

Making Markets Work for the Poor



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The smoke from hundreds of small kitchens rises towards the sky to meet the first daylight as the traffic begins to move. Every morning throughout the developing world thousands of businessmen and businesswomen are preparing to start their business activities for the day.

But it is not with a briefcase in hand dressed in a tie and suit that they start their day. Rather, their tool is the hoe, the cart loaded with gas cylinders or the box with cheap electronic gadgets.

We might not see them as entrepreneurs or business people, but that is in fact what they are. They are the foundation of the private sector in most countries. All around the world, poor people are striving to build themselves a better life. Given the right circumstances they are able to grow, and if they prosper and develop so will society. The small-scale entrepreneur is in many ways the key to development and poverty alleviation.

“I used to work in a large textile mill, but when the company went bankrupt I decided to work for myself,” says Flor de Maria Lopez, a tailor in Lima, Peru.

Together with her husband Jorge Rivera Miguel she bought the first sewing machine. The business is now thriving. The whole family is working, sewing school uniforms and other products for the local market. In the future they might even be able to employ people from outside the family.

They still remain in the same poor area as before. The house where they live and have their workshop is the simplest kind: walls made of plaited bast-mats, a floor of naked concrete and a roof through which you can spot the stars at night.

But they are improving: “We have great ambitions”, says Flor and smiles.

Towards a pro-poor growth

The word “growth” is often associated with banks and big business, but it is in fact fundamental in reducing poverty in the world. Without growth there is nothing to distribute and share. But growth in itself is not sufficient to

reduce poverty. If growth is to improve conditions for the poor then the poor people themselves need to actively participate in reducing poverty. UNDP uses the term ‘poverty reducing growth’ or ‘pro-poor growth’ versus ‘ruthless growth’. A good example of ‘pro-poor growth’, according to UNDP, a good example of pro-poor growth is when the per capita income of the poor has a faster growth than the average income. That means that income inequality is decreasing. Ruthless growth, on the other hand, is growth that does not reach people.

To generate economic growth, countries should use their resources in the most productive and sustainable way possible. There should also be an active redistribution, e.g. through provision of social services, so that the resources generated in society from growth are invested meaningfully for the poor. Redistribution also includes assets, and in particular when they are of great importance for the poor such as land and housing in urban areas. Countries with unequal distribution of assets are generally much less effective in reducing poverty.

Sida's view, the market and poverty alleviation

Economic and social development is [another] prerequisite for poverty reduction. An institutional environment for economic development is a sine qua non for sustained poverty alleviation: institutions, including the market, must be made to work for the poor. In order to be effective, policies must be pro-poor, with a clear focus on the need to strengthen capacities and increase the opportunities of the poor.

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Equally important is the inclusion of the poor in economic activities. If the poor are not included, little will be achieved no matter how good the policies.

The role of the market

Private sector development concerns agriculture, manufacturing and services including trade, infrastructure and social services. It also includes all types of market players, from the self-employed in the informal economy, to small, medium and large enterprises, and transnational companies. Thus, private sector development is not a sector in a conventional sense but more of an approach, or as the World Bank describes it: “a way of doing things”.

Since the fall of the Soviet Union in 1991, the market is the undisputed principle for the organisation of economic activities. The end of the Cold War also meant a stronger focus on globalisation: private capital increasingly began moving across borders, import-substitution was replaced by export-orientation in many developing countries, inspired by the economic

successes of countries like South Korea and Taiwan. Various trade agreements, leading to the creation of WTO in 1995, have reinforced the growth of a global world economy. The market and the private sector have also expanded into new areas, such as infrastructure, utilities and social services.

However, private sector development is not an instant recipe. More than 50 countries experienced economic decline during the 1990s, the majority of those in Africa and in the former Soviet Union. Agriculture, one of the most controlled sectors in the past, has been liberalised but the dividends are uneven. In some countries, e.g. in parts of the former Soviet Union, the market reforms resulted in Mafia-style economies and a drastic fall in the standard of living. In sectors such as health and education, governments strapped for financial resources and pursuing economic liberalisation have paved the way for unregulated supply of services by private providers. In many former planned economies, achievements in human development have deteriorated.

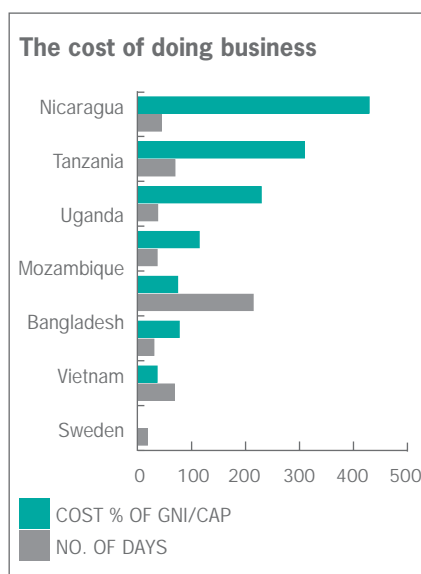
Starting their own business is often the only alternative for young people in developing countries once they leave school.

From Sida's policy guidelines

The main purpose of Sida's support to PSD is to contribute to poverty reducing growth based on three elements:

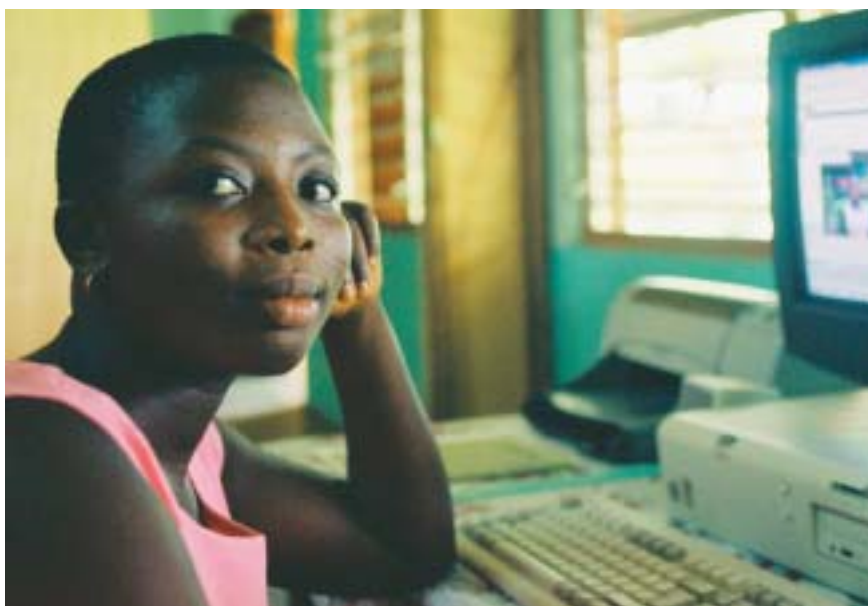
- Direct inclusion of the poor in economic activities, contributing to their employment, income and productivity, and to reducing their vulnerability.
- Economic growth as the means of generating resources in society and enhancing productivity, employment and income
- Redistribution so that the resources generated in society from growth are invested meaningfully for the poor, especially in human resource development.

POLICY GUIDELINES FOR SIDA'S SUPPORT
TO PRIVATE SECTOR DEVELOPMENT



Starting your own business is both a question of cost and time. The comparison in the table is based on data from the World Bank Doing Business Database (<http://rru.worldbank.org/doingbusiness>)

Access to information technology is one key to private sector development.



In many developing countries the private sector has failed to play a dynamic role. Foreign investments have not emerged as anticipated, and growth and poverty reduction have not taken place.

Property rights

Fair and effective property rights are essential for entrepreneurs and other private sector operators to be willing to take commercial risks and invest.

The Peruvian economist Hernando de Soto is known worldwide for his studies on the informal economy and more recently his work on capital and the economic potential of “dead” assets, i.e. property belonging to the world’s poor population which cannot be used as collateral because it is not legally formalized.

Through his research, de Soto has shown that the obstacles for turning informal property into formal are so great – and costly – that most people prefer to stay informal.

“People in developing countries are not fools. They calculate how much they have to spend bribing policemen and others and they know if it costs them more or less to be outside the legal system. What we have to do is to create the base which makes it possible for people to become legal”, says Hernando de Soto.

The cost of doing business

Lawlessness is bad for business, and the business that takes place in lawless environments often tends to be bad for society. The poor tend to be the

first victims of lawlessness, also in economic activities, and are often the major beneficiaries when rule of law is established.

Good governance is not a ‘luxury product’ and an effect of growth as sometimes argued, but very much a cause of growth. Bureaucratic red tape, corrupt practices, slow performance in essential public institutions, add costs and lead to various distortions. It is an obstacle to foreign investors and for trade. It is particularly a problem for small enterprises, including small-scale agriculture, as they have less means of by-passing all the obstacles.

The informal economy

Along with agriculture the informal economy is the most important source of livelihood for people in general and the poor in particular. The informal economy is estimated to employ around 60% of the non-agricultural labour force in developing countries, ranging from 50% in Latin America to 80% in Africa.

The informal economy is entirely private. The ‘enterprises’ operate largely or totally outside their countries’ formal legal framework. The informal economy comprises everything from the self-employed to small enterprises with sometimes 5–10 employees.

Helping informal companies become formal has been one important area for Swedish support through the Improve your Business programme. Based on a training programme by the Swedish Employers’ Association for small enterprises in Sweden, Sida funded an adaptation to developing countries in the 1970s through ILO. The programme, first applied in Africa, was expanded in the 1990s under the name Start and Improve Your Business. It has spread to 80 countries and a large number of entrepreneurs, mostly in the informal economy, have undergone training.

Agriculture of high importance

The agricultural sector is generally the most important source of livelihood for the poor in developing countries. Agriculture employs over half of the total labour force in developing countries, mostly as smallholders, tenants and agricultural labourers. In some of the poorest nations in Sub-Saharan



Africa, the ratio is over 90%. Small-holder agriculture must be considered an essential part of the private sector of the poor.

Both agriculture and the informal economy have in the past been subject to discrimination by governments in many countries, and also, in relative terms, have received less attention by donors. It also suffers from market distorting trade and agricultural policies in the West.

The poor suffers most from bad policies

Low inflation, a realistic exchange rate and a low budget deficit are well-established principles for both developed and developing market economies. It is also a pre-condition for pro-poor growth, as the major victims of poor macro economic policies tend not to be the rich, but the poor.

Serious macro economic mismanagement of the past, not least in Africa, mainly hit peasants and farmers by distorting both domestic and export-oriented agriculture in a negative way.

The structural adjustment reforms advocated by the World Bank and IMF from the 80s have also shown their shortcomings. As a result, the reform

process is today placed in a broader context, and the work by the donor community is linked to poverty reducing strategies. In countries such as Taiwan and South Korea, private sector development has gone hand in hand with investments in education, health and other social services. The income distribution in most newly industrialised countries is also more even than in many of the world's least developed countries.

Most businessmen are women

"When we started Grameen Telephone along with the concept of bringing mobile phones to the village women, people said: 'No, she will be afraid of the telephone. She will think a ghost is talking to her ears'. Others said, 'She's an illiterate woman. She doesn't even know how to push those buttons to dial people'. But the women saw the potential of making business. They picked up the technology quickly and became very good businesswomen, selling the service and making a lot of money. A typical Grameen telephone lady will be earning twice the per capita income of the country within a month. Through this, we have also

As products from the industrialised world reaches all markets, developing countries find that their agricultural products suffers from high trade barriers in USA and the EU.

What is good governance?

Good governance is a system of government encompassing the state's way of exercising its political, economic and administrative powers. It maintains that both institutions and processes ought to be based on principles of the rule of law and should be characterised by responsibility, openness, integrity and efficiency. Furthermore, a democratic state and its public sector ought to be characterised by a democratic culture and the rule of law.



Small scale trade is an important part of the informal sector, providing incomes for thousands of families all over the world.

The Millennium goals

Established by the donor community in 2000 and aiming at the eradication of poverty, The Millennium goals put the role of the private sector in a new light from several perspectives, namely as

- an engine of improved economic growth;
- a means to generate the required domestic resources for investments in human resource development through health, infrastructure and education;
- a potential provider of some of these essential services.
- a direct partner in trade and technology transfers.

created a different climate. Now the poor woman is an important person in the village.”

Muhammad Yunus, founder of Grameen Bank.

In many developing countries, most businessmen are women. Women are in charge of agriculture, they trade, produce garments and many other kinds of products. In many areas, the majority of micro entrepreneurs are women. Still their achievements are often seen as just an additional income for the family.

As a result, development, economic growth and private sector development have different outcomes for men and women in basically all societies. For that reason a pro-poor growth policy must also be based on a clear gender perspective. This is something that will benefit us all as discrimina-

tion against women in business also has a negative impact on the overall economic development.

Capacity building for banks

There is a close relationship between economic growth and the development of financial markets. Thus, financial market development triggers economic development and vice versa. In recent years Sida has stepped up its efforts to prevent financial crises in partner countries. For example, the Central Bank of Sweden, in co-operation with Sida, provides capacity building advice on monetary policy and capital market reform to the central banks of Uganda, Sri Lanka and Vietnam.

Micro-finance – a small loan pays

Financial services are not just demanded by formal businesses, but also by the poor. The formal financial markets have been notoriously bad in serving the great majority of the people. However, the worldwide growth of micro finance has paved the way for formal financial services to the poor and asset-less.

Sida was one of the first development cooperation agencies to go into micro credit by actively supporting Grameen Bank and other pioneers in the 1970s. More than 7,000 Micro Finance Institutions are now working worldwide providing capital to micro enterprises.

The road to development

Physical infrastructure, such as roads and harbours and systems for power transmission, water, telecommunication and other electronic media, are critical for business development. Efficient and accessible infrastructure reduces production and transaction costs, enhances productivity and competitiveness internationally. From that perspective infrastructure development can be an effective pro-poor business development strategy: rural roads or rural electrification tend to spur considerable local economic activities as physical access to markets is one of the greatest determining factors for the economic welfare of smallholders.

Towards a cleaner environment

Comparing the environmental degradation that took place in the planned economies of the Soviet Union and

Eastern Europe with that of the Western market economies up until the 1990s gives a clear indication that market economies were far more effective in reducing the negative effects on the environment from economic development.

But private sector development is no panacea for a sustainable environment. Rich countries tend to be effective in controlling local negative environmental effects, but they are the main culprits of global negative environmental effects such as the greenhouse effect. Poor countries tend to have less impact on the global environment due to their much lower degree of industrialisation, but often harm the local environment through for example non-sustainable use of land.

A perspective of environmentally sustainability must be integrated into all aspects of Sida's support to private sector development. At the same time, donors risk being accused of hypocrisy. If developing countries used the same per capita amount of non-renewable resources as rich countries, the world would not be ecologically sustainable. Hence, the greatest challenge in economic development is how everyone on earth can enjoy a decent standard of living without jeopardising the environment.

The role of civil society

Private sector development must never occur at the expense of the environment or by denying people their rights. Human rights, including labour

rights, are important elements in the development of the private sector.

Civil society, including non-governmental organisations, labour unions and consumer unions, are important element of the dynamic state-market system. One example is REN-LAC, an NGO in Burkina Faso, set up by unions, churches and others to monitor and campaign against corruption in the country.

"Corruption has definitely increased during the past few years but people are getting fed up. They don't want to pay policemen, civil servants and others for everything that has to be done", says Luc Damiba, coordinator at REN-LAC.

Civil society groups in industrialised countries are linking up with sister groups in developing countries and are becoming an increasingly powerful force. Such groups have stimulated the development of rules of conduct and other forms of ethic standards of multinational enterprises. Another important partner is the private sector in Sweden, which provides a valuable resource in development programmes.

Find out more

We hope this folder will stimulate to a discussion on the private sector in development and we welcome your comments. Sida has prepared a set of "Policy guidelines for Sida's support to private sector development". In a separate document "Making markets work for the poor – Challenges to Sida's support to private sector development" more detailed information is given about the private sector and Sida's support. You can download both documents from www.sida.se.

What can Sida do

A major challenge for Sida is to find ways to support the development of efficient markets where the poor participate on decent terms as both producers and consumers. The main focus is on the business environment and good governance – and in particular the rule of law. Special attention is given to markets in which the poor are directly involved, primarily agriculture and the informal economy. Other focus areas are trade, financial systems (including microfinance services to the poor) and infrastructure reforms.

...and what should Sida abstain from

Sida should avoid creating market distortions in its support to private sector development. Only in special cases, such as human resource development with clear positive external impacts, may Sida provide direct support to individual firms.



More and more investment in infrastructure, as with the new waste water treatment plant in St Petersburg, is done in a public-private partnership.

Halving poverty by 2015 is one of the greatest challenges of our time, requiring cooperation and sustainability. The partner countries are responsible for their own development. Sida provides resources and develops knowledge and expertise, making the world a richer place.



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