



Private Sector Development in Poor Countries: Seeking Better Policy Recipes?

(based on *Business for Development 2007*)

by Federico Bonaglia and Kiichiro Fukasaku

- ◆ Private business activity, by creating and using “ideas”, drives economic growth in both rich and poor countries.
- ◆ Creating an enabling business environment is necessary but not sufficient for fostering the private sector in poor countries.
- ◆ Open dialogue, transparency, accountability and evaluation make private sector development policies more effective.

Private business activity adds value to a nation's given resources, by introducing new ideas on how best to combine them among alternative uses. As economist Paul Romer put it, “economic growth springs from better recipes, not just from more cooking. New recipes generally produce fewer unpleasant side effects and generate more economic value per unit of raw material”. Examples abound in real business life. For instance, Thai canned pineapple producers ingeniously developed new lines of business by making use of by-products, such as leftover pineapple scraps, to make pineapple juices or pineapple fruit gels and pineapple peels as a mix for animal feed or natural sweetener. In China, the repairmen of Haier, a manufacturer of household appliances, discovered that customers in rural areas used washing machines not only to launder clothes, but to clean vegetables as well. They relayed this information to the product managers, who asked engineers to make tweaks to existing products, such as installing wider drain pipes that would not clog with vegetable peels. This and other innovations helped Haier to win the market leadership in the country and beyond.

The OECD Development Centre's 2007 flagship publication on *Business for Development* explores how private enterprises in developing and emerging economies can better seize the business opportunities arising from their increased participation in global and regional markets.

Understanding private sector activities and public-private interactions is indispensable for designing appropriate public policies and allowing the private sector¹ to play its full role in a nation's development process.

Fostering the private sector as a development policy issue

In recent years, policy makers in poor countries have paid greater attention to fostering private sector development (PSD) as a key pillar of their national development strategies, such as the Poverty Reduction Strategy Papers (PRSPs). Most second-generation PRSPs have been prepared in close consultation with private sector representatives and acknowledge the need to strengthen productive and trade capacities to promote growth. On their part, aid donors devote sizeable efforts to tackling “supply-side” constraints and strengthening the private sector's capacity to respond to the business opportunities created by globalisation and participation in global supply chains. In 2005 donors allocated about one quarter of total official development assistance commitments to “aid for trade” activities.

1. The term “private sector” covers all private actors – individuals and businesses – engaged in risk-taking activities to earn profits and income through market exchange. It applies to smallholder farmers as well as to very large multinational enterprises (MNEs).

Creating an enabling business environment is necessary but not sufficient

Analysis of the market for technology and innovation is instructive for the aim of understanding the rationale for PSD policies. Technology cannot simply be transferred to a developing country like a physical product. Its effective implantation must include important elements of capability-building: simply providing equipment and operating instructions, patents, designs or blueprints does not ensure that the technology will be effectively used. Technological change is the result of purposeful activities undertaken by firms. Such “technological effort” is neither exogenous nor automatic. Individual effort is required to make the many tacit elements of technology explicit, and most technological effort does not take place at the frontier of technology at all.

Learning is a central determinant of PSD, and its success depends on the efficacy with which markets or institutions function, uncertainty is coped with, externalities tapped and co-ordination amongst many actors achieved. The main policy message of this approach is straightforward: to support the building and strengthening of technological capabilities, i.e. the skills – technical, managerial or organisational – that firms need to utilise efficiently the hardware (equipment) and software (information) of technology.

Somewhat along similar lines is a recent approach labelled the “New Industrial Policy”. This approach tries to solve economic development problems *without picking winners*. Traditional industrial policies aimed at rewarding best practice, with subsidies contingent on performance. However, they often run the risk of inducing rent-seeking behaviour. Moreover, they are based on the assumption that the public sector has the information and capabilities to make a choice and “pick winners”. This poses a *discovery problem*, as winners are constantly evolving in dynamic industries, and a problem of *entrenched interests* capturing all the rents.

Further reading:

Business for Development 2007: Fostering the Private Sector, OECD Development Centre, Paris.

BONAGLIA, F. and A. GOLDSTEIN (2007), “More Than T-Shirts: The Integration of Developing-country Producers in Global Value Chains”, *Policy Insights* No. 49, OECD Development Centre, Paris.

BONAGLIA, F. (2006), *Meeting the Challenge of Private Sector Development: Evidence from the Mekong Sub-region*, OECD Development Centre, Paris.

Making private sector development policies more effective

The main thrust of “New Industrial Policy” lies in enhancing the diversification of the productive structure through a *process of discovery* of new profitable activities. This also implies a process of discovery of the relevant institutions required. Such discovery process is not automatic, as entering new market niches involves significant fixed costs and risks, and the private sector alone might not do it. The focus is on bridging private-public organisations, on business networks linking global and local (e.g. diasporas), innovation clusters and value chains, and on the best performers in public and private sectors (i.e. linking best public sector agencies with best and promising private sector performance). In a nutshell, this policy is about *generating missing connections* – without opening the door to rent-seeking.

Intervention design requires a careful understanding of the functioning of the private sector, of international value chains and of the potential for domestic producers to participate in them. The global value chain framework can serve as a diagnostic tool to identify critical bottlenecks, discover strategic complementarities and involve the lead actors in the international value chain with whom government and the local private sector should interact to promote domestic sourcing, linkage creation and upgrading.

To this end, open dialogue, transparency, accountability and constant evaluation in the design and implementation of policies are necessary to prevent insiders from capturing all the benefits resulting from policy interventions and ensure overall welfare improvements. Policies also need to adopt a dynamic approach and evolve over time, because the final beneficiaries are firms that are constantly facing economic, technological and regulatory changes.



Readers are encouraged to quote or reproduce material from OECD Development Centre *Policy Insights* for their own publications. In return, the Development Centre requests due acknowledgement and a copy of the publication. Full text of *Policy Insights* and more information on the Centre and its work are available on its web site: www.oecd.org/dev

OECD Development Centre
2, rue André-Pascal,
75775 Paris Cedex 16, France
Tel.: +33-(0)1 45.24.82.00
Fax: +33-(0)1 44 30 61 49
E-mail: dev.contact@oecd.org