



**DEVELOPMENT CO-OPERATION DIRECTORATE  
DEVELOPMENT ASSISTANCE COMMITTEE**

**DAC Network on Poverty Reduction**

**ROOM DOCUMENT No. 1 for its meeting on 2-3 June 2003**

**POVERTY REDUCTION AND THE ROLE OF THE PRIVATE SECTOR**

*This room document provides background information on earlier POVNET discussions concerning poverty reduction and the role of the private sector. It contains two earlier notes prepared by DFID:*

- *A concept note (Part I)*
- *A summary of the November 2003 informal discussion (Part II).*

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## **POVNET Meeting. Room Document 1**

### **Part I. Concept note (July 24, 2002)**

#### **POVERTY REDUCTION: THE ROLE OF THE PRIVATE SECTOR**

*In the past, too often development strategies focused on government; this was natural, given that to a large extent the 'plan' was a plan for public action. But given the broader role that we see for development strategies, it is natural to begin our discussion with the private sector which will, after all, typically be at centre stage. A key objective is the creation of a strong, competent, stable and efficient private sector. [Joseph Stiglitz, October 1998]*

#### **Summary**

Through the market mechanism, the private sector is the organising principle for most economic activity.<sup>1</sup> Market outcomes of private sector activities have a major impact on the incidence of poverty, yet private sector development and markets are little discussed in most poverty reduction strategies (PRSs). In comparison, public expenditure management, the focus of many PRSs, may have comparatively less impact on poverty. Governments (and donors) have a key role in making markets work to deliver poverty reduction through private sector development (PSD). This concept note proposes a programme of work to develop a consensus within the DAC on instruments that governments and donors can use to encourage the private sector to deliver pro-poor growth, and to prepare guidelines on how to do this within the context of developing PRSs.

#### **Background**

1. Existing DAC Guidelines for Poverty Reduction (2001) set a coherent and robust agenda for tackling poverty. But the specific guidance on promoting pro-poor growth and the way the private sector should be harnessed for poverty reduction are not well documented, especially the guidance on the PSD instruments that governments and donors can use.
2. Existing DAC Guidelines on Private Sector Development (1995) recognise the role of the private sector in promoting economic growth, and that there are distributional implications. However, there is no substantive guidance given on the mechanisms, linkages and sequences that are required for the private sector to deliver efficient, pro-poor growth. The focus is mainly on the general conditions for private sector development.
3. Both Guidelines fail to acknowledge the impact of globalisation. The opportunities and challenges that globalisation present for private sector development have not been addressed comprehensively – either in the poverty reduction context or in the private sector development context.
4. PRSs specify a mix of public actions likely to reduce poverty, prioritising macroeconomic stability and public expenditure management. Most pay scant attention to the role of the private sector in reducing poverty, despite it serving as the engine of growth. Achieving the MDGs requires growth. This is most obvious for the income poverty goal but true also for the sustained achievement of other goals. The private sector holds the key to delivering pro-poor growth and to providing opportunity, empowerment and security for the poor.

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<sup>1</sup>. DAC Orientations for Development Co-operation in Support of Private Sector Development, p4

**The challenge**

5. Growth can be more or less pro-poor, depending on market outcomes that, in turn, result from the structure, capabilities (efficiency) and behaviour of the private sector. Pro-poor growth can only be generated by the private sector, nurtured and conditioned by government. Drawing on existing knowledge and work by other groups, the programme of work proposed here would prepare concise guidelines on the conditions that enable the private sector to deliver pro-poor growth and the practical instruments and mechanisms that can be used to achieve this objective. Key issues that would need to be addressed are briefly discussed below.
6. Enhancing opportunity, empowerment and security for the poor will require more robust and accessible growth processes in which they can participate. Poor people are almost all located in the private sector, mostly in the informal sector. They all participate in markets: they may sell their labour; they may borrow (informally and formally); they may sell their crops or products; they may buy inputs; they may trade; they will buy transport and other services; they will pay for health and education (to some extent). Market outcomes (who benefits most, and who loses) are determined by a wide range of factors. The task is to identify the crucial factors that benefit the poor and prepare guidelines for PSD that would make markets work better for the poor.
7. Poverty reduction depends crucially on the value of assets the poor possess to trade in markets. The sustainable livelihoods approach has identified five main types of assets: human, financial, social, physical, and natural. PSD can help the poor build assets in a market context. It could help them develop skills in short supply, leverage their capital and rights over land, maximise the value of crops and products and utilise their social capital in support of economic activity. It can help them integrate sustainable practices in the use of natural resources. The programme of work would identify mechanisms and best practice in this field.
8. Globalisation, in the form of foreign trade and investment, has a major part to play in generating growth. But not all foreign investment or trade is growth enhancing and there are major challenges in taking advantage of the opportunities they provide. The programme would identify the conditions under which foreign trade and investment promote pro-poor growth, focusing on PSD mechanisms and instruments that help establish such conditions.
9. The guidelines would also cover how PSD should be incorporated into PRSPs. Guidance would be provided on the processes by which PSD policies and priorities need to be developed and agreed and integrated with public actions.

## **Part II. Excerpts from DFID's summary of the 7-8 November 2002 Workshop on Poverty Reduction: the Role of the Private Sector**

### **a. Statement**

#### **Poverty Reduction: The Role of the Private Sector**

We propose a programme of work on private sector development for the achievement of pro-poor growth to attain poverty reduction strategies' objectives. In particular, a better understanding is needed regarding effective approaches, mechanisms and instruments for governments and donors.

The work will be developed in the context of the existing DAC Guidelines for Poverty Reduction (2001) that set a coherent agenda for tackling poverty. We will build on existing DAC Guidelines on Private Sector Development (1995). We agreed to undertake this work programme using a consensual approach within DAC and a fully collaborative approach with developing partners, especially the low income countries.

An initial output will be a stock taking of diverse lessons of experience. Subsequently, the aim will be to develop guidance notes for the role of the private sector development in delivering pro-poor growth. After consultation with the DAC and SLM in 2003/4, formal updating of DAC Guidelines on Private Sector Development is envisaged.

### **b. Possible Structure and Contents of work**

The cross cutting themes that will run across all chapters are poverty reduction, capacity building, gender and sustainable development. The document will attempt, whenever possible, to address issues from the point of view of the poor.

#### ***I. Pro-Poor Growth and the role of the Private Sector, Markets and Governments***

- *This chapter will be a summary of knowledge and experience on pro-poor growth and PSD. It will take account of the DAC guidelines on poverty reduction and WDR 2003 (on market & government failure). It will describe the role of the private sector in reducing poverty and its contribution to sustainable development.*
  - Growth: A necessary condition for poverty reduction
  - What is pro-poor growth and which conditions promote it? Growth with equity.
  - The role of the private sector in poverty reduction
  - The role of efficient, market based resource allocation in increasing productivity and its contribution to poverty reduction
  - Market failure and governance failure; what do governments need to do to ensure that markets work efficiently?
  - What are the characteristics of pro-poor markets?
  - Market access and the returns to the assets of the poor (a livelihoods and rights based approach)
  - The role of the private sector in sustainable development (integrating economic & social development with environmental sustainability)

- The role of government in PSD

## **II Integrating PSD in PRS**

- *This chapter sets out processes for PSD to be incorporated in national, regional and local strategies for pro-poor growth and PSD. This is an important chapter as it will explain how (policy-) elements treated in the chapters 3 to 7 relate to each other. It will describe the process of (holistic) analysis and planning leading to the identification of opportunities for pro-poor growth and PSD, and how different stakeholders (governments, private sector and civil society) participate in it. It will d Explication of the importance of decentralisation/devolution, of area-based (rural, urban,...) approaches, and of capacity building (institutional development) to make it happen. Reference to the new WB Rural Development Strategy.*
  - The process of participatory identification and analysis of opportunities for pro poor growth and PSD; identification and planning of roles and activities by different stakeholders: private sector, governments and donor organisations
  - Private sector assessments – diagnostics to identify constraints to PSD and for its role in poverty reduction-
  - Use of PSIA and other instruments for poverty reduction assessments
  - Defining the basis of partnerships between governments, business and civil society to reduce poverty, at national and local levels
  - PSD strategies and responsibilities for implementation
  - Mainstreaming Gender & Sustainable development
  - Holistic or area based approaches and decentralisation
  - Rural and urban development, their linkage in addressing poverty
  - Role of municipalities to stimulate Local Economic Development (LED)
  - and evaluation
  - The importance of the informal sector and its potential: how to develop policies that take it into account
  - Institutional development and capacity building
  - Monitoring the contribution of PSD to the MDGs

## **III The Legal and Regulatory Environment**

- *This chapter will focus on the rights of the poor, the importance of sound governance to markets, reducing transactions costs for businesses and the poor and ensuring sustainable development.*
  - Promoting competition. How the poor benefit
  - How can governments ensure that the private sector (particularly the poor part of it) is able to exercise property rights and use its resources productively?
  - Measures to ensure security of contract and minimise costs of transactions
  - How to ensure sound corporate governance and socially responsible business

- How to develop appropriate social & environmental laws (at various levels). Mechanisms for monitoring environmental impacts and systems of enforcement
- How to make laws transparent and accessible in order to minimise the administrative burden on the private sector
- How to reduce regulatory obstacles for the informal sector in order to harness its potential
- How to build on traditional rules and regulations
- How to prevent discrimination of women and young entrepreneurs

#### ***IV Finance and Risk Mitigation***

- This chapter will focus on the importance of access to finance and banking services for the poor and the role that financial deepening can play in generating pro-poor growth.
  - The role of domestic savings, domestic investment and international investment in enabling growth and reducing poverty
  - What are the crucial conditions for deepening and broadening the financial sector?
  - How can poor countries attract foreign investment in the financial sector / FDI?
  - Which financial products and services do the poor need?
  - How to integrate micro-finance institutions and informal finance into the formal financial sector
  - Risk mitigation instruments for the poor.
  - Access to banking services for the poor

#### ***V Human & Social Capital and Innovation***

- *This chapter will focus on the returns to the poor from their labour and skills and how to build these assets in a market context.*
  - Labour markets and human resource development: Their role in growth and poverty reduction
  - Appropriate labour laws and codes
  - How to improve the functioning of the labour market
  - How can education/ vocational and technical / management training / business development services be made more market oriented?
  - Entrepreneurship, innovation and R&D
  - The role of social capital in providing information, knowledge transfer and accessing markets
  - Involving the private sector in the delivery of public services, PPP
  - Addressing the needs of the informal sector, entrepreneurs and providers of labour
  - Civil society organisations

## **VI *Product, Commodity Markets & Trade***

- Government intervention to address market failure – building capacity to intervene without distorting markets.
- The role of measurement, standards, testing and quality in protecting consumers and developing competitive markets
- Commodity markets, in-country and international
- What can be done in-country to build the capacity and competitiveness to take advantage of international trading opportunities?
- Capacity building in relation to WTO negotiations
- Privatisation & SOE reform
- Enterprise development support for micro, small and medium sized enterprises
- Supply chains, clusters and business linkages
- Private sector advocacy and the role of business organisations

## **VII. *Infrastructure***

- This chapter will focus on the role of infrastructure in providing access to markets for the poor and the private sector generally.
  - Its role in growth, PSD and poverty reduction (e.g. roads to improve accessibility for the poor especially in rural areas, water- and electricity supply enhancing opportunities for entrepreneurs, marketplaces, etc.)
  - Mobilising investment, appropriate frameworks for private sector participation and lessons learnt so far
  - Ensuring government regulation promotes access to infrastructure services by the poor
  - Public Private Partnerships for infrastructure services
  - Promoting access to land, services and markets for all businesses
  - The role of infrastructure in overcoming barriers to trade and increasing competitiveness
  - The role of infrastructure in regional poverty reduction strategies
  - The role of infrastructure in sustainable development.

## **VIII *The Role of Donors and Donor Organisations***

- *This chapter will describe the different roles that donors can and should play, from policy dialogue to direct support to civil society organisations and enterprises.*
  - policy dialogue at different levels (national, sub-national)
  - direct support to civil society organisations and enterprises
  - binding and unbinding of aid
  - donor coordination and collaboration (basket funding,...)
  - implications for the organisation of donor agencies