

GETTING BACK ON THE RAILS: THE PRIVATE SECTOR AND DEVELOPMENT

POVERTY

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Front cover photo: A female stallholder selling dried fruit and nuts in the busy market of Osh, south Kyrgyzstan

Christian Aid/Sarah Malian

EXECUTIVE SUMMARY

‘The Washington Consensus is over... the old world has gone... We have got to build a new consensus on economic development for the future, and we have got to send the message to every country that doing nothing is not an option.’

Gordon Brown, UK prime minister, 2009¹

‘What we’ve learned here, but if anybody had been studying history they would have understood earlier, is that the market is the most effective mechanism for creating wealth and distributing resources to produce goods and services that history has ever known, but that it goes off the rail sometimes; that if it’s completely unregulated, that if there are no thoughtful frameworks to channel the creative energy of the market, that it can end up in a very bad place.’

Barack Obama, US president, 2009²

The current financial crisis has exposed the deficiencies of a global economic system that was once considered impregnable.

The neo-liberal Washington Consensus, which elevated the market above the state in a false dichotomy that ignores their important inter-relatedness, imposed a policy mix that facilitated a distorted and partial form of globalisation and allowed parts of the private sector to create enormous new wealth.

When imposed on developing countries as the price for aid, elements of the Washington Consensus policy mix, especially deregulation, liberalisation and privatisation, have severely restricted the ability of governments to make the right policies, introduce the right regulations and build the right institutions for economic prosperity and social progress.

One potential benefit of the current financial crisis is that new ways of thinking about the global economic system must now be explored. The old ways have not just been found wanting – they helped precipitate the crisis in the first place.

Christian Aid has a vision to end poverty – now, not just in the future. We believe that, in the turmoil of the economic meltdown, a unique opportunity has arisen to help us change the systems that keep people poor. There is now the chance to usher in a new order that can meet the challenge that has eluded humankind since time immemorial – eradicating poverty.

A crucial aim that must be met if this ambition is to be realised is that poorer countries must be helped to thrive on their own terms. Development must be tailored and sustainable.

One vital player in eradicating poverty is the private sector. Globally, it is one of the primary contributors to economic

growth, starting and expanding businesses, and creating jobs and paying wages. But in developing countries, all too often, it underperforms.

The relationship between the private sector and development is a complex one. The private sector includes multinational companies (MNCs), small- and medium-sized enterprises (SMEs), and micro-enterprises. Each of these has the potential to contribute to development directly (through channels such as employment and income, infrastructure, goods and services, philanthropy and corporate social responsibility (CSR)) and indirectly (in areas such as the economy, tax, policy and governance, and impact on the environment).

An example of the complexities that exist between the private sector and development is the contribution that MNCs make to employment and income. The evidence of this contribution is mixed. While MNCs are often praised for their capacity to diversify economies and increase productivity, they accounted for only 3.4 per cent of the world's total employment (95 million of 2.8 billion employees) in 2000.³ Generally, incomes in MNCs appear to be higher than those in domestic firms, but their working conditions seem to vary.⁴

Since the 1990s, foreign donor private sector development strategies have grown in influence and received more funding.⁵ However, their strategies continue to push the Washington Consensus policy mix on to developing countries.⁶

Against this backdrop, two approaches to private sector development have emerged: the investment climate approach and the inclusive market approach. The former analyses policy from the perspective of investors and prescribes a package that aims to create the right business environment for investment. The latter seeks to uphold

the interests of the poor in designing interventions and programmes for better functioning markets.

Christian Aid is particularly concerned about the investment climate approach, which is championed by the World Bank. There is no doubt that the right business environment is needed to encourage both domestic and foreign investment, but the emphasis that this approach places on foreign investment can be misplaced and the measures that it prescribes can restrict the ability of developing countries to determine their own policies.

The World Bank's Doing Business Indicators (DBI) epitomise our concerns since they create pressure on developing countries to standardise business regulations and frequently award countries higher marks for scrapping regulations or cutting tax rates – regardless of the wider context.

After the G20 meeting in London in April 2009, UK Prime Minister Gordon Brown said that the 'Washington Consensus is over'.⁷ While acknowledgement of its demise is somewhat belated, the new political context should allow restoration of the balance between the market and the state.

The partial globalisation that has been pursued is profit-oriented and can lead to the creation of enormous wealth, but it does not always contribute to the eradication of poverty. All too often, it can make poverty worse. New policies, regulations and institutions are needed to ensure that markets function fairly and inclusively, and the private sector does not harm poor communities and is required to redress any harm that it causes.

To this end, corporate accountability cannot be left to voluntary initiatives under the wide umbrella of CSR. It is crucial that international agreements and national laws on

the environment, human rights and labour are ultimately extended to cover the private sector where they do not. It is crucial, too, that these agreements and laws are integrated in private sector development strategies and approaches in the future.

Even with greater legal obligations in place, the private sector must continuously strive to improve its business models and practices so that it contributes more to development. MNCs in particular must use their enormous resources to do more, most obviously by creating new jobs for poor people and providing them with better wages and conditions, but also by showing leadership in advocating for the right policies, regulations and institutions to strengthen the link between business activity and poverty eradication.

This new approach to private sector development must be founded not on ideological belief, but on pragmatic government that explores and promotes the kinds of policies, regulations and institutions that can deliver fundamental progress for people living in poverty.

Christian Aid believes that the private sector has a crucial role to play in poverty eradication and sustainable development and makes the following recommendations.

Developing-country governments and civil societies

They should work together to:

- strengthen the links between different parts of the private sector and different channels of development through appropriate policies, regulations and institutions

- ensure that poor people are included in markets but protected from exploitation through appropriate policies, regulations and institutions
- hold the private sector to account for strengthening its links with development, ensuring inclusion and protection of poor people, and preserving the right of developing countries to determine their own policies
- promote transparent, participatory and accountable processes for pursuing these actions.

Actions for foreign donors

They should:

- revise private sector development strategies to preserve the right of developing-country governments to make their own policies, introduce regulations and build institutions that strengthen the link between the private sector and development, ensuring poor people are included and protected.

Actions for MNCs

They should:

- work with developing-country governments, civil societies and foreign donors through accountable CSR, core business activities and global advocacy to strengthen the links between the private sector and development, ensuring the inclusion and protection of poor people, and preserving the right of developing countries to determine their own policies.

INTRODUCTION

Christian Aid believes that the private sector is a crucial stakeholder in development. The private sector generates economic growth by engaging in economic activity. By doing so, it creates jobs and wages for the poor, and opportunities and markets for small enterprises. Moreover, the positive role of the private sector in the eradication of poverty is a significant development issue and one that has often been neglected by civil society. Economic growth and private sector development must be key elements in development policies and strategies.

Christian Aid has engaged with the private sector for many years through our advocacy, projects, fundraising and supporter work:

- our advocacy has involved campaigning and dialogue. For example, we have demanded better pay and conditions for workers and producers in developing countries supplying raw materials and processing goods for UK supermarket chains. And our promptings contributed to the establishment of the Ethical Trading Initiative (ETI) in the UK
- our livelihoods work has emphasised the importance of making credit available to poor people to enable them to start their own businesses, giving them market access to increase their sales, and creating equitable value chains to increase their profits
- UK businesses have been generous donors to our humanitarian work, and we hope to extend fundraising relationships with them to other areas of our work, such as policy research, analysis and advocacy
- many Christian Aid supporters work in the private sector, and they have frequently shared their experiences and

insights with us to improve the effectiveness of our work. As consumers, many supporters purchase fair-trade products, reflecting their ethical concerns while helping to improve livelihoods.

During the 1980s and 1990s, neo-liberal economic ideology elevated the market over the state. In development economics it was enshrined in the ten policy recommendations of the Washington Consensus:⁸

- fiscal policy discipline
- redirection of public spending from subsidies to infrastructure and services
- broader tax base with moderate tax rates
- market-based but moderate interest rates
- competitive exchange rates
- trade liberalisation
- inward investment liberalisation
- privatisation
- deregulation⁹
- property rights protection.

The champions of such policies believed that the market would allocate scarce resources more efficiently than the state for sustained economic growth and increased business activity.

In the past two decades or so, parts of the private sector have derived enormous benefits from the Washington Consensus, especially through the deregulation, liberalisation and privatisation that the World Bank and International Monetary Fund (IMF) required developing countries to undertake in return for aid.

Facilitated by cheaper transport and improved technology, these policies triggered an explosion in global investment, production, trade, sales and distribution. In the case of investment, for instance, when the UN Conference on Trade and Development (UNCTAD) first published its World Investment Report in 1991, the value of annual foreign direct investment (FDI) inflows was a mere US\$173bn.¹⁰ The latest UNCTAD report shows that these inflows had climbed to a breathtaking US\$1.8 trillion by 2007.¹¹

If the Washington Consensus is over, it is apparent that it failed to mobilise the private sector to deliver the comprehensive and sustained gains needed to eradicate poverty and create a more equitable world. Evidence of this can be found in the lack of progress made towards the eight millennium development goals (MDGs) that UN members agreed to meet by 2015:

- eradicate extreme poverty and hunger
- achieve universal primary education
- promote gender equality and empower women
- reduce child mortality
- improve maternal health

- combat HIV/AIDS, malaria and other diseases
- ensure environmental sustainability
- develop a global partnership for development.¹²

Even before the financial crisis, it was becoming clear that many of these goals will not be achieved.¹³ The UK recently joined forces with United Nations Development Programme (UNDP) to call on the largest MNCs to rescue the MDGs.¹⁴ However, as long as private sector development policies and strategies do not align profit-making more closely with welfare improvements, no solution will be found.

The current financial crisis provides us with a momentous opportunity to revisit the roles of the market and the state, and to place equity and redistribution, and rights and obligations, at the centre of the relationship between the private sector and development. While, as Barack Obama says, the market might be 'the most effective mechanism for creating wealth and distributing resources to produce goods and services that history has ever known', it has gone 'off the rail(s)' and we have ended up 'in a very bad place'.¹⁵

The private sector contribution to development is now too crucial an issue to be neglected by civil society. As the international community struggles to get the global financial system back on the rails, development agencies such as Christian Aid must help ensure that the interests of poor people are championed. We urge you to join us.

THE PRIVATE SECTOR AND DEVELOPMENT

The private sector is a complicated stakeholder in both developed and developing countries. Generally, it comprises three types of actors: MNCs, SMEs and micro-enterprises. These actors can overlap. Large domestic companies that are either on their way to becoming MNCs or that have recently graduated from SME status sometimes blur the distinction between SMEs and MNCs. Further, the private sector can be understood in both formal and informal dimensions, with micro-enterprises tending to inhabit the informal sector in developing countries (see 'The informal sector' box on page 13).

The private sector can contribute to development through direct and indirect channels. While it has a natural motive to seek profit and to contribute only narrowly to poverty eradication via jobs and wages, there is potential for the private sector to do more; for example, by providing goods and services needed by poor communities that are of good quality and at the right price, or paying taxes honestly to boost the fiscal capacity of governments. The contributions of MNCs, SMEs and micro-enterprises will differ in scope and impact too. However, while the private sector has the capacity to benefit poor people, it has also been responsible for harming them. Christian Aid has been prominent in researching and revealing the harm caused by the private sector – and particularly by MNCs – in different sectors and countries.

General private sector contribution to development

The private sector is frequently referred to as 'the engine of the economy' because it is a significant generator of economic growth. Growth is measured by the rate of increase in economic activity, and the private sector is extremely active – growing crops and harvesting them, raising animals, building infrastructure, making products, investing in businesses and employing people, and trading, selling and distributing goods and services. The most common benchmark for growth is the gross domestic product (GDP).

While growth can contribute to development, we have concerns about just how inclusive and comprehensive a factor it is.¹⁶ First, it can take place in sectors or regions that might not provide the greatest benefit to poor people because they either live or work elsewhere. In such cases, growth can perpetuate existing inequalities (which in themselves can limit growth). Second, growth can be narrow, creating jobs and providing wages while making little impact on essential services and living conditions. Moreover, the distribution of jobs can be unfair and lead to greater inequality. The concept of development is now recognised as involving a wider array of human needs than jobs and wages. Shallow and weak development, such as inequality, has been shown to limit growth.

Specific private sector characteristics and contributions

Multinational companies

Characteristics

MNCs are the most powerful private sector actors in the world. They possess substantial economic resources and wield considerable political influence. Their products can make life easier – and even save lives. Of the 100 largest economic entities in 2000, a study found that 49 were MNCs and 51 were countries.¹⁷ The largest MNC then was General Motors, with sales of US\$176.6bn, compared to South Africa's GDP of US\$131.1bn.

MNCs are corporate entities that have commercial operations in more than one country.¹⁸ They are known by other names – such as transnational corporations or multinational enterprises – but it is fair to say that no name yet captures the true essence of their global networks. MNC networks can be constituted in different ways:

- one entity (called a parent) might own all or the majority of the shares or assets in a second entity (called an affiliate)
- two entities might own or operate equal (or nearly equal) shares or assets in a third entity (known as a joint venture)
- one entity might enter into a short- or long-term agreement with a second entity to manufacture, supply or distribute goods and services.

Globalisation in the past two decades has meant that the number of MNCs, and the wealth that they hold, has skyrocketed (see Table 1 on page 7).

Developing-country MNCs

Since the 1990s there has been a rapid rise in FDI from developing country MNCs.¹⁹ In 2005, for instance, they contributed US\$133bn (or 17 per cent) to global FDI outflows and held US\$1.4 trillion (or 13 per cent) of global FDI stock. These MNCs are mainly based in Asia, which in 2005 held 62 per cent of developing-country stock. Developing-country MNCs largely operate in the lower to

middle global value chains, primarily in the extractives and manufacturing sectors, and particularly in the automotives, electronics and garments industries. What drives and motivates them is little different to what drives and motivates developed-country MNCs: they seek to expand their markets, increase their efficiency, secure resources and invest in new assets.

Table 1 Comparison of various MNC figures in 1990 and 2007

	Number of parent MNCs	Number of foreign affiliates	Global FDI stock (US\$ trillion)	Global sales by foreign affiliates (US\$ trillion)
1990	35,000	150,000	1.7	4.4
2007	79,000	790,000	15.0	31.0

Source: UNCTAD, *World Investment Report: Transnational Corporations as Engines of Growth*, United Nations, 1992, p1; and UNCTAD, *World Investment Report: Transnational Corporations and the Infrastructure Challenge*, United Nations, 2008, pxxvi.

The locations of both MNC headquarters and FDI destinations are highly concentrated.²⁰ Western countries are still home to most of the largest MNCs, while the largest developing-country MNCs tend to be based in east Asia. Of the US\$1.8 trillion in global FDI inflows in 2007, US\$1.2 trillion of it went to just five countries – Canada, France, the Netherlands, the UK and the US.²¹ Similar intensity is evident in FDI inflows into developing regions. East and south Asia received US\$249bn comparing favourably with Africa (US\$53bn) and Latin America and the Caribbean (US\$126bn). Within Asia, China and Hong Kong continue to be key destinations (see box on page 6).²²

Contributions

Much has been written about the impact of MNCs on development. While donors have praised the contribution that MNCs can make to economic diversification and productivity, civil society has exposed the harm that they have caused to the environment and human rights. Their impact on development is both direct and indirect.

Direct impacts on development

Employment and income

The most direct way for MNCs to contribute to development is by creating employment and providing income. For most poor men and women, their labour is their main asset, and working is their main way of participating in and benefiting from economic activity. Despite the economic importance of MNCs, they provide surprisingly few jobs. In 2000, they accounted for only 3.4 per cent of the world's total employment (that is, 95 million employees out of 2.8 billion employees).²³ Nonetheless, one study on Namibia and Zimbabwe found that two to four jobs were created locally for every worker employed by an MNC in those countries.²⁴

It is frequently claimed that the wages and conditions offered by MNCs are superior to those offered by domestic firms. The evidence suggests that MNCs do indeed tend to provide better pay than their domestic counterparts,

especially when they operate in developing and emerging economies.²⁵ One study of average wages in domestic and foreign plants in Mexico and Venezuela concluded that they were up to 30 per cent higher in foreign plants.²⁶ However, there is no guarantee that MNCs will always offer better pay and conditions, although those employing skilled workers may well do so.²⁷

The evidence about MNC working conditions, where it is available, is more mixed.²⁸ Research has concluded that relatively few MNCs export labour practices from their home countries to their foreign affiliates. However, although enforcement of labour standards is usually weaker in developing countries, pressure from consumers and investors in developed countries can create incentives for MNCs to improve conditions. The ETI, for instance, is an alliance of companies, non-governmental organisations (NGOs) and trade unions that seeks to improve the implementation of corporate codes of practice covering working conditions throughout global supply chains.²⁹

In Christian Aid's 2004 report *Behind the Mask: the Real Face of Corporate Social Responsibility*, we investigated the working conditions of tobacco farmers in Kenya who are contracted to deliver tobacco to British American Tobacco (BAT).³⁰ One tobacco farmer, George O, explained that his contract required him to raise seedlings, harvest, cure and sort leaves, and then sell them for a yearly profit of just US\$140. He knew little about the true market value of his crop. Additionally, BAT sold him pesticides, but he said no protective clothing had been supplied, and he suffered from respiratory and skin conditions when using it.

Infrastructure and essential services

The provision and maintenance of accessible and affordable infrastructure and essential services – such as transport, energy, health, water and sanitation – is crucial to poor communities. Foreign donor policies starting from the 1990s pushed the idea that the private sector could fill gaps in infrastructure and essential services and do so more efficiently than the state. Consequently, the private

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sector has become increasingly involved in essential service provision; for example, by privatisation, contracting out and public-private partnerships.

But the track record of the private sector in providing essential services has been mixed. MNCs have failed to fill adequately the investment gap in some sectors. Investment in water and sanitation in particular has declined.³¹ Where water supplies have been privatised, there have been improvements in supply connections, revenue billing and collection, but increased rates have made water unaffordable for the poorest communities.³² Private-sector water suppliers have typically viewed connecting the poorest communities to water supplies as a high-risk enterprise with low returns.

In the 2001 Christian Aid report *Master or Servant?* on services, the World Trade Organization (WTO) and MNCs, we revealed the costs that a World Bank project to introduce a market-driven water supply in rural areas in Ghana (in the run-up to privatisation) had already imposed on one community.³³ With communities required to contribute five to ten per cent of start-up costs, the community in Bimbila in the north of the country found it simply could not raise the money.³⁴

Goods and services

One previously neglected aspect of MNCs' impact on development is the effect that they can have when selling to the poorest communities. MNCs have the design and production capacities to supply goods and services that can meet the needs of poor people. However, their increasing presence in the markets of poor people carries significant risks. MNCs can dominate, putting small enterprises out of business and poor people out of work, reducing the range of goods and services available, and forcing up the price of essential ones.³⁵ Where MNCs have that impact, governments should ensure that poor people still have access to the goods and services that they need. Further, if poor people do not have money to spend, it seems unlikely that market-based solutions per se will deliver poverty reduction because they cannot afford to buy goods and services.

Philanthropy and CSR

MNCs increasingly promote their philanthropic and CSR activities as a key part of their contribution to development. There is much enthusiastic discussion and debate in the UK at present regarding the potential of the UK business community to finance and achieve development.³⁶

The value of corporate philanthropy in developed countries is significant, although not as significant as individual donations or volunteering.³⁷ Yet only a small portion of philanthropy is used for international issues. Domestic

issues still dominate. Corporate foundations do give large sums of money to development agencies though, with global funds used to facilitate corporate financial support for specific development issues. A recent survey, however, suggests that the global financial crisis might reduce corporate giving in the UK by one-third.³⁸

Criticisms of philanthropy are common: it is deemed by many to be a public relations exercise; it is said to have limited impact and present difficulties with scaling-up to contribute more effectively to development; and it might not be aligned with national development plans.

Christian Aid has previously defined CSR as 'an entirely voluntary, corporate-led initiative to promote self-regulation as a substitute for regulation at either national or international level'.³⁹ We are definitely in favour of companies behaving responsibly to ensure that they impact positively – or, at a minimum, not negatively – on the environment and human rights. However, as we argued in *Behind the Mask*, the positive impact of CSR is inconsistent and there is no substitute for enforceable regulation in governing practice and granting redress. We identified the likely reasons why companies embark on CSR programmes:

- for public relations purposes
- to attract investors with ethical concerns
- to engage with civil society criticism and opposition
- to obtain government and donor permission to operate
- to lobby against certain national and international regulation.

None of these reasons reflect a genuine concern for livelihoods and lives. They are all commercial – maintaining a good reputation, securing financial support, neutralising critics, winning concessions and contracts, and reducing regulatory barriers. The positive impacts that might flow from these reasons are limited, not least because they can create a smokescreen that prevents consumers and investors having the right information on which to reach informed views on reputation and make balanced choices on investment.

However, Christian Aid is in no doubt that CSR has been valuable in many cases. Solid dialogue and greater understanding has arisen between the private sector and civil society, which has led to agreement on policies and practices. Company reporting of environmental and social impact has come a long way since its early days, although it is still hampered by different criteria and variable quality.

The ultimate test, though, is whether CSR activities – and, more importantly, core business activities – are delivering sustainable benefits to the poor. There are many instances where companies implementing CSR programmes have still caused harm.⁴⁰

Indirect impacts on development

Economy

Some of the most enthusiastic, though largely theoretical, claims that MNCs can have a positive impact on development are made in relation to the indirect benefits that they bring to local economies. MNCs are said to invest in staff skills and productive capacity, and to introduce new knowledge that benefits domestic firms through imitation and learning. They are also said to boost economic growth.⁴¹

The primary way that MNCs enter and operate in local economies is through FDI. FDI is defined by the IMF as ‘investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor’s purpose being to have an effective voice in the management of the enterprise’.⁴² Setting up new affiliates, buying domestic firms, or taking a majority share in and management control of domestic firms are all examples of FDI. However, not all such investment leads to the creation of MNCs, and not all MNCs use FDI. Foreign firms will sometimes invest in domestic firms without linking their businesses. Some MNCs are at the front of global value chains that arise by controlling suppliers via contractual relationships, rather than buying or controlling domestic firms.

Notionally, MNCs can boost growth and productivity in domestic economies by increasing competition so that

domestic firms become more efficient. They can also precipitate spillovers and linkages to the benefit of domestic firms.⁴³ (‘Spillovers’ take place when domestic firms imitate or learn from MNCs; ‘linkages’ refer to the relationship that can develop between independent companies – see the ‘MNC and SME linkages’ box below.)

The evidence of positive indirect impacts is mixed and appears to depend on the degree of economic openness, educational levels among the local workforce, strength of financial markets and regulatory environment.⁴⁴ A recent World Bank paper observed that there is no robust evidence linking FDI to income growth.⁴⁵ An UNCTAD review suggested that MNCs might confine domestic firms to less profitable parts of industry.⁴⁶ And, while MNCs are responsible for most global research and development (R&D), the majority of studies of technology transfer from MNCs to domestic firms are, at best, inconclusive.⁴⁷

Tax

One positive impact of MNC investment in developing countries might reasonably be expected to be increased tax revenue. However, tax incentive competition and contract negotiation, and MNC tax avoidance and evasion, reduce the prospect of such increases.

The main techniques for tax evasion are trade mispricing – consisting of transfer mispricing by MNCs and false invoicing by independent companies – and round-tripping. In the 2008 Christian Aid report *Death and Taxes: the True Toll of Tax Dodging*, we calculated that trade mispricing alone costs the developing world US\$160bn in lost tax revenues every year. If these revenues were used in the developing world, they would currently save the lives of 350,000

MNC and SME linkages

‘Linkages’ are relationships between independent firms that go beyond a one-off purchase of a standard good or service. These relationships can range in depth from the regular supply of an off-the-shelf product to more involved collaborations to develop dedicated production facilities to meet global production, supply or distribution.

There are three basic types of possible linkages between foreign and domestic firms –

backward, forward and horizontal.⁴⁸ Backward linkages are when foreign firms buy goods and services from domestic firms. Forward linkages are when foreign firms sell goods and services to domestic firms. Horizontal linkages are when foreign firms compete with domestic firms.

All types of linkages have potential benefits for development. Backward linkages are considered to be most immediately beneficial

because they involve domestic firms producing and selling for profit. Forward linkages can provide domestic firms with access to new technologies, products or practices that allow them to increase their productivity. Horizontal linkages might improve productivity by increasing competition, but they can also have negative impacts if the gap in competitiveness between foreign and domestic firms is too great.

MNC and SME linkages are not without risk for SMEs. The power imbalance between MNCs and SMEs or the anti-competitive practices of MNCs can result in unfavourable linkages. Instances of exploitative or exclusive relationships are numerous, especially for labour.⁴⁹ Current competition policies have been criticised as inadequate for dealing with unequal relationships and unfair behaviour.⁵⁰

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children under the age of five every year.⁵¹ These practices, as well as the existence of tax havens, drain tax revenues that should be available for public finances and significantly harm prospects for growth.

MNCs, particularly in the extractives sector, have demanded and received massive tax concessions from governments as the price for setting up operations. *Death and Taxes* listed 15 concessions that Tanzania has made to gold-mining companies to attract their investment.⁵² Tanzania is one of the emerging gold producers of Africa. Gold now accounts for more than 90 per cent of the country's mineral exports. In 2007, gold exports were worth more than £500m. However, most Tanzanians have gained little from this huge and wealthy natural coffer. That same year, some 140,000 Tanzanians died from HIV-related illnesses, while nearly half the country's population was classified as undernourished.

Policy and governance

MNCs have the potential to influence governments to improve business environments and to promote good governance and more inclusive development. Yet, in spite of this power to do good, civil society has frequently highlighted the detrimental impact that MNCs have had. Their self-interested effect on the process and substance of trade negotiations is one instance.⁵³

In Christian Aid's 2008 report *From Local to Global: Stopping Corruption from Stunting Development*, we showed that corruption is not confined to the public sector.⁵⁴ Corruption is seen in relations between the private and public sectors, and in the private sector. In the countries studied in the report, Kenya, Nigeria, Peru and Tajikistan, it had become a way of life in both formal and informal relationships.

Compared to corruption in the public sector, there is less research on the presence of corruption in the private sector. However, anti-corruption NGO Transparency International constructs a yearly bribe payers index (BPI) of the world's wealthiest and economically dominant countries based on the likelihood of their firms resorting to bribery in other countries.⁵⁵ The 2008 BPI ranked 22 countries, with Belgian and Canadian firms being equally least likely to bribe, and Russian companies being the most likely to do so. UK firms were equal fifth.

The environment

MNCs can, of course, introduce higher standards and green technologies to the countries in which they invest, but experience varies between sectors. Industries involved in using or removing raw materials, such as agribusiness and extractives industries, have a particularly weak track record when it comes to assessing and mitigating their environmental and social impact.⁵⁶

SMEs

Characteristics

SMEs can constitute the major employer in the private sector in developing countries. However, despite their importance to economic growth, SMEs do not always contribute positively to development. The wages that they offer might be below what employees need to escape the poverty trap, and their working conditions can be unfair or unsafe. Unlike MNCs, SMEs are often not subject to the same level of scrutiny or held to the same level of account.

Various definitions of SME are currently used based on different criteria such as employment, assets, sales and investment.⁵⁷ Further, the same criterion can be measured differently; for example, one country might define an SME as an enterprise with fewer than 500 employees, while another might define it as one with fewer than 250 employees. As at 2001, the SME department of the World Bank used the following definitions:

- a 'micro-enterprise' has up to ten employees, total assets of up to US\$10,000 and total sales of up to US\$100,000
- a 'small enterprise' has up to 50 employees, and total assets and sales of up to US\$3m
- a 'medium enterprise' has up to 300 employees, and total assets and sales of up to US\$15m.

Table 2 sets out the estimated numbers of SMEs in the developing regions where Christian Aid works. Their distribution is uneven, with east Asia and Latin America predominant.

Table 2 Comparison of SME numbers by region

Region	Estimated number of SMEs (million)
South Asia	3.6
Sub-Saharan Africa	7.3
East Asia and Pacific	10.3
Middle East and north Africa	4.7
Latin America	13.9
Total	39.8

Source: www.ifc.org/ifcext/sme.nsf/Content/Resources

Table 3 Comparison of SME contribution to employment and GDP by region/country

Region	Country	GDP per capita (US\$)	SME contribution to formal employment (%)	SME contribution to GDP (%)
Africa	Nigeria	256.6	16.7	-
	South Africa	3,922.6	81.5	-
	Zambia	418.9	36.6	-
Asia	Kyrgyzstan	972.3	63.2	-
	Philippines	1,099.3	66.0	31.5
	Tajikistan	56.4	35.9	-
Central America	Guatemala	1,460.5	32.3	-
	Honduras	706.0	27.6	-
	El Salvador	1,608.9	52.0	44.1
South America	Brazil	4,326.6	59.8	-
	Colombia	2,289.7	67.2	38.7
	Peru	2,162.0	67.9	55.5

Source: Adapted from Meghana Ayyagari, Thorsten Beck and Asli Demircug-Kunt, *Small and Medium Enterprises Across the Globe: A New Database*, World Bank Policy Research Working Paper no. 3127, August 2003, pp22-23. Values are 1990-1999 averages for all variables. Official definition of SME used.

SMEs are a heterogeneous group. They engage in a wide variety of commercial activities (ranging from primary production and basic service provision to complex manufacturing), at different levels and in different locations (including local, national, regional or international, and urban or rural), and in the formal and informal sectors (see 'The informal sector' box on page 13). In addition, as discussed, SMEs can enter into linkages with MNCs (see 'MNC and SME linkages' box on page 9).

A World Bank study found that the importance of SMEs in terms of the level of their contribution to employment and GDP varies across countries. Table 3 shows such variations in regions/countries where Christian Aid works.

The data suggests that SMEs contribute less strongly to formal employment in Africa and Central America, but heavily in Asia and South America, although data for Asia is limited. SME contribution to employment is lowest and highest in two African countries – Nigeria and South Africa. These results point to the importance of the informal sector in less developed African and Central American economies.

Figures for SME contributions to GDP are limited, but they show that SMEs are a major participant in economic activity – and a key driver of economic growth – in developing countries where GDP per capita is above US\$1,000. This supports one of the key conclusions of the World Bank study that countries with higher GDP per capita have larger formal SME sectors.⁵⁸

Contributions

Notwithstanding the variable role that SMEs play in the formal economy of developing countries, as with MNCs they can make a fundamental contribution to development and reducing poverty through the same or similar channels.

Direct impacts on development

Employment and income

SMEs create jobs and pay wages. Depending on the country, they can be a major source of employment and income. A World Bank study examined the argument that SME expansion boosts employment more than large-firm growth because SMEs are said to be more labour intensive.⁵⁹ The study cited research showing that

However, while the private sector has the capacity to benefit poor people, it has been responsible for harming them too.

SMEs are neither more labour intensive nor better at job creation than large firms. More crucially, it did not find 'a significant relationship between SMEs and poverty alleviation. Specifically, 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 when controlling for the level of GDP per capita.'⁶⁰ Such findings, however, say nothing about whether a successful SME will reduce poverty in a specific community.

Goods and services

SMEs can provide basic goods and supply essential services to the poor. They frequently produce light consumer goods – food, garments and textiles, and wood products – to meet household demand.⁶¹ SMEs can be an important part of the supply chain of essential services, such as sanitation and water, and even compete with major service providers in some cases.⁶²

Philanthropy and CSR

SMEs are less mobile than MNCs. Consequently, they are usually closer to local communities and they can contribute more relevantly and sensitively to community development and survival, beyond creating jobs and paying wages. One study found that half of the SMEs in the European Union are involved in socially responsible activities, such as culture, health and sport, to improve customer loyalty.⁶³ Yet the wide variety of self-regulation initiatives that have emerged in the past two decades have not been specifically targeted to include SMEs.⁶⁴

Indirect impacts on development

Economy

SMEs can play a significant role in local economic activity. Some argue that SMEs can enhance competition and entrepreneurship, and that they are generally more productive than large firms, but their development is constrained by institutional failures.⁶⁵ Others counter that large firms can exploit economies of scale and meet the fixed costs required for R&D, and they contend that institutional failures constrain all firms.⁶⁶ While there is a positive relationship between the relative size of the SME sector and growth, SMEs do not drive growth in the long term, although SMEs are characteristic of successful economies.

Tax

An expanding SME sector in developing countries can create a new and wider base for increasing tax revenue. Yet SMEs can suffer from an unfair tax burden because it is

easier for enterprises in the informal sector and large firms in the formal sector to avoid paying taxes.⁶⁷ Informal sector enterprises are usually not registered with tax authorities, so they cannot be taxed. Large enterprises have the means to structure their finances to ensure that they pay the minimum amount of tax. While the lawful amount of tax must be paid, this burden can disadvantage SMEs in relation to other businesses. Successful enterprises in the informal sector, however, might eventually enter the formal sector and join the ranks of SMEs.

Policy and governance

SMEs are often missing from national or international policy and rule-making processes, which tend to focus on the interests of larger firms. In cases where SMEs are represented by larger firms – for instance, in the context of business associations – their needs may not be properly represented, especially where they conflict with larger firms' needs.⁶⁸

The environment

The extent to which SMEs conduct their business in an environmentally sustainable way has not been studied in great detail. A general perception is that they have a less negative impact on the environment than MNCs.⁶⁹ However, their individual effects within specific contexts, and their cumulative effects, can be significant. One estimate suggests that the SME sector in the UK is responsible for about 50 per cent of commercial and industrial waste. SMEs can, of course, contribute to environmental sustainability by complying with environmental laws, investing in clean processes and using sustainable resources (see box below).

SMEs and climate change

The support of SMEs is essential if developing countries are to progress towards a low-carbon economy. They have the potential to extend low-carbon practices and to promote sustainable development for the poorest communities. SMEs represent an important proportion of the emissions in developing countries and

they would be good candidates for low-carbon development through carbon financing. For the poorest communities, particularly those in rural areas, clean renewable energy is often the cheapest option for basic energy supplies; for example, modern biomass, geothermal, wind, solar, or small-scale hydropower and marine energy.

Micro-enterprises

Micro-enterprises⁷⁰ are usually operated by self-employed individuals or are family businesses. They include street vendors, lottery-ticket sellers, taxi drivers, guesthouse owners, tour operators, locksmiths, photocopying and printing providers, seamstresses and farmers. In developing countries, most enterprises are micro, and most are in the informal sector.

Micro-enterprises are thus one of the most important parts of the private sector through which the poorest communities can work their way out of poverty. They also act as a crucial

safety net. With limited education and skills to compete for formal sector jobs, poor men and women find economic opportunities in micro-enterprises as business owners and employees. Establishing micro-enterprises is usually the only way for poor people to work and earn money.

According to the World Bank, there are two contrasting ways of assessing the growth potential of micro-enterprises, which reflect different economic views on their value over and above their vital role in poverty reduction:

*'One view is that small firms in the informal sector are a source of dynamism unburdened by the excessive regulations and other barriers to growth imposed on the formal sector. The informal sector can provide a testing ground for potential entrepreneurs, who try their luck at a small scale and don't engage in formal institutions until they gain experience and learn about their ability. In the alternative view, the informal sector consists mainly of subsistence and low-productivity firms, which exploit the cost advantage from informality and discourage the growth of larger, more efficient formal firms.'*⁷²

There are a range of policy reforms and new programmes that have been found to promote micro-enterprise growth, including:

- simpler business regulations
- simpler tax regimes and licensing requirements
- greater access to credit through financial sector reform and supervision
- more and better training in business and marketing skills and utilising technology.

The informal sector

The informal sector covers a wide range of economic activities that fall into two distinct groups.⁷¹

The first group is casual or unpaid jobs and subsistence agriculture that help individuals and families cope with poverty. These economic activities are typically characterised by ease of entry, reliance on indigenous resources, family ownership, small-scale operation, labour intensiveness, adaptive technologies, skills acquired outside of the formal sector, and unregulated and competitive markets.

The second group is entrepreneurs and businesses wanting to

escape regulatory burdens, such as labour standards, company registration and tax obligations. These two groups can overlap with each other, as well as with the formal sector.

The informal sector is a crucial provider of employment in the non-agriculture sectors of developing regions, with self-employment prominent.

Table 4 illustrates the share of informal sector non-agricultural employment in the regions where Christian Aid works. If the agriculture sector was included, the shares illustrated in this table would increase significantly.

Table 4 Share of informal sector non-agricultural employment by developing region

Region	Share of informal employment (%)	Share of self-employment in informal employment (%)
Asia	65	59
Latin America	51	60
Sub-Saharan Africa	72	70

Source: *Women and Men in the Informal Economy: A Statistical Picture*, International Labour Organisation, 2002, p20.

Income-generation projects

From 2000 to 2005, Christian Aid disbursed nearly £5m in microfinance and micro-enterprise support, and £9.3m in broad income-generation and employment-related projects. Our partners were located in all developing regions, but particularly in Latin America, south Asia and west Africa. We believe that the usefulness of microfinance can be gauged by the problems that it seeks to address. Often, it can plug livelihood gaps, but much

more is needed than microfinance to eradicate poverty. During this period, Bethania, one of our partner organisations in Guatemala, was running an education project to teach indigenous women basic reading, writing and mathematics. Bethania also provided some of its students with microfinance to use their newly acquired education to establish their own micro-enterprises, such as chicken farming.

FOREIGN DONOR PRIVATE SECTOR DEVELOPMENT STRATEGIES

There have been two phases of private sector development in recent times.⁷³ In the first phase, foreign donors and governments provided direct financing, capacity building and technical assistance to the private sector. The implicit objective of this phase was to create employment. The first phase ended with the realisation that it was unsustainable – many firms and sectors lacked the potential or capacity to achieve the competitiveness needed to free themselves from support, and foreign donors and governments lacked the funds to subsidise them forever.⁷⁴

The second and current phase sees markets being targeted directly, rather than firms and sectors.⁷⁵ Targeting markets has placed greater emphasis on institutions and policies, which are required for markets to function and for them to contribute to development.⁷⁶ The explicit objective of this phase is to create choices and opportunities. Moreover, this phase has increased the centrality of private sector development in national poverty reduction strategies because, after two decades of deregulation, liberalisation and privatisation, the successful functioning of different markets is more crucial than ever for development.

Indeed, the policies of deregulation, liberalisation and privatisation are the backdrop to this report. The very direct state intervention that was involved has, to a fair extent, given way to somewhat more nuanced approaches. However, there is still a need to hold foreign donors to account about whether their private sector development strategies reflect the end of the Washington Consensus.

The foreign donor community has designed two distinct approaches, which can complement each other. The first approach, led by the World Bank, focuses on the investment climate.⁷⁷ The second approach seeks to include poor people more in markets and has a number of adherents, perhaps most prominently UNDP.⁷⁸ The UK's Department for International Development (DFID) has something of a hybrid private sector development strategy that uses both approaches.⁷⁹

Christian Aid recognises the need to provide the right investment climate for the private sector to take risks, and the right policies and institutions to ensure that poor people have opportunities to work and buy goods and services. However, we do have concerns about these approaches, particularly as they continue to emphasise market-oriented solutions where they may not be appropriate in the short to medium term.

Investment climate approach

The World Bank's most recent private sector development strategy in 2002 is the leading example of the investment climate approach. This strategy aims to improve the

investment climate and to enhance the delivery of basic services, in support of poverty reduction.⁸⁰ Its initial implementation focused on the investment climate, based on the following rationale:

*'A sound investment climate unleashes the entrepreneurial talents of people, including poor people, leading to productivity improvements, diffusion of best practices and creation of productive jobs.'*⁸¹

Christian Aid is concerned about this approach for a number of reasons:

- its basic assumption – that FDI is good for development and, therefore, that more of it is better – is dubious because studies have shown that FDI can undercut or stifle development⁸²
- there is evidence that the investment climate is less significant in attracting FDI than other factors, such as market size, GDP, growth rate, available resources and existing infrastructure⁸³
- it continues to liberalise investment regimes despite developing-country opposition in recent Organisation for Economic Co-operation and Development (OECD) and WTO negotiations, and the ongoing civil society protests about liberalisation under EU bilateral and regional trade negotiations.⁸⁴

The World Bank identified that the core areas of the investment climate approach are:

- regulation and competition policy
- legal institutions for a market economy
- property rights
- corporate governance
- dispute resolution mechanisms.

It developed a set of tools – surveys, indicators and assessments – to determine the areas that need improvement.

The annual DBI are the most controversial of these tools. They are quantitative indicators of standardised regulations that are evaluated country by country. The 2008 DBI report used the following indicators for ten stages of the business life cycle:

- starting a business
- dealing with licences
- employing workers

- registering property
- getting credit
- protecting investors
- paying taxes
- trading across borders
- enforcing contracts
- closing a business.⁸⁵

The DBI trouble us in several ways, but particularly because they reduce the room for manoeuvre in terms of economic policy-making. The World Bank claims that the indicators represent the standardised regulations that are needed to promote business activity, which will be constrained if they are not adopted. Such standardisation does not allow for developing countries to maintain different regulations to meet their specific development needs. The World Bank publishes a survey of DBI performance annually. The effect is to pressure countries into meeting them. The World Bank's message is 'if you are not reforming, another country will overtake you'.⁸⁶

Moreover, some of the DBI reforms have the potential to harm development if they are taken to their logical extreme. The employing workers indicator (EWI) continues to pose a threat, despite recent alignment with International Labour Organisation (ILO) core obligations, by promoting labour market flexibility to the potential detriment of job security and good conditions. In the DBI 2008 report, the World Bank proclaimed optimistically that more 'flexible labour regulations... don't mean giving up protections', but caustically noted that 'slow clerks need not worry about losing their job [in Venezuela, as it has] expanded its ban on firing workers to cover anyone who earns less than three times the minimum wage'.⁸⁷ Meanwhile, the paying taxes indicator (PTI) encourages developing countries to lower total tax payable, which might reduce tax revenue, and, as a result, the capacity of developing countries to provide essential services to poor communities.

Lastly, by standardising regulations, the DBI ignore the importance of national differences. The same regulations might have different outcomes in different countries, depending on the economic structure, initial distribution of assets, and nature of economic and political institutions.

Shortly before going to print, and at the height of global anxiety about the current financial crisis, the World Bank announced:

*'The business climate is one aspect of development policy, and the [World Bank] emphasises that other development goals must also be given appropriate weight. These include issues as diverse as political stability, social safety nets to shield vulnerable parts of society from intolerable levels of risk, and protection of rights for workers and households as well as for firms.'*⁸⁸

Accordingly, the World Bank is removing the EWI because it is not policy and it 'should not be used as a basis for policy advice',⁸⁹ and it is re-examining the PTI. This is welcome news and responds to two of our issues with the DBI. Christian Aid hopes to assist the World Bank in reformulating not only the DBI, but its investment climate approach to private sector development.

Inclusive market approach

The name given by the UNDP to this approach is the inclusive market approach.⁹⁰ Similar approaches are being taken by other donors under different names, such as 'making markets work for the poor'.⁹¹ Indeed, the concept of 'inclusive markets' is of markets that work for poor people, whether they are entrepreneurs, employees or consumers.⁹² Such markets would increase profits on goods sold and services supplied, create opportunities for decent work, and improve access to basic goods and services.

The UNDP has identified four priorities to facilitate development of inclusive markets. For markets to work for poor people, they must:

- work, which requires establishing regulatory frameworks for ruled-based and non-discriminatory markets that promote fair competition but safeguard the rights of entrepreneurs, employees and consumers and ensure the inclusion of poor people
- generate employment opportunities, so developing integrated value chains in market sectors that offer the prospect of sustainable growth and transition to higher value-added and better remunerated forms of production and employment
- provide access to essential goods and services by developing markets for poor people through new investment opportunities and sustainable business models that target them
- permit new businesses to start up, by promoting entrepreneurship for poor people.⁹³

While the first and second priorities, in particular, accord very closely with Christian Aid's perspective, we remain

uneasy about a market-oriented solution to essential goods and services. Frameworks such as the 'bottom of the pyramid'⁹⁴ see poor people in their role as consumers, but they are producers and suppliers too, sometimes of essential goods and services. Promoting increasing competition in the markets of poor people can undermine their ability to produce and supply their goods and services, reducing their incomes and decreasing their capacity to pay for health and education. Further, MNCs might introduce pricing structures that reduce access to essential goods and services.⁹⁵ Finally, where poverty is acute or chronic, it seems unlikely that a market-oriented approach will reduce poverty because poor people cannot afford to buy goods and services.⁹⁶

GETTING BACK ON THE RAILS

Christian Aid contends that after two decades of neo-liberal ideological dominance, the state must become more involved in the operation of markets and development of the private sector to ensure that poverty is eradicated and development is sustained.

- 1 The 'visible hand' of the state is needed to create and manage the 'invisible hand' of the market.
- 2 The state must manage markets in such a way that produces equitable outcomes, and such management might involve redistribution of incomes and profits through taxing and spending.⁹⁷
- 3 The state must ensure that poor people are included in the development of the private sector by providing them with opportunities and resources so that they can find work and earn wages or start businesses and make profits.
- 4 The state must support poor people by providing basic infrastructure and essential services.
- 5 The state must protect poor people so that the private sector cannot exploit them, and that where it occurs it is quickly mitigated and properly redressed. The private sector should be prevented from anti-competitive behaviour and the unsustainable use of resources, and it should be prevented from hurting livelihoods and lives.

The tools at the disposal of the state are not new.

Table 5 suggests a package of the policies, regulations and institutions that might now be needed to govern markets and the private sector so that they contribute to development rather than doing nothing for it or undermining it. Governments will need to find the right balance of interventions and measures if the private sector is to drive the economy while at the same time including poor people and offering them protection. This might require trial and error, but it is a more sensible and realistic approach to private sector development than solely relying on market-based solutions.

Moreover, developing countries need space for making the right policies, drafting the right regulations and building the right institutions for dynamic, inclusive and protective private sector development strategies. The Washington Consensus recommendations, particularly deregulation, liberalisation and privatisation, increasingly denied developing countries the ability to determine their own policies. Developing countries must tread carefully now to ensure that their interventions and measures comply with recent international agreements and national laws (see box on page 18).

At the same time, it must be recognised that CSR is no longer a satisfactory substitute for national and international law. As Christian Aid has previously stated:

Table 5 Examples of state governance of markets and the private sector for development

Roles and responsibilities	Policies, regulations and institutions
Markets	<ul style="list-style-type: none"> • Growth strategy within development strategy. • Agriculture, industrial, investment and trade policies and regulations to support development strategy. • Competition and anti-corruption policy and law. • Informal sector policies and programmes. • Accountable and efficient public sector.
Equity and redistribution	<ul style="list-style-type: none"> • Progressive, simple and enforced tax regime. • Comprehensive education and health services. • Transparent and participatory decision-making. • Accountable budget and procurement processes. • Affordable and necessary basic goods and services.
Opportunities and resources	<ul style="list-style-type: none"> • Targeted banking, finance and insurance. • Agriculture, environment and land policies. • Tailored employment and training policies. • Appropriate linkage policies and regulations.
Infrastructure and services	<ul style="list-style-type: none"> • Affordable climate-friendly transport. • Accessible clean energy and water.
Protection and mitigation/redress	<ul style="list-style-type: none"> • Applied consumer, labour and human rights laws. • Access to justice and effective legal systems.

*'Voluntary approaches can only ever address company behaviour in a partial and non-sustainable way. Market forces will push some companies towards more responsible practices, while others will take advantage of this to undercut them. Without standardisation and regulation, companies will be at the mercy of their shareholders; communities will be at the mercy of the changing economic realities faced by companies; and consumers and investors will never know for sure if companies really mean it when they claim to be acting responsibly.'*⁹⁸

Having said that, CSR has spawned voluntary initiatives that are good precedents for negotiating the contents of new agreements and laws, and it has to be acknowledged that it has made a contribution to development – albeit a patchy one.

Finally, in addition to meeting its basic legal responsibilities, the private sector can contribute to development in a number of ways:

- improve its business practices to create employment for poor people with decent working conditions
- provide opportunities for small enterprises to join value chains and receive a more equitable share of profits
- produce goods for and provide services to poor people that are affordable and necessary
- manage the assets and resources that it shares with poor communities but on which poor communities are more dependent
- share skills and technology with poor people so that they can upgrade their employment and enterprises
- offer finance to poor people that will allow them to establish businesses and to invest in health and education.

Trade liberalisation: closing down the policy options

The manner in which trade and investment liberalisation shut down the policy options for guiding FDI to meet development needs is instructive.

Before the WTO was established in 1995, governments used investment measures to require foreign investors to promote development. The national treatment obligation in the WTO Trade-Related Investment Measures Agreement (TRIMS Agreement), for example, now requires trade-related investment measures (TRIMS) to treat foreign and local investors equally (in the

context of trade in goods).⁹⁹ TRIMS that are inconsistent with this obligation include measures that require particular levels of local procurement by a firm ('local content requirements') or that restrict the volume or value of imports such a firm can purchase or use to an amount related to the level of products it exports ('trade balancing requirements').¹⁰⁰

The recent proliferation of bilateral and regional trade agreements has further limited policy options by prohibiting performance requirements, including technology transfer, and introducing new rights for

investors to seek remedies against governments for measures that they claim harm their investments.¹⁰¹ The introduction of investor-state dispute settlement mechanisms has had a new chilling effect on the use of policy options to link investment with development.

Governments now often use incentives, subsidies and services to promote development, but they require substantial resources and advanced institutional and technical capacity to be effective, and they might not comply with another WTO agreement, the Subsidies and

Countervailing Measures Agreement, which disciplines non-agricultural subsidies.

However, it should be borne in mind that the extraordinary economic development that east Asia experienced in the 1980s and 1990s happened in spite of increasingly restricted freedom to make economic policy. Further, the constraints that WTO agreements place on members may not be that widespread or binding, although bilateral and regional trade agreements might impose greater ones.¹⁰²

CONCLUSION

At the heart of private sector development is a debate about the role of the market and the state. We believe that neo-liberalism and the Washington Consensus over-emphasised the role of the market to the detriment of development – and, ultimately, to the cost of markets themselves. The balance between the market and the state now needs to be re-weighted in favour of the state, so that the state can ensure equity and redistribution, and guide the private sector into contributing fully to development while protecting poor people.

There is absolutely no doubt that the private sector is the driver of the economy. MNCs, SMEs and micro-enterprises have made substantial contributions to development in the past. They have done so directly through jobs and wages, goods and services, and gifts and programmes, and indirectly via economics, policies, taxes and their impact on the environment. With greater state involvement and more appropriate policies, regulations and institutions, the private sector should, can and will make even greater contributions to development in the future.

However, elements of foreign donor private sector development strategies continue to pursue similar market-oriented solutions to development that neo-liberal ideologues have championed since the 1970s. The World Bank investment climate approach does not take into account the lessons learned about the failure of FDI to

contribute to development without government measures, and the standardisation of the DBI limits the policy options needed for effective strategies.

In addition, as Christian Aid has illustrated in its reports on corporate accountability and CSR, MNCs in particular have been responsible for environmental damage and human rights violations that were neither prevented nor redressed by their voluntary initiatives.¹⁰³ Stronger international and national legal regimes must regulate businesses. Such regimes reinforce the conditions needed for a vibrant and inclusive private sector: anti-corruption laws stop the poor paying the costs of bribery; competition policies prevent more powerful firms exploiting less powerful firms; environmental protection manages scarce natural resources carefully and shares them fairly between business and livelihoods; human rights promote an equitable, non-discriminatory, educated and healthy society; and labour standards ensure fair wages and decent working conditions.

Therefore, we emphasise the need to develop a more sophisticated and shared model of private sector development in which states can manage markets in ways that allow the private sector to do business, create wealth and make money, while ensuring that it makes a powerful and sustainable contribution to development by including and not harming poor people.

RECOMMENDATIONS

Based on this analysis, we make the following recommendations

Actions for developing-country governments and civil societies

They should work together to:

- strengthen the links between the different parts of the private sector and different channels of development through appropriate policies, regulations and institutions
- ensure that poor people are included in markets but protected from exploitation through appropriate policies, regulations and institutions
- hold the private sector to account for strengthening its links with development, ensuring inclusion and protection of poor people, and preserving the right of developing countries to determine their own policies
- promote transparent, participatory and accountable processes for pursuing these actions.

Actions for foreign donors

They should:

- revise private sector development strategies to preserve the right of developing-country governments to make their own policies, introduce regulations and build institutions that strengthen the link between the private sector and development, ensuring poor people are included and protected.

Actions for MNCs

They should:

- work with developing-country governments, civil societies and foreign donors through accountable CSR, core business activities and global advocacy to strengthen the links between the private sector and development, ensuring the inclusion and protection of poor people, and preserving the right of developing countries to determine their own policies.

ENDNOTES

- 1** Prime Minister Gordon Brown, G20 Press Conference, London, 2 April 2009, www.number10.gov.uk/Page18934
- 2** President Barack Obama, News Conference, The Whitehouse, 2 April 2009, www.whitehouse.gov/the_press_office/news-conference-by-president-obama-4-02-09/
- 3** Kim Kee Beom, *Direct Employment in Multinational Enterprises: Trends and Implications*, International Labour Organisation MULTI Working Paper 101, 2006, p13.
- 4** Elena Arnal and Alex Hijzen, *The Impact of Foreign Direct Investment on Wages and Working Conditions*, OECD Social Employment and Migration Working Paper no. 68, 2008, pp27-28.
- 5** *Private Sector Development Fourth Report of Session 2005-06* (1), International Development Committee, House of Commons, London, July 2007, p16.
- 6** In fact, the Washington Consensus required highly active and direct state intervention, not least in the widespread privatisation of public utilities and assets, and in the sweeping deregulation of national markets and liberalisation of the international flow of goods, services and investment.
- 7** Prime Minister Gordon Brown, G20 Press Conference, London, 2 April 2009, www.number10.gov.uk/Page18934
- 8** John Williamson, 'What Washington means by policy reform', in *Latin American Readjustment: How Much has Happened*, Institute for International Economics, 1990, www.iie.com/publications/papers/paper.cfm?researchid=486
- 9** Except for regulations that are justified on safety, environmental and consumer protection grounds, and prudent oversight of financial institutions.
- 10** *World Investment Report 1991: The Triad in Foreign Direct Investment*, UNCTAD, 1991, p11.
- 11** *World Investment Report 2007: Transnational Corporations and the Infrastructure Challenge*, UNCTAD, 2008, pxx.
- 12** Millennium development goals, www.undp.org/mdg/basics.shtml
- 13** See, for example, *The Millennium Development Goals Report 2006*, United Nations, 2006.
- 14** See DFID and UNDP announcements at www2.dfid.gov.uk/mdg/call-to-action-business.asp and www.undp.org/partners/business/business_call_to_action.shtml
- 15** President Barack Obama, News Conference, The Whitehouse, 2 April 2009, www.whitehouse.gov/the_press_office/news-conference-by-president-obama-4-02-09/
- 16** This paragraph is drawn from *Getting Growth Right*, Christian Aid, 2008, www.christianaid.org.uk/resources/policy/Trade.aspx
- 17** Sarah Anderson and John Cavanagh, *Top 200: The Rise of Corporate Global Power*, Institute for Policy Studies, 2000, pp9-10.
- 18** Alice Palmer/Foundation for International Environmental Law and Development, *Community Redress and Multinational Enterprises*, Christian Aid/Friends of the Earth, 2003, p5.
- 19** This paragraph is drawn from *World Investment Report 2007: Transnational Corporations and the Infrastructure Challenge*, UNCTAD, 2008, ppxv-xxvi; and *World Investment Report 2005: FDI from Developing and Transition Economies: Implications for Development*, UNCTAD, 2005, pp157-163.
- 20** This information is drawn from *World Investment Report 2007: Transnational Corporations and the Infrastructure Challenge*, UNCTAD, 2008, ppxv-xxvi.
- 21** The latest IMF statistics on investment as a percentage of GDP show declines from 2007 to April 2009 (that is, before and during the current financial crisis) for four of the top five FDI recipients in 2007 (see Table 6, right).
- 22** However, when FDI is measured against GDP, the concentration of FDI becomes diluted, with some poorer developing countries having better FDI-GDP ratios than the richer ones. Which begs the question: what is the best way of measuring FDI?
- 23** Kim Kee Beom, *Direct Employment in Multinational Enterprises: Trends and Implications*, ILO MULTI Working Paper 101, 2006, p13. This figure is probably an underestimate because the data does not include the whole MNC population, it omits employment in non-equity forms of investment (franchising and licensing) and dependent forms of employment, and, lastly, employment varies by country and sector.
- 24** Olukunle Iyanda, *The Impact of Multinational Enterprises on Employment, Training and Regional Development in Namibia and Zimbabwe: A Preliminary Assessment*, Faculty of Management and Administration, Africa University, Mutare, Zimbabwe, 1999, p12.
- 25** Elena Arnal and Alex Hijzen, *The Impact of Foreign Direct Investment on Wages and Working Conditions*, OECD Social Employment and Migration Working Paper no. 68, 2008, p31; and Rita Almeida, *The Labour Market Effects of Foreign-owned Firms*, World Bank Policy Research Working Paper 3300, 21 April 2004, p2.
- 26** After taking into account plant size, geographic location, skill mix and capital intensity. Brian Aitken, Ann Harrison and Robert E Lipsey, 'Wages and foreign ownership: a comparative study of Mexico, Venezuela and the United States', *Journal of International Economics*, (40), 1996, pp345-371.
- 27** Elena Arnal and Alex Hijzen, *The Impact of Foreign Direct Investment on Wages and Working Conditions*, OECD Social Employment and Migration Working Paper no. 68, 2008, p17.
- 28** *Ibid*, pp19-20 and pp27-28.
- 29** Ethical Trading Initiative, www.ethicaltrade.org/Z/home/index.shtml
- 30** *Behind the Mask: the Real Face of Corporate Social Responsibility*, Christian Aid, 2004.
- 31** *Health, Dignity and Development: What Will it Take?*, UN Millennium Project Task Force on Water and Sanitation, 2005, pp72-73.
- 32** UN-Water, *Water, A Shared Responsibility: The United Nations World Water Development Report 2*, World Water Assessment Programme, UNESCO, 2006, p70.
- 33** *Master or Servant?*, Christian Aid, 2001, www.christianaid.org.uk/resources/policy/Trade.aspx
- 34** Notwithstanding, the project went ahead but it did not generate enough income to cover operational expenses.
- 35** *Master or Servant?*, Christian Aid, 2001, p38, www.christianaid.org.uk/resources/policy/Trade.aspx
- 36** See, for example, <http://businessfightspoverty.ning.com/>
- 37** This information is drawn from John Micklewright and Anna Wright, *Private Donations for International*

Table 6 Latest investment trends for top FDI recipients (see endnote 21)

	Investment as percentage of GDP		
	2007	2008	April 2009
Canada	23.262	23.039	22.469
France	22.058	22.335	19.914
UK	18.222	16.782	14.122
US	18.781	17.452	14.681

Source: www.imf.org/external/data.htm

Development, Centre for Economic Policy Research Discussion Paper 4292, 2004.

38 www.ethicalperformance.com/europeamericas/articleView.php?articleID=5615

39 *Behind the Mask: the Real Face of Corporate Social Responsibility*, Christian Aid, 2004, p5.

40 *Ibid*, pp22-49.

41 Matthias Busse and Jose Luis Groizard, *Foreign Direct Investment, Regulations and Growth*, The World Bank Policy Research Working Paper 3882, pp2-4.

42 www.imf.org/

43 Elena Arnal and Alex Hijzen, *The Impact of Foreign Direct Investment on Wages and Working Conditions*, OECD Social Employment and Migration Working Paper no. 68, 2008, p20. The productivity advantage of MNCs may spill over to local firms for a number of reasons. First, domestic plants might imitate production or management practices in foreign firms. Second, workers who move from MNCs to domestic firms might contribute to the transfer of knowledge of modern production and management practices. Third, spillovers might occur from MNCs to domestic firms in the supply chain; for example, ensuring that quality standards of intermediate inputs are met or that labour practices correspond with codes of conduct. Finally, FDI may increase productivity in domestic firms when more intense product-market competition encourages them to remove inefficiencies in the production process.

44 Matthias Busse and Jose Luis Groizard, *Foreign Direct Investment, Regulations and Growth*, The World Bank Policy Research Working Paper 3882, pp4-5.

45 *Ibid*, pp3-4.

46 Gordon H Hanson, *Should Countries Promote Foreign Direct Investment?*, G-24 Discussion Paper Series, no. 9, UNCTAD and Centre for International Development, 2001, pp14-15.

47 *Ibid*, p2; and Matthias Busse and Jose Luis Groizard, *Foreign Direct Investment, Regulations and Growth*, The World Bank Policy Research Working Paper 3882, p3.

48 This paragraph is drawn from Kim Kee Beom, *Direct Employment in Multinational Enterprises: Trends and Implications*, ILO MULTI Working Paper 101, 2006, pp4-5.

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50 *Rebalancing the Supply Chain: Buyer Power, Commodities and Competition Policy*, South Centre and Traidcraft, 2008, pp18-21.

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53 Myriam Vander Stichele, Kim Bizzari and Leonard Plank, *Corporate Power over EU Trade Policy: Good for Business, Bad for the World*, Seattle to Brussels Network, 2006.

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55 www.transparency.org/newsroom/in_focus/2008/bpi_2008

56 See, for example, *Breaking Promises, Making Profits: Mining in the Philippines*, Christian Aid and PIPlinks, 2004.

57 This paragraph is drawn from Meghana Ayyagari, Thorsten Beck and Asli Demirguc-Kunt, *Small and Medium Enterprises across the Globe: A New Database*, World Bank Policy Research Working Paper no. 3127, 2003.

58 *Ibid*, p18.

59 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, 2008.

60 *Ibid*, p4. The study is subject to qualifications, perhaps the most important of which are that it uses cross-country analysis and does not examine the specific experiences of individual countries, and that the definition of SMEs used is SMEs in the formal economy.

61 C Liedholm and D Mead, *Small Scale Industries in Developing Countries: Empirical Evidence and Policy Implications*, MSU International Development Papers 9, 1987, p46.

62 Tova Maria Solo, 'Competition in water and sanitation: the role of small scale entrepreneurs', *Public Policy for the Private Sector*, Note no. 165, World Bank, 1998, p1.

63 *European SMEs and Social and Environmental Responsibility*, Observatory of European SMEs no. 4, European Commission, 2002, p7.

64 *Ibid*, p24; and United Nations, *Business and Human Rights: Mapping International Standards of Responsibility and Accountability for Corporate Acts*, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, Human Rights Council, A/HRC/4/35, 12007, pp22-23.

65 This paragraph is drawn from 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, 2008, pp1-3.

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68 Christina Weller, *Small business representation in Ghana*, Small Business Voices for Development, due to be published late 2009.

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70 As mentioned, according to the definition used by the World Bank, micro-enterprises have up to ten employees, total assets of up to US\$10,000 and total sales of up to US\$100,000.

71 This paragraph is drawn from <http://lnweb90.worldbank.org/eca/eca.nsf/Sectors/ECSP/2E4EDE543787A0C085256A940073F4E4?OpenDocument>

72 <http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/EXTPROGRAMS/EXTFINRES/0,,contentMDK:21152910~menuPK:3230660~pagePK:64168182~piPK:64168060~theSitePK:478060,00.html>

73 *Private Sector Development, Fourth Report of Session 2005-06* (1), International Development Committee, House of Commons, London, 2007, p16.

74 *Accelerating Pro-Poor Growth through Support for Private Sector Development: An Analytical Framework*, OECD, 2004, p57. Within ongoing neo-liberal discourse, too, the possible distorting effects of subsidies were increasingly problematic.

75 *Ibid*, p60.

76 Therefore, any continuing or new direct firm and/or sector support should be 'non-market distorting'.

77 *Private Sector Development Strategy Implementation Progress Report*, World Bank Group, 20 June 2003, http://rru.worldbank.org/Documents/PapersLinks/WBG_PSD_Implementation_Progress_Report_June_2003.pdf

78 *UNDP Private Sector Strategy, Promoting Inclusive Market Development*, Final Version, UNDP, 2007, www.undp.org/partners/business/resources/strategy_paper_ps_undp.pdf

- 79** *Private Sector Development, Fourth Report of Session 2005-06*, (1), International Development Committee, House of Commons, London, 2007, p18; and *Private Sector Development Strategy Prosperity for All: Making Markets Work*, Department for International Development, 2008, pp24-25.
- 80** *Private Sector Development Strategy Implementation Progress Report*, World Bank Group, 20 June 2003, http://rru.worldbank.org/Documents/PapersLinks/WBG_PSD_Implementation_Progress_Report_June_2003.pdf
- 81** *Ibid*, p2.
- 82** See, for example, Sanjaya Lall, *Is African Industry Competing?*, Working Paper Number 121, Queen Elizabeth House Paper Series, University of Oxford, 2005, p36.
- 83** *Economic Development in Africa. Rethinking the Role of Foreign Direct Investment*, UNCTAD, United Nations, 2005, pp35-36.
- 84** See, for example, *EPAs and Investment*, Christian Aid, 2006, www.christianaid.org.uk/resources/policy/Trade.aspx
- 85** *Doing Business 2008*, World Bank, 2007, Contents. Three new indicators are being developed: not paying bribes, opportunities for women, and infrastructure.
- 86** *Ibid*, p4.
- 87** *Ibid*, p4 and p19.
- 88** *Revisions to the EWI Indicator*, World Bank, 27 April 2009, www.doingbusiness.org/documents/EWI_revisions.pdf
- 89** *Ibid*.
- 90** *UNDP Private Sector Strategy, Promoting Inclusive Market Development*, Final Version, UNDP, 2007, p11, www.undp.org/partners/business/resources/strategy_paper_ps_undp.pdf
- 91** *Private Sector Development, Fourth Report of Session 2005-06*, (1), International Development Committee, House of Commons, London, 2007, p17.
- 92** *UNDP Private Sector Strategy, Promoting Inclusive Market Development*, Final Version, UNDP, 2007, p16, www.undp.org/partners/business/resources/strategy_paper_ps_undp.pdf
- 93** *Ibid*, p15. The fifth priority and indirect contributor is advocating for the use and alignment of CSR to contribute to the development of inclusive markets.
- 94** In economics, the 'bottom of the pyramid' is the largest but poorest socio-economic group. A 'bottom of the pyramid' framework seeks to develop new models of doing business that target this demographic, often using new technology.
- 95** *Master or Servant?*, Christian Aid, 2001, p38, www.christianaid.org.uk/resources/policy/Trade.aspx
- 96** Aneel Karnani, 'Romanticising the poor harms the poor', *Journal of International Development*, (21), 2009, pp76-86. This recent article has called the inclusive markets approach into question by contending that the underlying premise – the poor are capable and willing participants in markets – is false. Karnani argues that poor people are more vulnerable than the rich to making harmful consumption decisions because they lack education and information, and they experience economic, cultural and social deprivations. Further, he says that the vast majority of the poor – and so, too, the rich – lack the skills, vision, creativity and drive to be entrepreneurs, and they would prefer to be wage earners. Romanticising the consumption and entrepreneurial potential of the poor thus leads to unhelpful or harmful policies, such as weak consumer protection and an overemphasis on microfinance.
- 97** There is evidence that equity and redistribution are the 'missing link' in the causal chain from economic growth to poverty reduction (Duncan Green and Clare Melamed, *A Human Development Approach to Globalisation*, Christian Aid and CAFOD, 2000). Further, focusing on development policy rather than growth policy per se is more likely to result in a 'virtuous circle' of development and growth (*Getting Growth Right*, Christian Aid, 2008, www.christianaid.org.uk/resources/policy/Trade.aspx). Therefore, what is good for the poor and development is good for growth in the final analysis.
- 98** TRIMS Agreement, Article 2.
- 99** *Ibid*, Annex.
- 100** See, for example, The Dominican Republic Central America United States Free Trade Agreement, Article 10.9 and Part B.
- 101** Ha-Joon Chang, *The East Asian Development Experience. The Miracle, the Crisis and the Future*, Zed Books and Third World Network, 2006, pp51-52.
- 102** *Behind the Mask: the Real Face of Corporate Social Responsibility*, Christian Aid, 2004, p19.
- 103** *Ibid*.

ACRONYMS

BAT	British American Tobacco
BPI	bribe payers index
CSR	corporate social responsibility
DBI	Doing Business Indicators
DFID	Department for International Development
ETI	Ethical Trading Initiative
EWI	employing workers indicator
FDI	foreign direct investment
GDP	gross domestic product
ILO	International Labour Organisation
IMF	International Monetary Fund
MDGs	millennium development goals
MNCs	multinational companies
NGO	non-governmental organisation
OECD	Organisation for Economic Co-operation and Development
PTI	paying taxes indicator
R&D	research and development
SMEs	small- and medium-sized enterprises
TRIMS	trade-related investment measures
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
WTO	World Trade Organization

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'Governments once championing neo-liberal economic doctrines have been reminded starkly that they have duties no other social actors can fulfil, resulting in a recalibration of the balance between the market and state.'

Professor John Ruggie, special representative of the United Nations secretary-general on the issue of human rights and transnational enterprises and other business enterprises, 2009

The current financial crisis has exposed the deficiencies of a global economic system that was once considered impregnable. There is now the chance to usher in a new order that can meet the challenge that has eluded humankind since time immemorial – eradicating poverty. Christian Aid believes that one of the vital players in helping to achieve this ambition is the private sector. It contributes to economic growth, starting and expanding businesses, and creating jobs and paying wages. However, the relationship between the private sector and development is a complex one. And while the private sector has the capacity to benefit poor people, it has been responsible for harming them too.

Christian Aid is a Christian organisation that insists the world can and must be swiftly changed to one where everyone can live a full life, free from poverty.

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