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Private Sector Development in the context of Poverty Reduction Strategy Papers[1]

Niklaus Eggenberger-Argote

Contents

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[1] The following paper is a desk study of existing literature on behalf of the Swiss State Secretariat for Economy (seco).

Executive Summary

There is broad agreement that economic growth is a powerful tool for combating poverty: no country or region in the world has successfully reduced poverty in a non-growth environment. However, many interactions between economic policies and poverty are still not well known. This paper aims to provide an overview on: the significance of economic and, in particular, private sector development for poverty reduction; the role of the private sector in current PRSPs; and intervention opportunities for international donors.

The study reveals that:(1), Economic growth is a necessary, although not a sufficient, condition for poverty reduction. The extent of participation of people living in poverty in a growing economy matters.(2), Job creation is one of the major paths out of poverty, and private enterprises are the main source of jobs in almost all developing countries. However, (3), before putting trust in market extension and private sector development (PSD), numerous regulatory frameworks must be in place (e.g. to guarantee property rights or to assure competition). (4), Among private enterprises, Small and Medium-sized Enterprises (SMEs) play a leading role in employment and income generation for broad and often less privileged sections of the population. (5), No general recommendations can be made on private sector participation in the provision of infrastructure and basic services. The issue is very controversial and knowledge still “embryonic”. A case-by-case approach should be adopted.

Taking the positive role of the private sector for growth and poverty reduction into consideration, PSD should find its way into PRSPs. Recent studies of existing PRSPs reveal that: (1), PRSPs to date do take the private sector into account as a key factor in achieving poverty reduction. (2), However, some countries see the private sector as an adjunct of government policy, with directives guiding the development of the private sector, and subsidization being a key tool for poverty reduction. (3), The most serious weakness is a lack of concrete benchmarks and progress indicators. (4), Annual Progress Reports, most of which show a serious intent to implement the general propositions of the PRSPs with regard to PSD, might often provide a better source than PRSPs for drawing reliable conclusions on a country’s PSD efforts. None of the studies indicates whether or not the informal sector has been given any consideration in the reviewed PRSPs . Civil society organisations are concerned with the lack of country ownership of PRSPs and the strong influence of the World Bank and the IMF in policy-making. In many cases, it seems that no importance is attached to context specific ‘case-by-case’ approaches.

There are concrete opportunities for donor action in: promoting effective participation of all stakeholders in elaborating PSD strategies; supporting local governments in improving enabling conditions for PSD; and directly promoting SME development. Furthermore, ways of improving the representation of PSD in PRSPs need to be investigated.

Introduction

Poverty Reduction Strategy Papers (PRSPs) provide a mechanism for focusing policies and resources for development on poverty reduction. PRSPs describe the country's economic and social policies and programmes over a three-year or longer period. Pro-poor policies may cover: broad-based access to resources; priority for basic education and health; labour-intensive production, trade-related measures and the promotion of Small and Medium Enterprises (SMEs); pro-poor redistribution measures; and improvement of gender equity.

Many interactions between economic policies and poverty are still not well known and disagreements persist among policy makers, scientists and donors. This paper provides an overview of the significance of economic and, in particular, private sector development (PSD) for poverty reduction and the role of the private sector in current poverty reduction strategies. In addition, it suggests intervention opportunities for multi- and bilateral donor organisations.

1. Significance of Private Sector Development for Poverty Reduction

Economic growth and poverty reduction

There is broad agreement that economic growth is a powerful tool for combating poverty: The creation of jobs and incomes is a necessary condition for lasting poverty reduction. In addition, profitable industrial and commercial activities contribute to increased tax revenues and therefore strengthen the economic basis for public expenditure on health, education, and infrastructure, which in turn gives people in poverty a better chance to increase their productivity and earning capacity. Empirical data for several developing regions illustrate that the incidence of poverty is, at any time, largely a reflection of a country's previous economic growth performance. This is particularly true for the developing countries in Asia where poverty incidence decreased following growth acceleration in the 1980s and early 1990s, whereas the negative growth resulting from the 1997 financial crisis led to a rise in poverty incidence in the affected countries. The absence of economic growth is almost certain to result in large public budget deficits, a reduction in the basis for investment in health and education and increased dependence on development assistance. Indeed, no country or region in the world has successfully reduced poverty in a non-growth environment. In short, growth is critical to development. Without economic growth, sustainable poverty reduction will not be achieved.

While economic growth is necessary, it is not a sufficient condition for a lasting reduction of poverty. There are low- and middle-income countries with middle or high human development (e.g. Cuba, Uruguay, Tajikistan). The degree of poverty reduction depends on the type and pattern of growth and how the benefits are (re-)distributed.

The extent of participation of people in poverty in a growing economy is key; economic growth has to be broad-based. 'Trickle-down' theories, meaning that economic growth and increased income for some actors within the economy will 'trickle down' to other layers of society and indirectly lead to an improved situation for the whole population, have not proved to be reliable. Numerous studies have shown that such 'trickle down' effects have in many cases been very weak. Targeted pro-poor policies are crucial. The overall impact of economic growth depends on a number of other factors, including the (re-)distributional mechanisms within a country, the share of the income increase going to nationals, and hence remaining in the country, and the share going to foreign investors, who take the money back to their countries.

Private sector and poverty reduction

Job creation is one of the major paths out of poverty. Sustainable development and poverty reduction, therefore, require the development of productive sectors in order to create jobs, generate income and so reduce poverty. In almost all developing countries, including China, private enterprises are the main source of new jobs. Attempts to create jobs by governments and state-owned enterprises have often turned out to be unsustainable. In most developing countries, the private sector produces the lion's share of the country's output and Gross Domestic Product (GDP), and generates a large portion of the government tax revenues necessary for funding public health care, education, social safety nets, etc. In competitive economies, leading private firms constantly seek out information that has practical local uses. In this process, executives and employees upgrade their human capital, productivity, and incomes, contributing to the diffusion of useful knowledge and techniques. Over time, competitive firms improve the quality of products and make goods and services more affordable, thereby boosting the purchasing power of the consumers – including the poorer ones. A vibrant private sector is an essential prerequisite for triggering economic dynamism, enhancing productivity, transferring and diffusing new industrial technologies, maintaining competitiveness, contributing to entrepreneurship development and, ultimately, poverty reduction.

Not all private enterprises in all environments, however, generate jobs, investment, and human capital and thus contribute to poverty reduction. This is mainly due to unnecessary impediments to private sector development (an unfavourable investment climate) and the absence of regulatory frameworks, policies and strong institutions capable of preventing high concentration and abuse of market power (monopolies, oligopolies, 'market failure'). In addition, poverty reduction is completely dependent on: private sector development resulting in taxable profits; the existence of a functioning system of taxation; the taxes actually being collected; and proper use of the government revenue.

In short, before putting trust in market extension and a well-functioning and effective private sector, a vast number of components must be assessed and regulatory frameworks put in place. Among these are: reasonable government systems promoting adequate property rights and security of contract; a well-developed infrastructure; regulatory frameworks to assure competition; a sound financial sector; a stable macro-economic environment; an appropriate tax policy; and openness to trade.

Micro, Small and Medium-Sized Enterprises and poverty reduction

Small and Medium-Sized Enterprises (SMEs) play a leading role in creating employment, income and value added, and in providing the seedbed for developing and testing entrepreneurial talent. The comparatively high share of employment SMEs provide shows that they play a major role in income generation for broad – and above all often less privileged – sections of the population. This is why the development of the SME sector in developing countries increasingly figures as a central element in poverty reduction strategies.

Self-employment/micro-enterprises, as a means of subsistence, are the economic backbone for the livelihoods of large sections of the population in low-income countries. However, often they offer only limited growth prospects. Nevertheless, because of the employment and income they supply, they are highly relevant for development policy.

Small-scale enterprises – classified somewhere between the subsistence-only economy and the SME-sector – aim at earning a sufficient surplus for reinvestment. The more they provide poor sections of the population with employment, income opportunities, and goods and services, the greater their contribution to poverty reduction. Promoting small enterprises, therefore, lays the foundation for a domestic economic structure in which small enterprises can gradually act as suppliers to larger-scale enterprises. Small enterprises also mobilise entrepreneurial initiative and autonomy. This strengthens not only economic but also pluralistic and social emancipation processes – which particularly benefit women, who are heavily represented in the small enterprise sector.

Experience has clearly shown that promoting small-scale enterprises reduces poverty (increasing and stabilising income, human resource development, improved lobbying and problem-solving capacity) but does not generate substantial economic growth and employment, due to persistently small workforces and low investment volumes. *Large-scale firms* show the highest shares of added value, productivity and advance in productivity. However, an increase in value added and productivity is rarely compatible with an increase in employment – at least not in the short-run. Strong economic growth *and* increased employment can best be achieved through promoting SMEs. In many cases, however, SMEs would not survive without some link to large-scale enterprises. The reverse is also true.

Informality and Poverty

Not only the smaller scale of production, but also an extensive informal sector are characteristic of the business sector of many developing countries. Because of their scale, smaller firms are especially vulnerable to bad government, poor policies and weak institutions, and are therefore more adversely affected by high bureaucratic costs than larger firms. For smaller firms, remaining in the unregistered informal sector or 'exiting' the formal economy is often the only refuge. Being in the informal sector, however, places significant constraints on a firm's growth, reducing access to financial and other inputs, limiting access to public services and narrowing the kind of contracts or investments that they can make. Hernando de Soto has argued that the developing world is sitting on roughly US$9,3 trillion in unreleased land value, largely in the hands of poor people, because imperfect property rights do not allow its capitalisation through domestic financial markets. By discouraging enterprise creation and forcing small firms to go underground, governments limit job creation and chances for upward social mobility. A study by the World Bank and Princeton University has shown that an initial investment of US$15 million in legalising dwellings and small enterprises in Perú, between 1990 and 1996, provided US$9,4 billion in additional income to poor people. Moreover, there was a 28% increase in school enrolment in shanty towns where legal security had been established.

Start-up and small enterprises are also the seedbed of the middle class, the weakness of which in the majority of low-income countries hampers economic and social progress. The failure to attract firms to formal market activities also results in the foregoing of tax revenues and serves to undermine the quality and coverage of public services. In short, the informal sector is closely linked with poverty and low growth. Poverty reduction strategies in low-income countries *must* take the informal sector into consideration.

Private sector development at all costs?

Private participation in infrastructure (telecommunications, energy, transport, water or sanitation), and the private provision of basic services, thereby improving basic service delivery by extending the reach of markets, is a very controversial issue.

Supporters of private sector solutions argue that private sector participation in infrastructure and basic service provision can improve the efficiency of the delivery of essential services and extend these to people in poverty, thereby increasing the total amount of resources available, improving equity and multiplying consumer choices. They claim that increased efficiency from privatising utilities can benefit all income classes. Private investment in infrastructure projects that are properly regulated can also relieve pressure on public budgets and, thus, enable governments to redirect more resources to social spending. Central to the privatisation argument is an assumed shift of the performance risk from domestic taxpayers to private parties that appear better able to bear or manage risk. In short, according to advocates of private sector solutions, in providing key social services governments will tend to establish relatively rigid approaches, will be less innovative than the private sector, and will tend to continue with activities long after their usefulness has ended. The pressures of competition, through introducing private sector agents, would tend, in the long term, to solve such problems.

According to critics, private participation in infrastructure projects and the provision of social services gives rise to a number of risks and problems:

- First, experiences of ’shifting risk policies’ have shown that for-profit organisations are fairly risk averse and are not interested in taking on risks without certainty of payments and government guarantees. In order to avoid a demand risk, agreements are called for that include a guaranteed level of output, which will be paid for, regardless of actual demand from consumers – sometimes even in foreign currency if multinationals are involved. In the end, the risk would be shifted to the government and, therefore, the taxpayers, again.

- Second, the argument that state provision is in many cases inadequate, and that the private sector is therefore the single solution for the provision of services, does not consider the alternative of improving the state provision or/and expanding access to publicly provided services to cover bigger geographical areas. Many citizens in developing countries rightly emphasise that the developed world wants to impose and promote private solutions in developing countries, although public provision in developed countries seems to work fine as regards basic services such as health and education.

- Third, governments with weak capacities for service provision also have weak regulatory capacities. Therefore, privatising into an unregulated environment will foster unregulated private monopolies for essential services, with obvious adverse consequences for welfare – especially for poor people. Generally, experience shows that private firms tend to neglect service delivery to unprofitable populations.

In order to guarantee full access of poor customers to basic services provided by private sector agents, the World Bank has put forward the ’output-based aid’-model (OBA), stating that all service users should pay the full user fees, while government subsidies will be provided to poor customers. Public funding, therefore, will no longer be linked to the provision of services (e.g. financing inputs), but to service delivery, helping to enhance the purchasing power of poorer consumers. However, several concerns have been expressed about OBA-systems. These include: the difficulty of identifying eligible people in order to properly target subsidies; the incentives for private providers to pocket subsidies; the lack of regulatory mechanisms to oversee and enforce OBA-contracts and to ensure that services are delivered in acceptable ways;

the lack of judicial mechanisms that permit poor users to appeal or seek recourse when a contractor fails to deliver services in the specified manner; and the fiscal liabilities assumed by the public sector when OBA schemes fail.

In short, even the World Bank had to recognise that knowledge on how to use private initiative to improve health and education strategies is still ’embryonic’ and that the challenge lies in strengthening the analysis and finding ways to broaden the options for engaging with private firms that are consistent with overall social sector policies. On the one hand, there are examples of successful state-led service delivery in industrialised and developing countries; on the other, there is evidence of the limitations of private sector provision. It is not possible, therefore, to make general recommendations; a ’case-by case’ approach should be adopted.

2. Review of the Private Sector Role in PRSPs

Taking into consideration the positive role of the private sector, and SMEs in particular, in growth and poverty reduction, PSD should find its way into PRSPs. But do PRSPs, being primarily government instruments, in themselves provide any focus for business? This section will go further into the questions of whether PSD was integrated into existing PRSPs, and what kind of policies have been adopted (e.g. is there a case-by-case approach, with varying policies between the different countries, or does a ’cookie-cutting' approach seem to dominate?)

Is private sector development part of PRSPs?

Two studies conducted by USAID, in 2003 and 2004, reviewed the role of the private sector in the formulation and implementation of the strategies articulated in PRSPs endorsed by the World Bank and IMF. The purpose of both studies was to determine whether PRSPs had, to date, taken adequate account of the role of the for-profit private sector in reducing poverty. The earlier study reviewed the first 27 PRSPs approved by the Boards of the IBRD and IMF; the second study examined the 21 PRSPs endorsed for countries in sub-Saharan Africa, as well as the 13 Annual Progress Reports (APRs) submitted during the implementation of the Poverty Reduction Strategy. The main conclusions, which were very similar for both studies, were as follows:

- All reviewed PRSPs clearly endorsed economic growth as essential for poverty reduction; some reports characterised economic growth as necessary but not sufficient, but none of them was sceptical of economic growth, per se. Virtually all the PRSPs identified a sound macroeconomic framework as critical to the poverty reduction strategy.
- One third of the 27 PRSPs reviewed in 2003, and one quarter of the 21 African PRSPs placed little faith in market forces as a tool for poverty reduction. The

countries where market forces were not considered to be central typically saw government as playing a leadership role, directing the private sector's activities in the most socially useful directions. In such cases, PRSPs indicated that subsidies, directed credit, and preferential treatment for some enterprises or sectors would be applied.

Ethiopia is a case in point. It seeks to promote the private sector by directing its development through a variety of government programmes that subsidise or lead the private sector in desired directions, but expresses no commitment to the use of market forces or to market activity that is beyond the reach of government.

- Nearly all of the countries accorded a key role to the private sector in poverty alleviation, usually in conjunction with sound macroeconomic policies. However, as noted above, there is a need to distinguish between support for 'the private sector' and 'support for market forces'. In the majority of the countries studied, the private sector participated in the PRSP process.
- Most PRSPs reviewed in 2003 endorsed trade liberalisation. A minority focused on export promotion, while ignoring the key role of imports in improving welfare. However, there seems to be a significant regional variation in PRSPs with respect to trade liberalisation. Sub-Saharan African countries were less likely to include it than those of other regions: only about half of the African PRSPs reviewed in 2004 endorsed trade liberalisation. Most African countries that did endorse it did so in the context of integration into one of Africa's regional free-trade agreements. All four Latin American countries and all but one in each of the Asian and former Soviet regions reviewed in 2003 endorsed trade liberalisation.
- Virtually all countries stated their intention of improving the legal, regulatory and judicial system. Usually, this included steps to reduce corruption, actions to strengthen the independence of the judiciary, and promotion of the rule of law. The difficulty is with implementation. Typically, there is a lack of specificity with respect to the means by which these ambitious goals are to be achieved.
- The most serious weakness in most PRSPs reviewed in 2003 and 2004 was the lack of concrete benchmarks or progress indicators for commitments with respect to the private sector. Only very few PRSPs met modest standards in this area. But the existence of such benchmarks and time-bound progress indicators is key in turning rhetorical commitment and general statements into concrete policies and improvement. This is, therefore, clearly a neglected area in the PRSP process.
- Most PRSPs contemplate a role for the private sector in infrastructure services. Only seven of the 27 reviewed in 2003, and five of the 21 reviewed in 2004 did not include this option as part of the Poverty Reduction Strategy. In

some of the countries where this option was not considered, government also generally tended to be more suspicious of the private sector. Only a small minority of the PRSPs consider involving the private sector in delivery of social services. The countries that do propose action in this area identify only limited actions, usually with very general statements. E.g. Benin notes an important role being played by private institutions in education but the PRSP appears to propose action only for public schools.

- Most PRSPs reviewed in 2003 contemplate a reduction in the role of government in controlling and directing the economy; but only slightly more than half of the African PRSPs reviewed in 2004 did so. One third of the PRSPs reviewed in 2003 – and 10 of the 21 African PRSPs reviewed in 2004 – were judged as seeking a larger role for government in economic activity. All countries of the former Soviet bloc countries intended to reduce the role of government.

- The 13 Annual Progress Reports (APRs) reviewed in 2004 suggest that some modest progress is being made in identifying ways in which the private sector can be a more powerful engine for growth and poverty reduction. Most of the APRs show a serious intent to implement the general propositions of the PRSPs with respect to the private sector, and to provide a satisfactory treatment of the private sector in the APRs.

In short, PRSPs do in general duly take the private sector into account in their development, implementation and strategic conception; in the majority of countries studied, the private sector participated in the PRSP process. In most countries, the PRSPs treated the private sector as a key factor in achieving poverty reduction over the long term. In countries with less faith in the private sector, two types of problems emerged. First, some PRSPs saw the private sector as an adjunct of government policy, with directives guiding the development of the private sector. Second, some PRSPs saw subsidisation of the private sector, or particular industries within it, as a key tool for poverty reduction. The most serious weakness in most PRSPs was the lack of concrete benchmarks or progress indicators for commitments with respect to the private sector. It is not apparent from the studies whether the informal sector has been given any consideration in the reviewed PRSPs, although some proposed policies clearly encourage a ’formalisation of the informal sector.

While judging PRSPs in such a general way, one has to bear in mind that PRSPs are typically documents of several hundred pages, with more or less glaring internal inconsistencies. No document of such length is likely to be completely internally consistent. Instead, such documents tend to be the amalgamation of the efforts of different people with different visions or aims, cobbled together with superficial efforts to produce the appearance of coherence. In this regard, the APRs, showing a serious intent to implement the general propositions of the PRSPs with respect to the private sector, might provide a basis for more reliable conclusions.

What private sector policies are included in PRSPs?

Many civil society organisations in the North and in the South, together with various other stakeholders, have expressed concerns that the policies in the PRSPs look very much like the policies and reforms promoted under the Structural Adjustment Programmes (SAPs). Against this background, in April 2001, the World Development Movement investigated the macro-economic content of 12 interim, and four full, PRSPs and concluded that the consistency of policies put forward was remarkable, given the different histories, characteristics and drafting processes of the 16 countries surveyed. The general thrust of the macro-economic policies found in the PRSPs and Interim-PRSPs seemed very similar to that of standard SAPs in the past.

In April 2002, the European Network on Debt and Development (EURODAD) looked at 10 PRSPs that had then been finalised. The results are consistent with the main findings of the above-mentioned study. EURODAD concluded its research stating that the core policies across all the countries are 'fairly similar'. The different country documents all included policies on: privatisation (privatising telecommunications, energy, public enterprises, railways, ports, airports, electricity, oil, gas, water, banking, factories, pension systems, transport, air and water); withdrawal of the state from productive activities and marketing; expansion of the role of the private sector (making the private sector the engine of growth); stimulation of private investment (e.g. in infrastructure/utilities, production, marketing, agriculture, tourism); and efficient delivery of services to the private sector/removal of constraints on the private sector. In short, the emphasis in the 10 PRSPs is on privatisation, stimulation of private investment, be it foreign or domestic, and on the removal of constraints on the private sector.

A 'one-size-fits-all' approach to policy formulation is further commented on by a civil society organisation in Tanzania, which noted that specific reform measures, such as trade liberalisation, privatisation, fiscal austerity, retrenchment, and cost-sharing, have been adopted as a universal formula in all African countries, without taking into account specific differences and the probable impact on poor people, women, and youth.

According to EURODAD, policies to encourage fast economic growth and low inflation, as put forward in the PRSPs and Interim-PRSPs reviewed, are mostly the same as those at the centre of the SAPs. In a desk study of six full and 17 Interim-PRSPs conducted by 'Save the Children Fund UK', it is noted that only a quarter of these PRSPs and Interim-PRSPs contained a statement about ensuring that growth is equitably distributed, suggesting faith in the power of growth alone to reduce poverty.

In brief, PRSPs to date seem to have taken account of the role of private sector (at least in the formal economy) in reducing poverty, although some of the objections mentioned above make it difficult to distinguish between true intentions for action and mere lip service. Civil society organisations, however, are concerned about the lack of country ownership of PRSPs and the strong influence of the World Bank and the IMF in policy-making, promoting the same type of macro-economic policies as before. In many cases, ‘one-size-fits-all’, rather than appropriate, context specific ’case-by-case’ approaches, seem to dominate.

3. Opportunities for support

What can international donor organisations do in order to promote sustainable and pro-poor PSD in developing and transition countries? Starting points and opportunities for action can be identified in different areas, such as: supporting local governments in improving enabling conditions for private sector development; directly promoting SME development; and boosting the active involvement of the domestic and international business community in poverty reduction strategies. Furthermore, international donors need to investigate ways of improving PSD representation in PRSPs.

Contributing to an enabling environment

As discussed before, in many developing countries and countries in transition the business environment includes many unnecessary impediments to PSD; the investment climate must be improved considerably. The goal of a strategy to improve the investment climate is to design and implement policies and institutions that increase opportunities and incentives for PSD and contribute to reducing production and transaction costs. In the following section, the main investment climate variables and associated policy areas will be identified and corresponding enabling conditions for PSD described.

Policy area	Enabling conditions
Political system and bureaucratic processes	*Political stability and good governance* Influencing factors: checks and balances, division of powers, prevention of political, red tape and bureaucratic corruption, functioning of civil services, dialogue with civil society, free elections, rule of law, existence of transparent, stable, and effective regulatory and legal structures governing the private sector.
Macroeconomic policy	*Macroeconomic stability* Influencing factors: overall fiscal policy, limits to deficit generation, deficit financing, quality of budget cycle, monetary policy, exchange rate policy, tax laws and other revenue regulations. → *Poverty reduction is particularly dependent on the existence of a functioning tax system, and on the taxes actually being collected!*
Microeconomic policy	*Functioning markets and competitive environment* Influencing factors: Reduction of distorting market interventions, competition policy, anti-trust policy, privatisation and de-monopolisation, transparency and efficacy of public sector procurement, consumer protection.
Trade policy	*Liberal trade regime* Influencing factors: WTO negotiations and compliance, EU accession, regional and bilateral trade agreements, trade policy, tariffs, customs, non-tariff barriers, quality standards, intellectual property.
Investment regime (foreign and domestic)	*Incentives for potential foreign and domestic investors* Influencing factors: WTO negotiations and compliance, regional and bilateral investment agreements, foreign and domestic investment laws and related regulations.
Labour law	*Flexible labour market and adequate labour standards* Influencing factors: wage policy, trade union laws, collective bargaining arrangements, occupational safety regulations, labour mobility, social security laws and regulations.
Finance sector regulations	*Stable, secure, and efficient finance system* Influencing factors: property rights of creditors and debtors, credit information system, banking and securities laws, bank supervision, stock exchange regulations, regulation of capital markets and non-financial intermediaries. → *The provision of domestic instruments for effectively transposing domestic savings into affordable and accessible debt and equity capital to fund economic activity at home could provide dramatic growth in the private sector of the countries. (The capital already in developing countries is much more important than FDI, which captures a disproportionate amount of attention but amounts to less than 15% of capital formation across all developing countries (except China).*

Commercial law regime	*Secure and low cost laws and regulations* Influencing factors: company law and registries, entry regulation, corporate governance regulations, contract law, collateral registries and law, land titling and registration (access to land!), property rights. → *The removal of unnecessary production and transaction costs and the guarantee of property rights (particularly of poor people) enable the entry of informal entrepreneurs/enterprises into the formal economy.*
Judicial system	*Independent judiciary to enforce laws and regulations* Influencing factors: court administration, judicial capacities and procedures, judges' training, supervision.
Public and private supporting systems	*Sufficient capacities and low-cost supply and regulation of public and private goods (and services) in various areas.* Influencing factors: *Human and 'knowledge' capital* (education at all levels, specialised training, technological research and development), *physical infrastructure and environmental goods* (energy, transport, communications, water supply, waste disposal, environment protection in general), *social infrastructure* (health system, pension system, other safety nets); *financial infrastructure* (capacity and quality of the finance sector, barriers to access to capital, particularly for SMEs), *accounting standards* (international accounting and audit standards for private firms and banks, public sector accounting for government entities), *business associations and enterprise clusters* (competent organisations for policy dialogue between the private sector and government).

A worldwide survey of 10,000 enterprises, carried out during 1999 and 2000 under the leadership of the World Bank, points to the leading obstacles to doing business identified by business managers and owners in developing countries. The list is headed by: taxes and regulations, financing difficulties, inflation, and political instability or uncertainty. Among other perceived serious obstacles are: corruption, exchange rate problems and street crime.

Priority concerns of domestic investors and international investors, however, may differ considerably. World Bank research carried out in Mozambique shows that access to finance tops by far the agenda of domestic firms, followed by government policies and demand (not among the concerns of the foreign firms). For international investors, access to finance was also a concern, but was immediately followed by bureaucracy (not among the top three of domestic firms) and government policies. External support should be carefully targeted, with an emphasis on strengthening domestic entrepreneurship.

These findings indicate areas where the need to improve private sector enabling conditions is highest and interventions are most urgently required.

Strengthening Micro, Small and Medium-Sized enterprises

Measures to promote a pro-poor private sector development should also include direct interventions on the micro-level, strengthening the performance capacity and hence competitiveness of SMEs. A major challenge is the pro-poor orientation of this support. It is relatively easy to reach the better off SMEs but much more challenging to strengthen small and micro enterprises. When shaping the supporting policies this pro-poor context should be kept in mind. Several intervention approaches can be envisaged in this regard, such as:

- Improving access to, and the quality and range of, *commercial business development services* for eliminating in-company problems and constraints; support should focus on creating markets for financial and non-financial services. Improving access to credit and micro-finance services is of particular importance.
- Promoting *horizontal and vertical cooperation* among enterprises, particularly through cluster and supply chains; advisory services should focus on setting up supplier links among SMEs and between SMEs and larger-scale or international enterprises; promoting the *assimilation of SMEs into local and regional economic cycles* as part of local and regional economic development.
- *Export promotion* for the SME sector: making contacts with foreign importers, providing information on quality standards and market trends, and arranging attendance at trade fairs.
- Promoting *sectoral-policy dialogue* between SME-representatives (e.g. chambers, associations) and the state sector (e.g. ministries) by strengthening capability for dialogue and negotiation on both sides.
- Providing *business information services* that assess, verify and apply information to a specific business problem, bringing together information from different sources and transforming it into solutions, including ICT and e-business support.
- Developing *rural and women entrepreneurship* through: supporting governments and other stakeholders in improving the regulatory environment for such initiatives; promoting affordable and effective business development services, by strengthening the capacity of both public and private providers to develop the entrepreneurial, managerial and technical skills of rural and women entrepreneurs; building capacities of rural and women entrepreneurs to strengthen their policy advocacy role; developing rural markets and market institutions for agricultural staples, etc.
- Assisting *capacity building* of business, sectoral and professional associations, labour/trade unions, and self-employment associations

- Supporting the application of *environmentally responsible technology and knowledge transfer*, modern management techniques and sound corporate governance policies; supporting innovation and leadership in corporate social and environmental responsibility.

Promoting active involvement of the private sector in poverty reduction

The role of international donor organisations in reducing poverty through private sector development is not limited to supporting local governments in enhancing the investment climate and directly boosting the development of SMEs. Multi- and bilateral donor organisations alternatively should also promote active involvement of domestic and international private sector companies in poverty reduction efforts.

Firstly, this could be achieved through actively promoting and fostering Public-Private-Partnerships. The range of challenges that are faced today cannot be met by governments alone. The only way infrastructure challenges in developing countries can be met is through partnerships of public leadership with private capital. For example, the public sector alone cannot solve the problem of limited or erratic access to electricity of billions of people worldwide. Decentralised local power generation solutions are going to require private know-how, technology and capital in partnership with a public regulatory environment, and probably some public seed capital to make these ventures viable. The same is true with regard to other capital-intensive services where the private sector must be involved in order to meet development goals.

Secondly, there is the question of the terms on which multinationals engage with the developing world and of whether they can become more transparent, accountable and, above all, engaged in the affairs of the country where they operate. It should be ensured that multinationals commit to being more transparent about royalty and investment flows, so that the public can clearly see what money is going where, while also expanding the role of social projects. This vision is a central element of a number of broader initiatives such as the 'publish what you pay' movement or the UN-Global Compact. Some good examples already exist: Coca Cola and Unilever's work in training distributors and retailers across Africa shows huge positive spin-offs in terms of small business development. But much more can and should be done.

Improving private sector representation in PRSP processes

What can multi- and bilateral donors do in order to promote an adequate inclusion of pro-poor private sector development in PRSPs and to guarantee an effective implementation of commitments made? The deficiencies of existing PRSPs described in Section 2 indicate opportunities for action, such as:

- Considering the *inclusion of the informal sector* in poverty reduction strategies and PRSPs and enabling the entry of informal entrepreneurs and enterprises into the formal economy by removing barriers and guaranteeing property rights.

- Creating awareness of the *role and importance of market forces* for sustainable private sector development; if the private sector is seen and treated as a mere adjunct of government policy, private sector development will not achieve its goal.
- Demanding more *specificity* with respect to the means by which, for example, the legal, regulatory and judicial system should be improved.
- Emphasising the need for concrete benchmarks and time-bound process indicators in order to measure and survey implementation efforts of policy commitments. The World Economic Forum's Global Competitiveness Report includes more than 180 indicators that could be used to assess the climate for private sector development; about 100 might also be applicable to the poverty-reducing role of the private sector. Further, the World Bank has issued an important database of indicators that relate directly to the environment for private enterprise in developing countries.
- Promoting scientific research and a broad-based dialogue on the *social impacts of private sector involvement in the delivery of social services*, which is by far the most controversial, and the least investigated, issue relating to private sector development.
- Improving the *basic conditions* under which PRSPs are elaborated, such as: supporting multi-stakeholder approaches and partnerships in developing countries in general; strengthening government and institutional capacity to develop pro-poor growth policies, including analysis and development of policies for the informal economy; building capacities in analysing, formulating, negotiating and implementing private sector, development-related policies in developing countries (civil society organisations are to be included); supporting a broader participation of developing countries and countries in transition in the Bretton Woods Institutions, etc.

Promoting real and effective participation of all stakeholders in elaborating private sector development strategies to be integrated into PRSPs is perhaps the most powerful tool for guaranteeing that proposed strategies are endogenous, country-specific, and widely accepted, and that real 'ownership' and sustainability of the chosen strategies can be generated. Real participation helps to curb the 'one-size-fits-all' approaches affirmed by many civil society organisations in the North and in the South, and many general and specific deficiencies of PRSPs that have been observed can be remedied in advance.

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