7 Aid to the Private Sector

The second aid role consists of assisting the private sector, on which successful economic growth will crucially depend. It is no less important to define and limit this aid function carefully.

The leading organisation engaged in this type of work in the Third World is a part of the World Bank group, the International Finance Corporation or IFC, which I headed for over nine years. The IFC deals with private companies direct, providing both finance and advice, in pursuit of the basic aim of economic development. There are also parallel institutions in a number of donor countries, such as Britain, France and Germany.

As in the case of aid to governments, this type of aid activity has also to be justified in the light of market principles. The obvious question is: why not simply leave it to the private sector? Why should any official agency concern itself with what private companies do? The basic case for aid to the private sector rests on the proposition that markets work imperfectly, and that it is, therefore, legitimate to look for ways of facilitating the working of markets and helping private companies and investors to cope with these imperfections. To begin with, however, it is important to understand just how imperfect and flawed the market environment is in much of the Third World.

First, in varying degrees, the legal systems through which business is conducted are deficient. In most countries companies, domestic or foreign, do not have access to an efficient system of courts in which disputes can be settled reliably. For example, enforcing a foreclosure on a mortgage is often either impossible in practice, or at least very difficult, even assuming that all the documentation is in good order. In many cases the law does not impose satisfactory accounting and disclosure requirements and it is often difficult to secure good accountancy services. In a number of countries, even after the general improvement in the past decade, government regulation and interference are burdensome, sometimes including price controls. And in a number of cases, especially in Africa, corruption is a barrier to the efficient conduct of business.
Secondly, the backwardness of financial markets continues to be an obstacle to the smooth functioning of the market economy in many countries. This has been changing in the past ten years or so, but there is still a long way to go. In most developing countries, it is still difficult for companies to raise finance from local banks in the form of term loans, except on a short-term basis. This is slowly improving, but conditions are still very different from those in the advanced countries. Equity markets are developing fast in many countries, but markets in debt securities are much less advanced. And in many countries economic conditions are such that real interest rates have to be very high.

Thirdly, there are barriers to investment, especially foreign investment, stemming from lack of information and understanding, and of confidence related to these things. Investors in advanced countries are less familiar with conditions in Third World countries and more cautious about investing there. Political risks, real or perceived, can discourage foreign investment even where the commercial case is strong. Again, things are changing in some parts of the Third World and investment is beginning to flow on a larger scale; but the perception of higher risk is still there.

All this adds up to an environment (and of course the situation varies widely from one country to another) which makes business more difficult than in the advanced countries. This applies to both domestic and foreign companies, but the difficulties are usually greater for foreigners. So to assist the progress of the market economy, there is room for a market-facilitating aid role which consists of helping companies and investors to measure and manage the risks of investing and operating in developing countries.

But we must be aware of the dangers. The IFC, like the World Bank itself, is owned by governments, which provide its capital. (Since Russia and the other members of the former Soviet Union joined, these owners are virtually all the governments of the world.) The danger is that, because it is a powerful government-owned agency, its efforts to help the private sector will in fact undermine the private character of its clients. Official financing of the private sector, like investments undertaken by governments, may displace and crowd out market financing. It may reduce or