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The role of the European Development Fund

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or otherwise of a firm is determined by a whole range of factors, all of which contain most different elements.

Some progress can be made, however, by considering what single factors influenced the decision by an investor to invest in Africa. Past experience here can open up perspectives for the future. We can explain the obstacles and incentives and how—by overcoming or exploiting these—investment activity can be stimulated and steered.

A government decides its investment policy on the basis of politico-economic concepts, economic priorities or social economic considerations. The private investor, however, acts in a different way. The only decisive factor for him is whether an investment will be profitable. Such profitability thinking is characteristic of private investments. An entrepreneur who is accustomed to operate in a free economy acts on the basis of economic principle and according to the profit outlook. Therefore he

also expects to make a profit from his overseas investments because "business without profit is madness". The private investor will, therefore, consider whether his investment in capital, technical know-how and entrepreneurial initiative is likely to be more successful in Europe, or in developing countries such as the African states. His decision to invest will depend essentially upon his estimate of the risks to be run and the chances of profit. In order to assess these factors, he must have a precise knowledge of the particular developing country's economic situation. Much will depend upon the judgment of his local partner who will normally be more familiar with the market than any foreign investor: often this partner has previously acted as his export agent. It is absolutely essential to service and prepare the market and estimate correctly the quantitative and qualitative requirements of the market. Market size is of particular importance because it determines production capacity.

It is also of the utmost importance for the investor to be well-informed about the investment climate in any particular country. It must be appreciated in advance that practically all developing countries are competing against each other to attract private capital and in order to do so they must offer favourable conditions. Political stability, economic security and a stable currency are of cardinal importance here. The West German Government, it is true, offers the German investor a certain amount of assistance by concluding capital promotion contracts, special depreciation allowances and guarantees for insuring against the so-called "political risks"; but experience has shown that such assistance alone is inadequate to promote private investment. Nationalisation, or the threat of this, invariably stops the influx of private capital. By contrast, the greater the security of economic and political conditions in a country, the more that country can count upon attracting private capital. *Dr Herbert Mittendorf, Cologne*

The Role of the European Development Fund

The last analysis of the position of development aid published by OECD shows, on the whole, a definite rise in private investment. This is borne out by the table next page.

What is remarkable in this development, where 1965 was particularly encouraging, is the rise in investment. This is due, in the first place, to an increase in new investment. It seems premature at this stage to deduce from this increase any lasting or even rising trend. Future development is difficult to forecast, since the scanty material at our disposal permits no really sound prognosis.

The influx of private capital from EEC countries to the 18 associated African states and Madagascar probably amounted be-

tween 1960 and 1965 to about \$ 100 million annually—exact statistics are not available. This means that these states received about one seventh of the private capital which flowed from EEC countries into developing countries. Of this, rather more than half was derived from reinvested profits. A number of indications lead us to expect this rising trend to continue.

Differential Investment Incentives

One of the main obstacles to German private investment in the associated African states is probably the small size of the markets—apart from other problems mentioned above. In spite of local customs unions, African markets are far too cut up by political frontiers. Distribution costs are

also high, because of scattered and weak concentrations of purchasing power. The creation of production units capable of replacing imports is also handicapped: concentrations of demand and purchasing power occur mostly near the coasts and can quite easily be satisfied from overseas at low sea transport costs. Additionally, the exchange rate for CFA francs is advantageous for the import of industrial goods and domestic production finds it difficult to compete with these. The threshold of profitability for new domestic production units is, therefore, comparatively high. Markets in the associated states are often too marginal to stimulate interest amongst European or American manufacturers and encourage them to shift their production capacities to Africa.

On the other hand, to build up export production aimed at the established industrial countries may become quite profitable in certain instances. This is particularly so for exports of certain mineral and vegetable raw materials. Indeed, between 1960 and 1965, more than half of all private investment in the associated territories seems to have been connected with opening up mineral deposits (oil).

It must be admitted that this type of investment sometimes encounters psychological resistance on the part of African governments: this is for historical reasons. They still have memories—however unjustified—of the traditional plan for a division of labour and world trade (the colonial pact), with its undesirable effects on the social and economic development of developing countries.

Real Competitive Disadvantages, In spite of Legal Equality

The private investor resident in EEC member states which had no previous traditional relations with African countries is likely to meet with particular problems. As we know, the German "colonial" epoch in Africa was a short one and occurred a long time ago. For many years, therefore, Germans had very limited opportunities to invest capital in Africa; in the former French territories, such opportunities were practically non-existent. Such considerations apart, German firms are, in general, more inclined to export to Africa than to invest there. This attitude still survives and may have been instrumental in restricting German investment in the associated states (1960-1965) to a mere 3 per cent of the total foreign investment.

The practical difficulties which German investors have to face, even nowadays, are obvious. Whereas the Yaoundé Agreement established the legal equality of all subjects of EEC member countries, it could still not abolish immediately all the real competitive disadvantages which have accrued from decades of historical development. If, for instance, a German businessman wished to switch from importing to local production for import substitution, his lack of knowledge of local market conditions would constitute a considerable risk for him. To set up manufacturing units for export he would need to have detailed knowledge of local conditions in the country in question. His competitors from other European countries with traditional connections with associated states enjoy undoubted and considerable competitive advantages. They not only know the country and its people, but also have many informal contacts in government and business circles. And naturally, they also profit from the fact that all modern developments in the legislation, administration and often the entire economic structure of an associated state tend to derive from the spirit of the mother country; they are thus familiar with this structure, even though there may be slight differences. Generally speaking, they are so closely associated with existing structures that they may easily be tempted to bar all access to undesirable competitors. This is a very real damage, alleviated to some extent by a general willingness to co-operate in European circles.

The importance of this close link with formal and informal contacts

becomes particularly clear when we consider that in most associated African states, investments are channelled, if not actually regulated. African governments promote certain definite investment sectors—usually on the basis of existing development plans—whilst neglecting other spheres. Thus, for many investors it is an essential element of competition to obtain information speedily about government decisions—or even to attempt to influence such decisions. This is frequently done via contacts with research organisations and the industrial advisers to the governments in question.

Promotion of Investment through the European Development Fund

The European Development Fund (EDF) plays a considerable role in facilitating investment in the associated states. This Fund is administered by the EEC Commission and is fed from contributions made by member states. The first fund ran from 1958 to 1963 and disposed of 580 million accounting units (1 unit = US \$ 1). The second fund, which covers the period 1964 to 1969, has funds available to the amount of 684 million accounting units. Whereas the first fund concentrated almost exclusively on infrastructure projects, the second fund shows a tendency to place increasing emphasis on directly productive investment. It must be admitted, however, that the proportion of infrastructure investments is still running at about 50 per cent. It is also true that infrastructure projects constitute a considerable burden for developing countries because of the necessary follow-up investment. But a certain minimum infrastructure is a necessity in order to be able to deploy productive energy in such countries. In many associated states, this basis still does not exist and it is therefore one of EDF's most important tasks to fill this gap.

In connection with the promotion of private investment via EDF's infrastructure investment, we should do well to distinguish initially between "general" and "spe-

Development Aid by DAC Countries
(expressed in million of US \$) *

Year	Total Funds	Private Funds			Public Funds
		Total	Investments	Export Credits	
1962	8,600	2,500	1,800	700	6,100
1963	8,500	2,400	1,800	600	6,100
1964	9,100	3,200	2,300	900	5,900
1965	10,200	3,900	3,200	700	6,300
1966	9,900	3,400			6,500

* Source: OECD, *Efforts et politiques d'aide au développement*, Examen 1966, p. 168-196.

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cific" investment. In the case of general investment, private investment is promoted only insofar as this coincides with the public interest. Initially, measures taken by the Fund are always concerned with the overall economic development of a particular associate state or group of states. The administration of the Fund quite pragmatically supports those projects which promise the greatest economic and political advantage.

On the other hand, private enterprise disposes, perhaps, of the most important instrument for promoting private investment in the EDF's financing the planned infrastructure projects. The development of private enterprise in Africa is often inhibited by the need for investment in infrastructure which would not be necessary in industrially developed countries since such structures are already in existence there. There are several instances of such specific infrastructure investments: the Fund has undertaken the financing of the Koudougou (Upper Volta) water supply project; this then enabled a textile factory to be established, which is supported by private groups. It has made available funds for the construction of a power station in Garoua (Cameroon), and thus made it possible to establish another private textile factory. The financing of transport systems (railroads,

harbours and roads) also falls into this category; these are indispensable for the establishment of private enterprise in the raw material sector, such as the extraction of mineral deposits, the establishment of fish-processing industries or the exploitation of remote forests. The number of specific infrastructure projects is not yet particularly high, but is increasing steadily.

There is a close link between this type of enterprise and certain productive investments made by the Fund in agriculture or the public services, which precede or follow on upon private foundations. This includes measures to increase production of agricultural produce to a level where it is possible to set up private processing plants. The building of slaughter houses is linked with measures to promote cattle breeding and delivery of cattle (by developing transport facilities); this creates a basis for the foundation of secondary industries (like canning factories or tanneries).

Better Market Information

In Africa, like everywhere else, exact knowledge of local development conditions is indispensable for successful investment. This applies to government agencies as well as to private enterprise. The regional studies financed by the

European Development Fund and its project studies frequently give valuable information on the situation in a particular market, transport conditions, availability of raw materials, fiscal legislation, etc. The private investor can thus obtain indications about investment opportunities and sometimes even details about the successful operation of individual projects. A comprehensive analysis of industrialisation opportunities in all associated African countries has been initiated and financed by the Fund and will shortly become available to all interested parties; this will serve directly the promotion of private investment. It points up real investment opportunities which it is hoped will be of interest to businessmen, including those European investors who have hitherto felt that these markets were closed to them. It will be particularly useful because it supplies information of a kind that had been hitherto unobtainable or incomplete.

Training Management Personnel

The availability of qualified local managers and skilled labour is often one of the essential elements in the success of foreign investment. In the initial stages of a project, perhaps, the European investor in Africa can afford to employ highly paid European personnel, but certainly not in the long term because the payment of—apart from the top management—such high salaries would raise the profitability threshold to the extent where the whole undertaking would become unprofitable, so that the European entrepreneur would lose interest in such an investment.

This is where the European Development Fund's opportunities occur; for its own grant-aided training courses it can select sufficient candidates who may later prove themselves as managers in industry. It may be said that the essence of EEC's grant-aided training courses lies not so much in the preparation of candidates for future administrative work as in the study of agriculture, industrial

know-how and technical procedures. Whether this system will really achieve the intended reinforcement of the personnel infrastructure for private industry is a problem largely beyond the influence of the Commission. The danger here—that the host of somewhat unproductive white collar workers may be increased—must be accepted.

Training problems and those connected with possible "white collar" risks are naturally less in the case of skilled labour training. In connection with the foundation of a private enterprise, the Fund has financed the training of a core of specialists in suitable institutes and firms. A special decision on the part of the EEC Council was necessary to push through the Commission's view that specific training programmes which may benefit the private sector should be considered equally important—if not more so—in the interest of the overall economic development than the training of personnel for government administration work.

Purposive Promotion of Private Investment

Apart from these more or less "indirect" measures for promoting private investments in associated African states, the EDF may also undertake straightforward financing of private investment. It can do this by granting loans on special conditions, i.e. at extremely low interest rates and with repayment periods of up to 40 years (of which a maximum of 10 years are exempt from amortisation). In addition, the Fund can grant interest subsidies on loans from the European Investment Bank, so that the interest rate may drop to about 3 per cent.

It is exceptional, however, for loans to be granted to private enterprise on special conditions. One of the reasons for this is that the Fund concentrates—as has been mentioned—upon overall economic development in the associate states. There is also another difficult

problem: Do the special costs and risks involved in an investment, which is to be encouraged from the point of view of development policy, merit the special treatment of a "soft loan" or would this give it an unfair advantage? Should this type of privilege be accepted because of the country's interest in a particular investment, since otherwise the investor would not accept the risks involved? This line of thought leads us to other awkward questions, like the danger of distortions of competition or of the existing economic structure. It is therefore clear that loans granted to private firms on special conditions must be subject to restrictive rules of procedure. The request for finance must come from the government of the associate state. What is more, the members of the Fund committee involved, i.e. delegates of the partner countries, must be unanimous in their support of such a project, whereas normally a simple majority vote is sufficient.

There are other, purely economic, reasons: In the associate countries, truly productive projects are rare. In addition, Fund regulations demand that capital should be serviced in the currency in which the loan was originally granted, i.e. in the currency of one of the EEC member states. This creates an additional obstacle. For this reason, the Fund can only consider projects which not only offer a proper degree of profitability but are to be carried out in a country whose balance-of-payments situation promises that the capital will be serviced in the medium and long-term. Membership of the Zone franc is not, in itself, likely to be considered adequate in view of the various risks and uncertainties.

Unorthodox Methods

The Commission has attempted—with limited success, it must be admitted—to extend the range of loans to private investors by unorthodox means. The EEC Council has been hesitant about going

along with the Commission's proposal to grant, in one particular case, a loan to an associate state for transfer to a newly founded firm. In this particular case, the firm was a profitable one, but operated in a country with a definite balance-of-payments deficit. As a first step, the government of the associate state obtained a loan on very favourable conditions—having regard to the adverse balance-of-payments situation; the government then passed on the loan to a private firm on almost normal business conditions, having arranged for both interest and capital to be serviced in the local currency. The difference which thus accrued to the government was then to be used for future development inside the country, based on a decision to be taken by the Commission at a later date.

Private investment potentials inside the associate states and its encouragement within the framework of EDF's investment policy have not yet been exhausted. This also applies to investors in member states which have no particular traditional ties with certain associate countries. In many cases, difficulties can be overcome through contact with firms already established in the associate state—and this must certainly be what is meant by European co-operation.

The actual mechanism of association could also be improved. A renewal of the association agreement, which is due to expire on 31st May, 1969, will provide an opportunity to make the Community's provisions for giving aid more flexible and versatile; it might be worthwhile reconsidering the old project of a European credit insurance. The first European Development Fund was particularly concerned with infra-structures; the second placed special emphasis upon productive investment by the state; a third Fund might devote itself mainly to the promotion of private investment.

Heinrich Hendus, Brussels