

**The UNDP Commission on the
Private Sector and Development**

**Unleashing Entrepreneurship:
Making Business Work for the Poor**

A CCIC Commentary

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March 2004**



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1.0 Introduction

- 1.1 Earlier this month, Prime Minister Paul Martin and Ernesto Zedillo, former President of Mexico, co-chairs of the UNDP's Commission on the Private Sector and Development, presented their report, *Unleashing Entrepreneurship: Making Business Work for the Poor*, to UN Secretary General Kofi Annan. The Prime Minister described the report as “a call to action” to unleash the potential of local small business and the informal, village based micro-enterprises. He pledged at the UN that the report's recommendations “are going to become an important initiative of [Canada's] foreign aid thrust”. The report suggests that “unleashing local private enterprise, supported by strong, indigenous democratic institutions” is “a new pillar of development”. For the Prime Minister, the report's call to action is motivated by “the most pressing challenge we have for the 21st century ...[that is] to end poverty – to realize, in human terms, the aspirations of the Millennium Development Goals”.¹
- 1.2 CCIC's Commentary highlights in the next section some key points in the report's analysis of the private sector and development. It then takes up in a final section some of the report's recommendations in terms of the report's stated goals – unleashing the potential of the private sector in developing countries and engaging the existing private sector to meet the challenge of ending poverty and the aspirations of the Millennium Development Goals. (i)

2.0 Key Elements in the Commission's Report on the Private Sector and Development

2.1 Targeting the poor

The report is premised on the notion that “the private sector is already central to the lives of the poor and has the power to make those lives better” (5). But the Commission's analysis is sometimes unclear on which segments of the poor are the primary target of its recommendations. On the one hand the report acknowledges the immense challenge posed by 1.2 billion people living on less than \$1 a day, whose numbers are increasing when China is excluded. On the other hand, the reference point for much of the analysis of the report seems to be an income pyramid where 4 billion people earn less than \$1500 a year or approximately \$4 a day. The

¹ Paul Martin, “The business of helping others: Global poverty won't end until entrepreneurs are allowed to thrive”, Ottawa Citizen Special, March 2, 2004.

World Bank's *World Development Indicators 2003* calculates that 2.7 billion people or more than half the population of the developing countries lives on less than \$2 a day. As a target population, those at the bottom of the pyramid used by the Commission includes therefore an exceptionally high percentage of the population of developing countries as a whole as well as a significant percentage of the population of countries in transition. As such the bottom of the income pyramid should not be confused with the first Millennium Development Goal that aims to halve the percentage of people living in absolute poverty (the \$1 a day population) between 1990 and 2015.

2.2 Growth, poverty reduction and the private sector

The report is also premised on the notion that economic growth is essential to lift people out of poverty, but in order to do so it must be pro-poor growth; “it must translate into incomes of the poor” (7). Employment is key, including the quantity of employment, the rate of pay as well as productivity and returns for the self-employed. In this analysis, people living in poverty are concerned about both their livelihood and their position as consumers of essential goods and services (water, health, education etc.). The informal economy provides benefits to the poor as employment substitution for those who are excluded or lose their jobs in the formal economy. But the Commission also highlights its concern that the informal private economy, in sustaining the majority of poor people in many countries, does so with goods and services of inferior quality and high cost. It suggests that for poor people “in many cases, where services exist, they are provided by private sources” (8) and that “an innovative [formal] private sector can find ways to deliver low-cost (even sophisticated) goods and services to demanding consumers across all income ranges” (within the right regulatory framework) (8).

2.3 Focus on the domestic private sector and its potential contribution to strong economic growth

The Commission makes a strong case for focusing their attention on strengthening the domestic private sector, which “is likely to create a more stable and sustainable pattern of growth” (9). It adopts the notion of “market-oriented business ecosystems” comprising “many forms of private enterprise coexisting in a symbiotic relationship” (8). The Commission takes up the work of Hernando de Soto in stressing the entrepreneurial potential inherent in the assets of the poor living within the informal economy. They note the importance of agriculture from which 75% of people living in absolute poverty derive their livelihoods. Women constitute the majority of micro-entrepreneurs in the informal economy. At the other end of the spectrum, the report claims that foreign direct investment brings not only substantial financial resources for investment, but also “managerial know-how and best practices. [It also] provides access to international markets, transfers technology and innovation, introduces competitive pressures in previous closed markets and [is] the principle driver for the growth of local business” (9).

2.4 The informal economy is a drag on the potential for entrepreneurship in the domestic private sector

The Commission acknowledges the rationale and contributions of the informal economy to the livelihoods of the poor. However, these same market conditions along with high cost and uncertain (often corrupt) government regulatory frameworks marginalize the potential competitiveness of small and medium enterprises (SMEs) in the formal economy, often to the

advantage of established larger firms. (13) Entrepreneurs in the formal economy are hurt by the implicit subsidies of the informal economy (subject to no taxes and little regulation). Therefore in the words of the report, “more productive firms are less able to drive the less competitive informal firms out of business “ (12), take advantage of economies of scale and increased productivity to thrive. According to the report, widespread informality and the lack of skills affect the ability of entrepreneurs to scale up a business, perpetuate reliance on out-of-date technology, limit access to financial instruments to reduce risk and access to foreign markets. Based on this analysis, a central goal for the Commission’s recommendations is to formalize the economy by creating the conditions to reduce informality and change the composition of the domestic “private sector ecosystem” over time.

2.5 A strong domestic private sector requires a strong foundation in the global and domestic macro-environments, physical and social infrastructure and rule of law

The Commission notes the essential preconditions of a well functioning global macro business environment, the foundations of peace, good governance (the rule of law), transparency and accountability and “sound macro-economic policies” as well as basic infrastructure of roads, power telecommunications, basic education and health. (14-15) The report concentrates on “three pillars of entrepreneurship”:

- *A level playing field for firms competing in the domestic market:* “Predictable rules ensure that entrepreneurs have open access to markets and can do business efficiently. And basic trust in the system encourages entrepreneurship and attracts talent (local, foreign, and diaspora) to embark on entrepreneurial ventures” (17).
- *Access to finance:* Domestic financial institutions must be able to efficiently manage risk and allocate capital to productive investments. However, “many developing countries have had weak, state-dominated financial sectors unable to act as catalysts for development. But where genuine reform has been implemented, the benefits have been quick and evident...” (18). Moreover, when “domestic financial institutions ... operate in oligopolistic or monopolistic conditions, ... [they are subject to] limited shareholder pressure to enter new and more difficult markets, such as lending to small and medium enterprises” (19).
- *Access to skills and knowledge:* “Technological innovations and the shift towards knowledge-based economies make human capital investment a prerequisite for sustained economic growth and central to the start-up, growth and productivity of firms” (19).

3.0 Assessing the Commission’s Recommendations

The Commission’s report has a number of provocative proposals that aim to launch action plans for both developing and developed country governments, multilateral institutions, private sector organizations and civil society. (1 - 3) This Commentary does not examine these proposals in detail; rather it suggests some important issues and approaches as the Prime Minister seeks the means to follow-up the Commission’s recommendations.

3.1 Actions to encourage a strong domestic private sector must demonstrate positive impacts for poverty reduction.

- 3.1.1 *Unleashing Entrepreneurship*'s strong emphasis on strengthening the domestic private sector is most welcome, along with its stated goal of directing support for entrepreneurship in terms of an overarching goal of reducing and eradicating poverty. The report makes some important recommendations that will create a more favourable and enabling environment for strengthening the private sector. Creating more transparent and cost effective legal procedures for small and medium business provides an important legal framework for many who are currently working in the informal sector who may wish to function as small enterprises in the formal sector.
- 3.1.2 It is not clear, however, in either the analysis or recommendations how many of the report's proposals will address poverty. The report seems to make the assumption that those currently subsisting in poverty in the informal sector will necessarily be the beneficiaries of a stronger formal private sector in developing countries. The evidence for this assumption is weak. A recent World Bank cross-country study concluded that the evidence on small and medium enterprises, growth and poverty, "does not support the contention that SMEs are particularly effective job creators".² Moreover, "the size of the SME sector is not significantly associated with the income of the poorest quintile of society, the percentage of the population living below the poverty line, or the poverty gap..."³ While a prosperous SME sector is characteristic of flourishing economies, "cross-country comparisons do not indicate that SMEs exert a particularly beneficial impact on the incomes of the poor, [nor show] a significant relation between SMEs and measures of the depth and breadth of poverty".⁴ More positive impacts from the Commission's recommendations may be distorted by its emphasis on the incomes pyramid where the focus in development policy making is a much broader population – i.e. those living on less than \$4 per day rather than the more recognized poverty measures of \$1 or \$2 a day.
- 3.1.3 CIDA's recently approved policy *Expanding Opportunities through Private Sector Development* recognized the extent of the private sector within which the poor find their livelihoods. CIDA's framework aims to strengthen the private sector as an approach to poverty reduction by stressing the importance of a pro-poor lens that should qualify a business lens and governance lens in determining appropriate strategies and policies to improve the livelihoods of the poor.
- 3.1.4 While CIDA has not elaborated methodologies for considering private sector development and poverty reduction beyond its 2003 policy statement, Canadian CSOs have suggested a number of essential ingredients for a pro-poor approach. These ingredients might usefully inform the Commission's action plan arising from its report. An impact analysis of new initiatives should

² Thorsten Beck, Asli Demirguc-Kunt and Ross Levine, "Small and Medium Enterprises, Growth, and Poverty: Cross-Country Evidence", World Bank Policy Research Working Paper 3178, December 2003, p. 3.

³ *Ibid.*, p.4.

⁴ *Ibid.*, p. 26.

- focus on the sectors and regions where the livelihoods of the poor are located in rural and urban settings (particularly the absolute poor in the agriculture and non-farm rural sectors);
- integrate a thorough gender equality perspective;
- demonstrate that improvements in productivity in the informal sector and/or SMEs result in increased income for the poor disproportionate to the non-poor; and
- adopt a rights-based approach that strengthens the legal framework for organizations representing the interests of those living in poverty as well as core labour rights.⁵

3.2 Formalizing the informal sector is not a panacea for either domestic private sector development nor improved livelihoods for the poor.

3.2.1 The Commission calls for concerted national government action with indicative targets “to increase the shares of formal enterprises and smaller enterprises in the economy, monitorable over a five to ten year horizon”. (39) The report goes on to suggest “improving rules and processes for registering and titling land” as a critical precondition for access to financial resources based on these landed assets of the poor as well as “practical, user-friendly processes to obtain and enforce property rights”. (39) These proposals are very much influenced by the important work of Hernando de Soto who has examined in depth the entrepreneurial skills of the poor.

3.2.2 Formalizing landed property rights for the poor, in order to use these assets as collateral for financing, must be carefully considered. This formalization may undermine other important uses of land, equally important to the livelihood strategies of poor people, including, for example, community use of land. Land titling must also not undermine the position of women in household power relations, making formal assets increasingly under male control. As Roy Culpeper notes in his review of de Soto’s book, *The Mysteries of Capital*, if such policies are to truly benefit the poor, they must also be accompanied by far-reaching agrarian reform, the affordable provision of a range of public services in education, health and infrastructure, accessible credit in well functioning local credit markets, and open transparent government, willing to challenge the propensity of the elite to take advantage of formal property rights to maximize and extend their own control over property as the poor fall into default on loans.⁶

⁵ CIDA’s policy, *Expanding Opportunities through Private Sector Development* was published in 2003 and can be found on CIDA’s web site at www.acdi-cida.gc.ca. CCIC and the Canadian Labour Congress submitted a substantial commentary on an earlier CIDA framework for this policy, “A Commentary on Expanding Opportunities: A Framework for Private Sector Development: A CIDA Consultation Document”, March 2003 available at www.ccic.ca/e/docs/002_aid_2003-03_commentary_cida_consultation_clc.pdf. The latter analyzes a pro-poor framework for private sector development.

⁶ See Roy Culpeper, “Demystifying Hernando de Soto: A Review of *The Mysteries of Capital*”, March 26, 2002 available on the web site of The North-South Institute at www.nsi-ins.ca. A more detailed critique is Woodruff, Christopher, “Review of de Soto’s *The Mystery of Capital*”, *Journal of Economic Literature* XXXIX:4 (December 2001), 1215-1223.

3.2.3 Research in Africa suggests that the informal sector has a complex relationship with the formal sector and the former may better serve the livelihood interests of the poor and the cost effectiveness of inputs into the domestic formal economy. Without very dramatic changes in international aid and debt burdens, structural adjustment conditionalities, and global commodity markets, African governments will continue to rely on the informal sector as “a social safety net” for the economic calamity that has resulted for the poor. Several authors argue that the informal sector is not haphazard and lawless but rather creates its own rules and means for settling disputes. In the case of the Congo, “the stability of economic transactions with the unofficial economy is the result of dense informal mechanisms of control” and that “these relations rely on trust, reciprocity and security of pre-existing interactions”.⁷ Given the weakness of institutions across Africa, reliance on the formal juridical system by the poor may reduce their capacities to sustain these complex economic and social relationships that are the source of the current livelihoods.

3.3 Developed countries and the multilateral system must allow developing country governments policy space to determine their own policies for the development of domestic informal, small and medium enterprise sectors in the interests of the poor.

3.3.1 The Commission rightly urges developed country governments “to foster a conducive international macro-economic and policy environment to unleash the full potential of entrepreneurs in developing countries”. (39) But just as Roy Culpeper notes that de Soto ignores important aspects of the disastrous impact of the Western historical experience with property rights for the English peasant or native people of North America⁸, the Commission’s report largely ignores domestic policies that were essential for the historical development of strong private sector-based economies in the North.

3.3.2 As an enabling environment for **domestic** private sector development, the report is broadly supportive of open trade policy (15) as well as “the movement of private capital of all kinds”. However, it also recognizes the vulnerability of developing countries in capital account liberalization and calls for “great prudence”. Unlike policies promoted by the International Financial Institutions, it acknowledges that “a sound financial system with good regulations ... is required before proceeding to full liberalization”. (23) But at the same time, the report urges national governments in developing countries, as noted above, to establish “a level playing field for firms competing in the domestic market”. (17) It calls upon transnational corporations to integrate with national SMEs and strengthen their links with domestic ecosystems. (41)

⁷ Emizet, K, “Confronting leaders at the apex of the state: The growth of the unofficial economy in Congo”, *African Studies Review*, vol 85, No 3 (June 1995), p.129, quoted in Haeri, Hussein, “The informal sector in the African context: A counternarrative”, *Lattitudes* (e-journal), 2001, at www.ausmcgill.com/idssa/lattitudes/pdf/informal-haeri.dpf, p. 3. This paragraph summarizes some key points in this excellent short review of the informal economy in Africa.

⁸ Culpeper, *op. cit.*, p. 2

3.3.3 The historic experience of northern countries, including Canada, in developing their own domestic private sector, as well as more recent industrializing countries such as South Korea, took place in a very different policy context that privileged the domestic sector. All of these countries liberalized trade gradually, over decades not years, with strong state support for their domestic private economic actors, which in turn became strong enough to compete effectively in an international business environment.⁹ As Dani Rodrik points out open economies and “best practice” institutions are seldom key factors at the outset in promoting economic growth in developing economies. Each successful country’s domestic investors were motivated by very country-specific and government-led strategies “requiring local knowledge and experimentation for successful implementation”. Applied to the challenges facing developing countries today, a development-friendly international economic regime would

“enable poor countries to experiment with institutional arrangements and leave room for them to devise their own, possibly divergent solutions to the developmental bottlenecks they face...What the world needs right now is less consensus and more experimentation. The role of external agencies, in turn should be to enhance the capacity of national democracies to undertake such innovations, not constrain them.”¹⁰

3.3.4 Others have suggested that developing countries require national industrial development policies and capacities. These policies should aim to achieve broad national social and economic development goals in which each country’s citizens determine the pace of its integration into the global economy.¹¹ The Commission’s report is notable for the absence of any review of policies that promote SMEs and poverty reduction within nationally oriented socio-economic development goals. Rather, the Commission seeks to maximize an externally-oriented integration of national economic sectors into the global economy, in other words, by adopting the policy reforms advocated and implemented by the international financial institutions and major donors for several decades.

3.3.5 There are well-established analyses of the impacts on poverty that have resulted from donor-imposed conditionalities based on macro-economic policies of the Washington Consensus. More recent derivative (Post Washington Consensus) models, also largely donor-created, which stress local ownership of these same policies, are likely to fare little better. The Commission itself rightly notes that there is no one model for private sector development and that “reforms linked to conditionality rarely succeed when implementing governments are not committed to them”. (22)

⁹ Dr. Ha-Joon Chiang (Assistant Director of Development Studies, Cambridge University), “Development: A Game of Ladder Kicking”, South Bulletin, #40, July 30, 2002.

¹⁰ Dani Rodrik, “After Neo-liberalism, What?”, Harvard University, mimeo, June 2002, pp. 7-9.

¹¹ Ann Zammit, *Development at Risk: Rethinking UN-Business Partnerships*, Geneva: South Centre and UNRISD, 2003, pp. 216 – 218, on the Internet at [http://www.unrisd.org/unrisd/website/document.nsf/\(httpPublications\)/43B9651A57149A14C1256E2400317557?OpenDocument](http://www.unrisd.org/unrisd/website/document.nsf/(httpPublications)/43B9651A57149A14C1256E2400317557?OpenDocument).

3.3.6 The Commission highlights roles in domestic policy consultations for civil society organizations, including business associations representing the informal economy. But the action plans that come next should go beyond consultations and seek ways that all actors can collaborate to strengthen processes for locally determined policy directions and alternatives, even where these do not coincide with the donors' presumptions of "correct" policies. In their report, the Commission recommends that transnational corporations can contribute to strengthening domestic enterprise, including SMEs. In doing so, TNCs and northern governments should consider refraining from lobbying at the WTO and elsewhere for further liberalization of investment rules in developing countries. These rules supporting a so-called "level playing field" open the door for TNCs that "crowd out" local firms in developing countries unable to compete with the market power of these transnational economies.¹²

3.4 The promotion and brokering of North / South private sector mentoring and partnership relationships, as proposed by the Commission, should be guided by and be accountable to a set of common principles for equitable relationships that strengthen the Southern counterpart.

3.4.1 The Commission strongly encourages both private sector partnerships with government to deliver cost effective essential services for the poor as well as innovative North/South partnerships. The report recognizes that "the sustainable delivery of basic services depends on effective partnerships and other forms of public-private cooperation, *which have proven difficult*". (41, emphasis added) Indeed the experience to date of privatization of public service delivery on the whole has not been welcomed by those living in poverty. Academics, CSOs and unions have challenged many of the assumptions about the effect of privatization of services such as water and electricity on improved quality of life for those on low incomes.¹³

3.4.2 Privatization and forced public private partnerships for the delivery of essential services for the poor have become standard conditions in aid for the poorest countries.¹⁴ Building on its recognition that many of these have failed, the Commission should pilot new approaches. Such approaches would involve citizens with their governments, who are given the policy space and the means by donors to determine overarching objectives in relation to the MDGs and international human rights obligations, such as universal service delivery, and the optimal modalities for delivering services to realize these objectives.

¹² As Zammit suggests, "large companies would be clearly manifesting greater Corporate Social Responsibility if, and only if, in addition to demonstrating good practices with respect to labour, environment, human rights standards, they were to promote and work within an economic policy framework, including rules for foreign direct investment, that was more conducive to sustainable development and poverty reduction in the South." *Ibid.*, xxviii.

¹³ Paul Cook and Yuichiro Uchida, University of Manchester, "Privatisation in Developing Countries: An Engine of Growth?", ID21 *Society and Economy*, October 2002 and Tim Kessler, "Putting the Private Sector in its Place", Citizens Network for Public Services (www.servicesforall.org). The ICFTU has documented reduction in employment in some cases, with the transfer of workers from the formal to the informal sector through sub-contracting. ICFTU, "IMF and World Bank Sponsored Privatization and its Impact on Labour", October 2002.

¹⁴ See for example, David Hall and Robin de la Motte, "Dogmatic Development: Privatization and conditionality in six countries", War on Want and Public Services International Research Unit, February 2004, <http://www.waronwant.org/?lid=7540>.

3.4.3 The Commission's report suggests that "the private sector needs to make a genuine commitment to sustainable development – with a sharp focus on corporate governance and transparency". (41) It promotes "the triple bottom line" for transnational companies while recognizing that "the majority of companies that have taken an enlightened approach to sustainable development have been pushed and pulled in that direction" (34). As a positive model among others, it acknowledges the importance of the "Publish What You Pay" campaign to help citizens in resource rich developing countries hold their governments accountable. (33) Yet it remains unclear whether the Commission foresees its own initiatives in partnership brokerage will be accountable to these same principles of social, environmental and governance transparency and accountability. As a recent UNRISD/South Centre study on the UN Global Compact partnerships with the private sector suggests, "business interests cannot be considered neutral actors in the world policy arena" and UN-business partnerships "may themselves be vehicles for attaining TNC objectives that are incompatible with developing country interests".¹⁵ This is equally true when considering all forms of partnership between highly developed Northern business interests and SMEs in the South, whatever their stated purposes. What is the normative framework that will guide the work of the panel of experts that Canada is hosting whose mandate is to propose mechanisms for brokering such North/South private sector relationships?

3.4.4 The UNRISD study notes a number of considerations that might be taken into account¹⁶:

- Mutual respect for international human rights legal obligations, including core labour rights as defined by the International Labour Organization;
- Full social and environmental cost benefit analysis of partnerships, with accountability to the Millennium Development Goals as an overarching framework for the promotion of partnerships;
- Common understanding of the scope and mutual benefits to be derived from the partnership, including how financial benefits accrue to private sector partners and the public sector;
- A balance in business advantages between developing and developed country partners, taking into account highly unequal capacities in developing countries, and including repatriation of investment income to the northern partner;
- Provision of technical assistance and relationships that avoid creating dependencies on foreign companies, technologies and markets inappropriate to national goals to strengthen a national economy;
- Transparent mechanisms to provide space for expression of concern on the part of developing country governments and different sectors of society.

¹⁵ Zammit, *op.cit.*, p. 195.

¹⁶ "A New Development Strategy and True Test of Corporate Responsibility" in Zammit, *op.cit.*, pp 259 – 276. See also the Africa Canada Forum proposals along similar lines for the management of the Canada Investment Fund for Africa in a letter to Minister Susan Whelan, April 7, 2003, available at http://www.ccic.ca/e/003/acf_2002_04_letter_whelan_investment_fund_africa.shtml

3.4.5 Transnational corporations are already involved in a myriad of partnerships with local factories producing goods and services for people in the north. The Ethical Trading Action Group in Canada has proposed practical policies for the Canadian government to implement that would provide consumers and shareholders in the North the information they need to make ethical choices and promote fair labour practices in the global garment industry.¹⁷ At the global level, human rights organizations and other CSOs are urging their governments to support the *UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with regard to Human Rights*.¹⁸ These norms represent a major step forward in the process of establishing a common global framework for understanding the responsibilities of business enterprises with regard to human rights. The five-person Working Group of the Sub-Commission for the Promotion and Protection of Human Rights, which drafted the *Norms*, developed them through an open process of consultation with governments, businesses, NGOs and unions over a period of nearly four years. The panel of experts developing follow-up action plans for the Commission should consider testing the application of these norms in its promotion of north/south private sector mentoring and partnership relationships.

4.0 Conclusions

4.1 The UNDP Commission on the Private Sector and Development, with its dual focus on the domestic private sector and strategies to reduce poverty, offers opportunities for Canada to take leadership in new approaches to development cooperation. The government will be well advised in assessing its options to support the outcomes of the Commission's report to elaborate and build upon the pro-poor framework established by CIDA in its 2003 policy *Expanding Opportunities through Private Sector Development*. Canadian civil society organizations involved in international cooperation have a range of experience in different partnerships and approaches with counterparts overseas to expand livelihood options for those living in poverty. CCIC members will be looking forward to new initiatives from the government and CIDA to share this experience and pilot new approaches.

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March 2004

¹⁷ See ETAG, "Transparency and Disclosure: New Regulatory Tools to Challenge Sweatshop Abuses", Submission to Public Policy Forum's National Consultation on Textile Labeling, September 30, 2003, accessible at www.ppforum.ca/textile_labelling/aETAG-Executive_Summary.pdf

¹⁸ Information on the *UN Norms* can be found at Amnesty International at <http://web.amnesty.org/pages/ec-unnorms-eng>