 1, 1969.

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their best interest to encourage as great a use of labour as possible in order to solve the unemployment problem. The company must resist these pressures and do what is in its own best interests. Its own best interests, if these are firmly based on the concept of efficiency, cannot fail to be the best interests of the country involved (subject to certain assumptions, to be mentioned below).

A further factor in the debate on return is that there is a flow of money from the poor to the rich country. This is regarded as the prime reason why private investment is not the best way to develop a country. However, it may be argued that the existence of this flow serves to concentrate the mind wonderfully on the problem of making a profit. If there is no incentive to increase wealth then it is highly probable that the whole process will be inefficiently organized. Furthermore, for those who would wish all investment in developing countries to take the form of that granted by the International Development Association at interest rates of .75 per cent there is a basic dilemma that cheap money may encourage the view that investment funds are plentiful and that many schemes can be tried out without being put under the critical criteria of investment analysis. There are certain projects in the field of social welfare and general infrastructure development which must fall into the category of 'desirable without looking too closely at their returns', but there are no such projects in the field of small-scale industry and fabrication industries which form the industrial superstructure and which are optional for development. They are optional in the sense that most countries could absorb any number of them, but even a rich country must choose which projects, which industries, it will have. For these there must be profitability goals and it is easy for wrong decisions to be made when politicians, clever salesmen and local entrepreneurs all have their own kites to fly. The aim of development is to invest as little as possible to give the maximum increment in welfare. An inefficient concern borrowing money at 2 or 3 per cent might be sending as much out of the country as an efficient concern which borrowed a quarter of the capital and made it yield 12 per cent.

There is a further matter which must concern us here which relates to the need for markets. The British and Japanese economies were built up on the ability to export. It should be a matter of great concern to us that many of the developing countries of today are being denied the opportunity to export. That this country should see fit to put a 15 per cent import duty on cloth imports from India is a negation of the principles of international trade in the interests of a small and well-organized caucus of manufacturers from Lancashire who have only recently made any attempt to save an industry which has been in decline since the end of the nineteenth century. The existence of a body of investors in this country would go some way towards avoiding this situation since the health of their industries would be threatened by our government's actions. Already com-

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panies are in a position to influence opinion in their Annual Reports as was done in a different context by the Chairman of the Calcutta Electric Supply Corporation Ltd, who in his 1968 report said: 'When this process [of assessing for Corporation Tax income that has already been taxed in the country of origin] is complete, many British companies trying to pay their dividends already heavily taxed abroad will be faced by an insupportable burden of additional tax. I think that it has now come to be widely recognized that . . . the 1965 Finance Act has been less than fair to such companies.'

From this it may be seen that what is good for the company is good for the developing country in which the company is situated.[1]

Conditions of Mutually Beneficial Private Investment: True Partnership

Such debate as does continue on the relative merits of investment in developing countries turns on whether companies established should be wholly owned subsidiaries of a parent company, or companies in which the overseas government, companies or people participate. It is argued that if there is participation and partnership, then the overseas country must give something to the relationship and cannot just be a sleeping partner, or a watchdog that only bites when decisions are made that are politically unpopular. It is adduced that capital participation is difficult not because there is an inherent lack of capital in the developing countries but because investors have not much confidence in their own economies, or have not learned that risk is inevitable in development. It is still the case that often when development is proposed and foreign capital begins to flow in there is an outflow of local funds from the developing country because it is feared that the new development will spoil the market, or upset the traditional source of income in the developing country, and a safer haven for the funds must be found. Technological participation is by definition probably impossible but the developing countries do have one resource to offer which, if any development at

[1] I have taken private enterprise to represent the most efficient method in economic terms of transforming capital, labour and land into productive resources and so into real output, but pure efficiency is not necessarily either humane or developmental. It is for this reason that in this country special arrangements are made for the slowing down of the natural rate of decline in the coal industry or for the introduction of industry to the north-east. So in developing countries, governments have the right and the duty to their own citizens to modify and smooth the effects of efficient transformation. The argument that what is good for the company, is good for the country rests, therefore, on certain assumptions which could be spelled out as follows:

(a) The country in which a firm is situated is strong enough to set its own rules, i.e. it sets the rules of labour hiring and firing, taxation of profits and incomes, company law setting out the duties, obligations and rights of the company, etc.
(b) Labour which is improperly paid is inefficient; i.e. low wage rates yield discontent, absenteeism, sickness, etc.
(c) In order to pay labour adequately it must be backed by sufficient capital to yield a suitable return.
(d) There is no point in installing low yielding assets because (i) the product will be uncompetitive with similar products produced in other countries, (ii) there will be little surplus available for plough-back, tax, etc.
(e) If there are low profits the general environment of the company deteriorates because the country is unable to take sufficient tax to enable it to build up the social and economic infrastructure.

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all is possible, must be made: that of land and possibly of raw materials. Thus, participation is possible in which both sides are contributing to the general good of the firm.

There have been occasions in the past when ignorant savages have signed away their rights in real estate for strings of beads. This type of relationship, even if it comes in the more sophisticated terms of modern trading, must be exposed for the blackguardry it is and be banned by international law. This is outside the scope of the present paper, though it impinges on our theme since its existence vitiates the relationships which might exist between rich and poor. The upright and god-fearing trader and manufacturer at home was tempted too often in the past to make his profits from the ignorance of those who had different values and this has blighted the discussion on investment ever since.

Any investment must be made on terms of equality and legal equity with the country in which it is being made. Only then can the less developed countries move forward without fear of exploitation and take their places in the concert of nations. But equality and equity assume that the recipient knows what is happening and can help in the process of development. There are three main areas in which the developing countries are deficient but in which the position is remediable. These are (1) in information, (2) in management skill, (3) in financial acumen.

Under (1) we may include administrative procedures which ensure that the personnel know what is happening, the advertising skill to ensure that people outside know what they are making, in what quality and for what price, and the ability to recognize what is needed both at home and in the vital export markets, and in what quantity. To some extent this is dependent upon good secretarial backing, and in this the developing countries are sadly lacking. It has been remarked of Julius Nyerere that he once said: 'My state for a good stenographer'. There are well-documented examples of letters and documents being sent from Kenya for typing in London and New York. A great deal of commercial work is dependent—and in this country we fail to recognize it because we take it for granted—upon fairly low-grade but literate secretaries, shorthand-typists and clerks who keep documents in order, advise clients and ensure that the flow of goods through the system is well organized.

In advertising we have a field in which many of the developing countries are also sadly deficient because of the colonial heritage. Raw materials which were the mainstay of the colonial relationship are part of the market-place economy. Their value goes up and down with the state of the market and the quantity for sale. In many cases the differentiation, if any, is made in London at the auction. To the producer it is just 'cocoa' and it is for the manufacturer in Bournville with the skilful help of the admen to turn it into 'Cadbury's cocoa' which is a supermarket shelf product with its own

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connotations of fineness, excellence, and creamy smoothness. A product is transformed in the admen's office. It loses its generic title and becomes an individual thing with a price which moves a few pence up and down but does not reflect the vacillations of the market. There is no reason why, with training, this transformation could not be undertaken in Accra, rather than Birmingham, in Lagos rather than New York.

Management skill was at one time passed from father to son in a very haphazard fashion, and it was the reason for the rise and fall of firms because all sons did not have the application of their fathers. It was felt that such skill could not be taught. Today it is taught. Young men and women are being given a rigorous training in cost analysis, marketing, critical path analysis, O. & M. and all the other techniques which a manager needs to ensure that his firm can be efficient and will be able to turn its raw materials into output profitably while giving the workers the highest possible remuneration commensurate with their abilities. With this we may couple financial acumen, since this too can be taught in the same way. It is today possible to make a fortune out of a single idea providing that it is backed by the resources of a good financial controller and an expert manager and adman. There is no reason why the less-developed countries should not contribute to the pool of ideas.

There is no particular reason why partnership between developed and developing countries should be essentially based on equality in these fields, but development would be easier if the less-developed country could supply some of the essential factors of successful company promotion before accepting capital in order to avoid the possibility, or even the suspicion of being dominated.

Organization of the Capital Market

There are some less-developed countries which are attempting to 'go it alone' without financial help or technical assistance from the rich. There are others who will attempt to model themselves on the organization of the socialist countries. *But for those who wish to trade and develop under the general manner of western capitalist society, the attraction of private capital on terms which do not degrade is important.*

In some areas I see little point in trying to attract private capital—the establishment of the social and economic infrastructure would seem to be a sphere in which public capital should be involved, but in the industries which fabricate the raw materials, the process plants, there would seem to be scope and necessity for private capital from overseas to supplement local capital supplies and to provide some of the initial management and advertising expertise, though this should pass quickly to indigenous labour. The less-developed country should ensure that when it attracts private capital it can successfully trade with the developed world and to this end there is much to be said for creating marketing subsidiaries

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in the rich countries. If sufficient local capital can also be attracted, there might be little need for any net flow from the poor to the rich country in the form of dividends since the marketing subsidiary could make enough profit to cover the dividend payments in the country in all but poor years. But profits tend to accrue in those countries which have the least oppressive taxation in the case of international companies; it would therefore be advantageous when setting up these companies to ensure that the rules favoured the less-developed country. The rich countries have developed their tax laws over many years and have a greater degree of expertise when it comes to assessing tax liability. It has therefore been most practical for companies resident abroad to ensure that dividends are remitted from the least taxed area to the greater taxed area, and this is purely a matter of whim and fortune.

For the true internationalization of the capital market those things which are fortuitous should be removed. An equitable world cannot be a world where one country creates rules to the detriment of another, and the provision of capital in the world is at present painfully distorted by created inequities, *but this need not be the case.* This country could take the lead in creating a society in which the provision of capital for a project in Calcutta was treated equally with a project in Blackburn.

Such internationalism in the field of commerce will also depend upon financial markets in the developing countries. The first step towards viable capital markets is the establishment of banks. Nowhere is this taken more seriously than in India. The *Economist* correspondent writes: 'When four bank branches opened their doors in villages near Delhi on a bright autumn day recently, over a thousand rural folk trooped in to open accounts. By the day's end there were almost two million rupees in the till including a Rs. 200,000 pile—the accumulations of a local temple—brought in a large tin box.'[1]

Another may be the provision of Unit Trusts to encourage small men everywhere with the chance to invest in industry. India and Pakistan already have Unit Trusts, and if tax laws in the developed countries could be changed it would be worth exploring the possibility of creating international unit trusts which sold units to the people of the rich and poor countries alike for investment within the poor areas. It is worth remembering that the Unit Trust idea first came to Britain nearly a hundred years ago for the purpose of investing in the colonies and plantations and so spreading the risk. The idea died and was not resurrected until the 1930s, when the original concept had become lost.

[1]The *Economist* special supplement, 'Boundless Banking', 15th November, 1969. 'The Indian Experiment.'

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Summary

To summarize the argument, therefore, we may say that private investment in the less-developed countries is optional, but can provide the necessary funds for many desirable but otherwise non-urgent projects. It would not be envisaged that private funds should be used in those areas of the economy which yielded little or no surplus for export, those areas which provided immediate social benefit for the populace. However, in those areas in which it is desirable to build up competitive, exportable fabricated products of manufacture, private investment would seem to offer the most rewards. Although the cost of the capital may be high, if efficiently worked it might be cheaper than inefficiently worked capital provided at lower rates. Foreign investment in India in manufacturing yields above average[1] rates of return but is discouraged because of Government restrictive policies, tax difficulties (the problem of double taxation of profits) and protectionism in relation to the import of consumer goods from the poor world.

If private investment is to be disconnected from the spectre of the neo-colonialist, capitalist or imperialist, it must be provided as part of a partnership or co-operative effort in which both sides can give something to the relationship. One-sided relations poison any attempt at equity or equitable commercial dealings, and have been far too common in the past. The way out is to show that the less-developed countries do have something to offer—first, their land and people; second, their resources in cash and raw materials when these can be adequately mobilized; third, their ideas, which can be turned into viable commercial projects; fourth, their skills gained by diligent training in management, advertising and finance. Some of these may only develop over years, after considerable educational advance, but in some cases the skills and the offerings are there.

[1] *The Times*, Special Supplement, 'East of Suez', 7th January, 1969. 'Private Investors Confident', John White, p. 3.

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For further reading:

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**The books so marked are relatively simpler to read than the others.*

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