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Aid, Paris and the Private Sector: How to Square the Circle

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CONTENTS

LIST OF ABBREVIATIONS

AAA	*Accra Agenda for Action*
ACE	*Access, Competition and Engagement (DFID)*
CGD	*Commission on Growth and Development ('Spence Commission') 2008*
CIDA	*Canadian International Development Agency*
CRS	*Corporate Social Responsibility*
DAC	*Development Assistance Committee (OECD)*
Danida	*Danish International Development Assistance*
DCED	*Donor Committee for Enterprise Development*
DFID	*Department for International Development*
FDI	*Foreign Direct Investment*
GBS	*General Budget Support*
GDP	*Gross Domestic Product*
GTZ	*Deutsche Gesellschaft für Technische Zusammenarbeit*
IDD	*International Development Department, University of Birmingham*
ILO	*International Labour Organisation*
JICA	*Japan International Cooperation Agency*
MDG	*Millennium Development Goals*
M4P	*Making Markets Work for the Poor*
MMW4P	*Making Markets Work for the Poor (initial abbreviation)*
MSE	*Micro and Small Enterprises*
MSME	*Micro, Small and Medium-seized Enterprises*
NMA	*New Minimalist Approach*
ODA	*Official Development Aid*
OECD	*Organisation for Economic Co-operation and Development*
PD	*Paris Declaration on Aid Effectiveness*
PRBS	*Poverty Reduction Budget Support (DFID)*
PS	*Private Sector*
PSD	*Private Sector Development*
RoU	*Republic of Uganda*
SAP	*Structural Adjustment Programme*
SBS	*Sector Budget Support*
SE	*Small Enterprises*
Sida	*Swedish International Development Agency*
SME	*Small and Medium-seized Enterprises*
SOE	*State-owned Enterprises*
UNCTAD	*United Nations Conference on Trade and Development*
UNIDO	*United Nations Industrial Development Organisation*
USAID	*United States Agency for International Development*
WB	*World Bank*
WDR	*World Development Report (WB)*

ABSTRACT

Support for private sector development is an important item on the ODA budgets of most donor countries and recently, there has even been an upsurge in the weight given to 'private sector led growth'. The paper raises the basic questions: Why inherently commercial activities should actually be supported? Which objectives are pursued in practice and which interventions are appropriate to achieve inclusive and sustainable development? What level of coherence is found between support for private sector development and the principles of the Paris Declaration? In focusing on these issues of 'rationale', 'practice' and 'policy coherence', the analysis finds that according to the development paradigm subscribed to by donors different rationales exist for supporting PSD and based on ideological grounds donors do contest the guiding principles for support. In parallel, however, some donors do directly support private enterprises without concern for a legitimising rationale. Increasingly parts of the donor community has focused on achieving pro-poor growth and sustainable private sector development by implementing the concept of 'making markets work for the poor' (M4P), locally as well as through global value chains. Due to the inherent differences between state and market a hybrid implementation approach is needed, using both public and private modalities and thus colliding with Paris declaration principles of using country systems. Donors have shown little interest in harmonizing their private sector development interventions and the development community has neglected the obvious problems of policy coherence.

INTRODUCTION

Support for private sector development has for a couple of decades formed a heavy item on the ODA budgets of most donor countries. A major reason has been the belief that support for private sector activities is an efficient way of stimulating economic growth, which is the 'sine qua non' regarding poverty alleviation (Collier 2007:11). Recently, there has even been an upsurge in the weight given to 'private sector led growth' as illustrated by the reports of both the Commission on Growth and Development (CGD) 2008 and the Danish Africa Commission 2009. In the words of the former: 'Government is not the proximate cause of growth. That role falls to the private sector, to investment and entrepreneurship responding to price signals and market forces.' (CGD 2008:4).

Even with this apparent consensus the basic question, however, remains: Why is it advisable – perhaps even necessary – for achieving poverty reduction and sustainable development to support activities that are inherently commercial? And further: Finding such a 'rationale' for investing the money of the taxpayers' is there not some limitations – a 'borderline' – where support for private interests are not legitimate and should therefore not be pursued?

Having questioned the 'rationale' for supporting private sector development, the most pertinent questions are about 'practise': Which objectives are actually pursued in programmes and how do they match with residing development paradigms? Is design and implementation of private sector development interventions appropriate in order to achieve inclusive and sustainable development?

Finally, this raises the question of ODA 'policy': How does actual support for private sector development comply with principles of the Paris Declaration? And what level of coherence is achieved in the official policy of the development community, when aiming both at private sector development and aid effectiveness?

After having dealt briefly with some conceptual matters and the history of support for private sector development, the paper concentrates on these basic questions: the 'rationale', the 'practise' and the 'policy coherence' in three consecutive chapters, trying to take stock of the present position of the development community on support for private sector development and indicating future challenges. In the final chapter some major conclusions of the analysis are summarized and in view of the potential strategic role of private sector development – continuously stressed by donors – those issues representing challenges in particular are highlighted.

1. THE CONCEPTS OF PRIVATE SECTOR AND PRIVATE SECTOR DEVELOPMENT

One of the recommendations for refocusing international development cooperation with Africa, tabled by the Danish Africa Commission in its May 2009 report, appears very short and concise: 'Increase support from development partners to build the private sector'(Africa Commission 2009:28). Using the vocabulary of frequent recommendations by the international donor community this initiative depicts the private sector (PS) as a well defined entity within society, parallel to e.g. the health or educational sectors.

Although present in the sector programme portfolio of many donors, PS is not a sector in the ordinary sense, delimited by its objectives and governing institutions. Rather it is a – market-based – way of organizing economic activity (CIDA 2003:1), including formal and informal institutions (e.g. markets) as well as social behavioural rules and practices. Thus a decision to 'increase the support to build the private sector' is not a stringent recommendation for certain development activities, but an indication of preferences for how to organize such activities. PS is present in all strands of economic activity and is thus probably best handled as a cross-cutting phenomenon.

Therefore also the concept of private sector development (PSD) ought to focus on the elaboration and development of this organizing paradigm for economic activity. Sometimes, nevertheless, PSD is defined less consistently as 'a way of doing things' (DAC 1995, WB 2002) with relevance to any sector of the economy and even presented with a normative guidance: 'the pursuit of private sector development is not a goal but a means of doing things better' (WB 2002:44).

Emphasizing, however, the word 'development' it is here found to be more appropriate to use the Canadian definition of the objective of PSD: 'To create more, better and decent jobs and sustainable livelihoods by helping markets to function well and by stimulating the growth of the local private sector in developing countries and countries in transition.' (CIDA 2003:1) The indicated scope of policy extends to rural and urban economic development, to formal and informal sectors as well as to smallholder farmers and cottage industries[1].

[1] In accordance with CIDA's definition of the PS as 'a basic organizing principle for economic activity in a market-based economy' its policy applications are also wide: 'The scope of this Policy extends to rural and urban economic and market development, to a diverse range of enterprises and producers in the informal and formal economies, as well as to cottage industries and cooperatives engaged in market activities.'

2. HISTORY OF PSD SUPPORT: STAGES AND OBJECTIVES

In the aftermath of the struggle for national independence and liberation from colonialism many developing countries, particularly in Sub-Saharan Africa, in the 1960'ies and 1970'ies resorted to government led central economic planning and policies of industrialisation based heavily on state-owned enterprises (SOEs), protected by policies of import-substitution. In most cases experiences from this policy paradigm – much exacerbated by external economic factors (Tarp 1993:25) – turned out very badly due to fast deteriorating macro-economic variables – stagnation, inflation, public deficits, overvalued currencies etc. – destabilising both domestic and foreign economic relations.

At the beginning of the 1980'ies the economic situation reached crisis proportions in a number of countries and the WB and the IMF took on the design of plans for economic reform and restructuring. The reform packages that afterwards were to be known as 'structural adjustment programmes' (SAP) intended to: '… reduce the state's role in production and in regulating private economic activity. They assigned more importance to exports, especially those from the much neglected agricultural sector. And they placed more emphasis on maintaining macroeconomic stability and avoiding overvalued exchange rates.' (WB 1994: 34) Predominantly the focus was on curbing state intervention and creating or reinstating appropriate market incentives in order to stimulate private economic activity and growth, thus clearly relying on a strategy of PSD.

The influence from neo-classical economic thinking was clearly visible in the SAP of the Bretton Woods institutions (Degnbol-Martinussen 1999:263), but also in the design and implementation of individual country programmes[2]. To a large degree an ideological affiliation with dominating conservative politics of the Reagan, Thatcher era was obvious and that influenced not only actual programmes, but also the debate and evaluation of the impact of the programmes. Basically, however, the market-based economic restructuring – 'getting prices right' – adhered to in the 1980'ies were not successful as growth rates stayed low and e.g. in Sub-Saharan Africa only took off in the middle of the 1990'íes in response to a change in economic policies (CGD 2008:71). Together with the downsizing of the public sector the SAP carried considerable social costs in its wake, which increasingly became a concern of both academics and the UN organizations, leading to a call for 'adjustment with a human face' (Tarp 1993:121-22). Therefore, the effort to distil the essence of the gained experiences in a somewhat moderate recipe of ten guiding principles, termed the 'Washington Consensus' (Williamson 2002)[3], turned out to have almost the opposite impact and the phrase came afterwards to be identified with a stamp of excessive weight on deregulation, private initiative and lack of social concern in the pursuit of PSD.

During the 1990'ies gradually the need for state regulation of private economic activity was reinstated also at the WB, together with the debate of an appropriate division of labour between the public and private sectors. It is disputed if actually a change of paradigm took place already in the beginning of the decade (Degnbol-Martinussen 1999:264), but eventually with Joseph Stiglitz joining the WB as chief economist in 1997 the influence of 'new institutional economics' (Degnbol-Martinussen 1999:252) with its weight on lack of information, uncertainty and transaction costs became clear also in actual programmes. Obviously, also the success of state initiated PSD in Asian emerging economies – including the success of gradual liberalization in China and India – showing high and stable economic growth along with fast declining numbers of poor people contributed to a change of paradigm and the end of the 'Washington Consensus era'.

Essential to the influence of the new school of institutional economics was the clear rejection of an inherent conflict between state and market. Contrary to neoclassical thinking, state and market are seen as complementing each other in the pursuit of PSD. Government failures do occur, but so do market failures and it is not a priori given which ones are the more challenging. The barriers to PSD has to be identified and handled in the context of the country in question and the division of labour between public and private initiatives – and the ways to avoid or compensate for possible failures – is to be decided on this basis.

In the new approach institutions are not limited to be – more or less perfect – neoclassical economic markets, but are a diverse collection of both formal and informal rules, procedures and norms, governing economic behaviour and transactions. Also enterprises and their organizational structure are ruled by such institutions, which are clearly ra-

[2] A prominent example, in particular, is the case of Chile, where the so-called 'Chicago-school' of Milton Friedman played an influential role in forming the economic policies of Chile from the late 1970'ies during the regime of the Pinochet junta.

[3] Coining the phrase 'Washington Consensus' in 1989, Williamson underlined the specific focus on economic problems of Latin America.

tional even though they do not necessarily follow the principles of economic markets (Coase 1960). Therefore these institutions are essential in order to understand both the working of the PS and the possibilities for promoting PSD. The creation of appropriate institutions will further PSD through reduced costs of transactions, better information and less risk and uncertainty.

This change of paradigm most naturally brought the mixed-economy model with assigned roles for and partnership between public and private sectors into donor focus. A central theme at the WB and with most donors became the achievement of fair rules and procedures to all – 'a level playing field' – as well as an 'enabling business environment', building institutions conducive to PSD. Increasingly on the donor agenda items like good governance, anti-corruption, gender and effective institutions came into focus.

All through it has been part of the objectives to achieve economic growth and poverty reduction. The proponents of the 'enabling environment' model, however, argues that the very process of removing macro and meso level barriers to PS activity and ensuring free and fair competition will also benefit the poor. Thus there is no need to further pursue these objectives at the micro level through targeted PS interventions and in particular the WB has advised against trying to 'pick the winners'.

Interventions at the micro level in support of individual enterprises have, nevertheless, been a solid part of the PSD agenda for most donors. The relevance of such programmes have not been substantiated through the results of evaluations, as even with a considerable number of evaluations executed little or no evidence of sustainable development impact has been produced (Schulpen and Gibbon 2002:1, 12; Schaumburg-Müller 2007b:23-25)[4].

While such programmes have been challenged on the basis of possible market distortions, it has increasingly been clear that ways of creating 'more, better and decent jobs and sustainable livelihoods' as spelled out in the above CIDA definition of the PSD objective (cf. section 1 above) will need support directed towards the micro level to come into focus. Not least the universal acceptance of the UN GA 2000 Millennium Development Goals (MDG) has directed attention towards the micro level by graduating the objectives of economic growth and poverty reduction into imperative status and promoting the pro-poor growth concept (OECD/DAC 2007).

This development and the challenges presented by the MDGs have opened up to the evolved 'neo-structuralist' thinking of the 1980-90'ies (Degnbol-Martinussen 1999:77-78). Its influence is felt both in public sector planning of PSD and, in particular, with regard to the importance of the social distribution resulting from the initiated growth process.

3. THE RATIONALE FOR SUPPORTING PSD: 'RED TAPE', PUBLIC GOODS AND SOCIETAL TRANSFORMATION

Based on hard-core neo-classical theory, ODA and not least the idea of support for PSD are misunderstandings as PSD will be realized most effectively when left to market forces

[4] In parallel since the 1970'ies donor support for FDI and other forms of direct business engagement, shaping PSD – and arguments about its appropriateness – has taken place. The 2001 Danida PSD action-plan – 'Promoting Business Development – a joint task' – stated: 'At the same time priority will be given to further developing specific market instruments, i.e. facilities and programmes that are aimed directly at enterprise-level initiatives.' (p. 7).

and a liberalized global economy. There is thus no rationale at all for supporting PSD. In particular, based on this paradigm – as well as on most others – donor support directly to individual economic agents and companies in developing countries will be dislocating market forces and reducing economic efficiency. Such programmes are thus not only questionable because of the above mentioned actual lack of supporting evidence regarding their impact on sustainable development of partner countries. They also lack the basic theoretical rationale.

3.1 Eradication of 'Red Tape'

The conditions forming economic behaviour are, however, quite different from this idealized world and even neo-classical thinking accepts that markets – and not only governments – may be working imperfectly or not at all and therefore may need to be corrected in the pursuit of PSD. Thus a rationale for PSD support is created. What then clearly separates different theories and practical approaches to the support of PSD is the extent to which such imperfections are found to be the rule rather than the exception: Whether missing and failing markets, deficient institutions, insufficient private sector capacity and seriously lacking social infrastructure are found to be typical of developing countries and then, nevertheless, adjustable in a way that will promote PSD. Therefore also the rationale for supporting PSD will differ according to the development paradigm adopted and to the strategy derived, governing interventions.

PS activity being market-based, it is natural to start looking for the rationale of PSD support in the observed deficiencies of working markets. The traditional – neo-classical – explanation of why markets function badly or not at all is linked to bureaucratic interference from the side of government or local authorities: putting up unnecessary barriers and regulations to carry out economic activity, introducing biased taxes, dues and customs, pursuing undue political objectives and then on top of this using these inroads on private economic activity to enrich officials through rent-seeking or sheer corruption will sidetrack market forces. When identifying such barriers to PSD, clearly there is good reason to support the removal through appropriate deregulation and eradication of 'red tape'. This rationale for PSD support has almost universal acceptance – academics and practitioners alike – and forms the basic philosophy of the 'Doing Business' approach of the WB[5].

3.2 Correcting Market Failures by Provision of Public Goods

The reason, however, for markets not to function in a proper way may not have anything to do with outside interference. Markets may fail to operate according to standard theory because they are incomplete or because information is imperfect. Incomplete markets may need government regulation to institute competition and an optimal tax system in order to communicate the proper price incentives to operators in the market. But market failures may also be caused by the very nature of the particular market: goods either not being fully private because one can not exclude others from their benefits and also – perhaps alternatively – being non-rival so that consuming them is not leaving less for others to consume; further, activities of agents on the market may influence the welfare of other agents quite apart from the market price incentives, so-called

[5] In 2004 the WB started publishing the 'Doing Business' series, that on an annual basis keeps track of the most important indicators of the costs of PS regulations in developing countries and the ranking of individual countries.

externalities of production or consumption. When markets are operating under such deficiencies social benefits will exceed private benefits and goods will be undersupplied. This may be remedied by the provision of public goods.

Information is such a public good and asymmetric information in single markets may cause market failure. However, deficient information will in particular influence the linkages or coordination between markets and may be the source of so-called 'coordination failures' (Ray 1998:138). Information being by nature about the past, the present and the future such failures can be of a static as well as of a dynamic kind. Coordination failures mean failure of more, complementary markets and are thus potentially of much greater importance than ordinary market failures. They may have grave implications on the macro level, for instance with regard to the investment climate of the economy, but are in general disruptive to organized economic activity, e.g. commodity value chains. Also the execution of major national policy programmes and formation of public-private partnerships involving PS economic activities will depend on successful coordination of decisions and actions made by public and private sector actors.

Correcting coordination failures is essential to achieving the general PSD objectives of growth and poverty reduction: 'The fundamental issue relevant to the discussion of market failures is that coordination failures require actions to improve efficiency and the transfer of information. These depend on inputs in more than one sector or firm, while more traditional market failures … can be addressed in a piecemeal or firm specific manner …' (te Velde and Morrissey 2006:41-42). Provision of public goods such as governance, knowledge and – in general – information may be what is required to address identified coordination failures. Together with other public goods their enhanced supply forms a basic rationale for the support of PSD.

3.3 Achieving Societal Transformation

Markets in developing countries may often be incomplete and fail because those institutions – formal as well as informal – supposed to govern or support them are deficient or missing. The 'Doing Business'– initiative of the WB has its focus mainly on correcting and upgrading a limited section of government institutions dealing directly with day to day transactions of PS actors. Lowering costs of such economic transactions is the central objective of these interventions.

However, institutions of a much wider coverage are essential to the proper working of markets. In particular decisions and actions of the PS actors will depend on facts and expectations forming the basis for economic activities in the longer run, where investments are made. A transformation or development of institutions that creates a proper environment for investment decisions is in line with the thinking of 'new-institutional economics' and offers clearly a rationale for PSD support. Providing an enabling environment for such decisions is essential to PSD and government policy can provide the needed public goods of e.g. security, knowledge, health, environment and not least governance through appropriate institutions.[6]

[6] The WB in its 2005 WDR acknowledges this need for a wider public sector framework in support of a 'better investment climate' and PSD: 'Government policies and behaviours play a key role in shaping the investment climate…the security of property rights, approaches to regulation and taxation…the provision of infrastructure, the functioning of finance and labor markets, and broader governance features such as corruption.' (WB 2004: 1)

While emphasis on a strategic role of government in forming an enabling investment climate clearly marks a distance to orthodox neo-classical philosophy of rolling back the public sector, it should be noted that still recommendations may only bear on the PS framework conditions: 'The goal is to identify constraints that face firms.' (WB 2004:8) The word 'constraints' is telling: Essentially, it may be only a strategy of addressing incomplete markets and avoiding potential failure of individual markets through the provision of public goods. If this is the case, then the concept of 'coordination failures' and its cybernetic implications for the role of government, building an enabling investment climate on the macro economic level, plays little if any role.

The neo-classical rationale for supporting PSD is based on an interpretation of what is needed to emulate as far as possible the allocation mechanism for inputs and outputs of perfect markets. Looking, however, to the initially suggested CIDA definition of the PSD objectives (cf. section 1 above), the achievement of 'markets to function well' is not the sole – or even dominant – objective to pursue. Clearly a rather different and more holistic development strategy – and paradigm – is needed to accommodate the emphasis on 'jobs and sustainable livelihoods' as well as on 'the growth of the local private sector' of this definition.

Such a paradigm for development was outlined by Joseph Stiglitz a decade ago under the headline of 'Development as a Transformation of Society': 'Development represents a *transformation* of society, a movement from traditional relations, traditional ways of thinking, traditional ways of dealing with health and education, traditional methods of production, to more "modern" ways … The changes that are associated with development provide individuals and societies more control over their own destiny … a development strategy must be aimed at facilitating the transformation of society, in identifying the barriers to, as well as potential catalysts for, change.' (Stiglitz 1998:3)

This is far from the neo-classical paradigm and its harmonious image of society. Rather, setting 'transformation' up front as the keyword, the stage is set for a neo-structuralist[7] approach to social development and in particular to its links with PSD. A parallel approach is presented in other parts of the academic literature: 'After a long period of treating development as a technical problem of growth in macro-economic aggregates, which could be tackled by the freeing of markets, social science seems to have awakened to the realisation that development is a process of profound social transformation.' (Fine et al. 2001: xiii)[8]

Essential to the success of the Stiglitz-strategy of 'transformation of society' is *growth and poverty reduction*: 'If successful, the new development strategy will not only raise GDP per capita, but also living standards, as evidenced by standards of health and literacy. It will reduce poverty – our goal should be its elimination … It will be sustainable, strengthening the environment. And the real societal transformations will enhance the likelihood that the underlying policies will be durable, withstanding the vicissitudes sometimes accompanying democratic processes.' (Stiglitz 1998:15)

[7] It may be noted that 'the new development paradigm' was launched at the prestigious 'Prebisch Lecture' at UNCTAD, indicating the heritage of classical structuralism.

[8] Even with this obvious parallel in approach to the basics of development, it is worth noting, that, taking Stiglitz as the pioneer of a 'post-Washington consensus' at the WB, the analysis of his writings is most critical in the quoted preface and throughout the collection of papers from a seminar series at the School of Oriental and African Studies (SOAS), University of London.

The strategy is, in particular, confronted with a comprehensive challenge of *'coordination'*: 'In traditional economic theory, prices perform all the coordination that is required in an economy. But this requires a full set of markets – an assumption that patently is not satisfied in less developed countries. Having a sense of where the economy is going is essential: if, for instance, an economy is to move to the "next" stage of development, the appropriate infrastructure, human capital, and institutions all have to be in place. If any of the essential ingredients is missing, the chances of success will be greatly reduced. Not only must there be coordination of different agencies within and among levels of government, there must be coordination between the private sector and the public, and among various parts of the private sector.' (Stiglitz 1998:17)

Inside the Stiglitz paradigm 'coordination' has a much wider responsibility to carry than just 'technically' keeping PS actors informed of the proper prices in order to clear markets of the PS. If PSD is to succeed a 'sense of where the economy is going is essential' and coordination should be established in accordance with such broader vision of strategic policy on all levels of society – macro, meso and micro.

The core objective is development in the sense of 'transformation of society', which means growth as well as poverty reduction. The strategy should outline how best to use the PS in bringing about the overall transformation envisioned and those needed instruments of 'societal transformation' thus represents a basic rationale for support of PSD.

4. APPROACHES TO PSD

The different rationales for PSD support outlined above hinge on the understanding of, what are the objectives of PSD: operational, but unguided markets of the PS or 'societal transformation'? And then on what are the most effective ways to achieve such PSD.

Essentially, answering the question of 'what works' is an empirical matter, but presently it appears that evidence is in no way conclusive, meaning that still neither scholars nor the donor community really agree on what lessons have been learned from previous experience. (Schaumburg-Müller 2007b:23) There is universal agreement that sustainable poverty reduction will not be achieved unless substantial and lasting PS growth is engineered. But how to set in motion the PS growth needed: Through direct interventions or mainly through support for catalytic activities? At the macro, meso or micro level? And what kind of a growth process is needed to ensure the inclusion of poor people?

Approaches within the donor community differ and in order to understand the possible implications from such differences in design for programme implementation and impact as well as for donor coordination some major dividing lines are discussed.

4.1 Deregulation and an Enabling Environment for PSD: A New Minimalist Approach?

The rigid version of the Washington Consensus was discarded for its unacceptable social and political effects and for its lack of institutional analysis, in particular the belief in self-sustaining markets. However, the basic principles of removing constraints to competitive markets and reducing costs of transactions to PS activities were never challenged. In the donor community the catchword of forming an 'enabling environment' for PSD[9] became the agenda for a major part of the support for PS activities. The focus has in particular been on improving the business climate for small enterprises (SE)[10], but otherwise the approach has differed both in regard of level of intervention and the functional areas to be targeted.

4.1.1 Donor approaches to Enabling Environment Reforms

At some point donors were preoccupied with the subjects of direct provision of financial services and later on with business development services (DCED 1995 and 2001), both important aspects of upgrading and capacity building in PS activities at the micro level. In recent years, however, the much broader notion of the 'enabling environment' has once more surfaced, bringing the framework conditions for PS activities to the forefront of donor considerations and at the same time shifting focus from the micro level to macro and meso initiatives. Through this change of approach donor agencies expect to be able to improve substantially programme impact: '… at a time when questions are asked about donor effectiveness, support for a better business environment presents itself as an approach that can improve the conditions for all enterprises across the developing world. This is in contrast to support for financial and business development services …' (White 2005:11)

While in general terms a 'consensus' of the approach to PSD was reached (Schulpen and Gibbon 2002:2) it was, however, never agreed how the concept of an enabling environment should be delimited with regard to functional support areas and also terminology differed widely (OECD 2006:25). Definitions wary (White 2004:19) from the 'generic' type, comprising in principle all external factors influencing the 'business climate' of the enterprise; over the 'investment climate' version, considering those areas supposed to be of importance to investment decisions and then to the more limited 'business environment' form, focusing mainly on the prerequisites of competitive markets.

Trying to illustrate the differences between these main interpretations of the enabling environment concepts the results of a donor agency questionnaire from 2004, regarding the potential SE programme areas, are interpreted and grouped below based on the published individual responses.

The donor responses recorded indicate obvious differences in the functional areas considered for enabling environment support. The 'business environment' approach is concentrating on the PS framework conditions influenced by government, including the 'organizational framework' and its function with regard to PS advocacy. The strategic role assigned to government with regard to macroeconomic policies is, however, ambiguous as indicated. The alternative approaches of 'investment climate' and 'business climate' include these support areas in their portfolios, but add a considerable number of other

[9] Already in 1992 a report on the subject of an 'enabling environment' was published by the Committee of Donor Agencies for Small Enterprise Development, which was an informal gathering of donors formed in 1979 on the initiative of the WB. In 2001 this group developed into a specialized 'Working Group on Enabling Environment' still affiliated with the WB. Since 2005 the Committee has been acting more formalized as the Donor Committee for Enterprise Development (DCED), comprising the major bilateral and multilateral donors and aiming at improved donor coordination and the realization of the Paris Declaration.

[10] 'Small enterprises' is a convenient concept, indicating the focus at micro, small and medium seized enterprises (MSME).

Table 1. Number of agencies subscribing to particular approaches to 'enabling environment' for small enterprises.

	'Enabling Environment' Approach[12]		
Functional Areas:	*'Business Environment' 4 agencies*	*'Investment Climate' 5 agencies*	*'Business Climate' 4 agencies*
Governance issues	4	5	4
Policy framework	4	5	4
Legal/regulatory set-up	4	5	4
Organizational set-up	4	4	3
Macroeconomic policies/strategies	2	5	4
Organizational capacity	0	3	4
Access to infrastructure	0	1	3
Cost of infrastructure	1	3	3
Access to finance	0	3	4
Cost of finance	0	3	4
Business support services	1	3	4
Social conditions/services	0	2	4
Cultural factors/attitudes	0	1	3

Source: Compiled by the author on the basis of: White, Simon: 'Donor approaches to improving the business environment for small enterprises', 2004, pp. 18-22.
Sida is classified in accordance with 'Policy Guidelines for Sida's Support to Private Sector Development', October 2004.
Note: 'Business environment' agencies: ILO, JICA, UNCTAD, WB (SME)
'Investment Climate' agencies: Govt. of Switzerland, GTZ, UNIDO, DFID and WB (IC)
'Business Climate' agencies: Danida, Sida, OECD and USAID

fields of activity: Financial services, business support services and to some degree infrastructure facilities are common to both, but the 'business climate' approach has a much more comprehensive agenda with a clear inclination towards PS structural issues, like social and cultural factors[11].

Tentatively the three approaches may be termed: 'neo-classical', 'neo-institutional' and 'neo-structural' respectively and the respective functional areas delimited by the bold lines in the table.

Considerations have, in particular, been given to the poverty reducing impact to be

[11] Apparently, however, even though donors use a certain terminology they do not agree on the implications for support areas, leading to quite some deviations in the three approaches as shown by the recorded responses in the table. E.g. UNIDO response is recorded in accordance with its use of the 'investment climate' terminology, but rather the organization has a 'business climate' approach to support areas. DFID, however, is recorded in accordance with its normal use of the 'investment climate' terminology, while in the published comments to the questionnaire actually two divergent expressions are used.

[12] The three categories used in table 1 for the grouping of donor approaches are constructions by the author, using the data presented in White 2004. The 'investment climate' approach is identical with the term used by the WB: '...the location-specific factors that shape the opportunities and incentives for firms to invest productively, create jobs, and expand' (WB 2004:1). The 'business environment' and 'business climate' approaches, respectively, are indicating approaches on both sides of the 'investment climate': the former representing a 'minimalist approach', the latter a comprehensive 'generic' approach.

expected from building an enabling environment for PSD. Quite some donors find that the very targeting of SEs through enabling environment initiatives will not only enhance competitive efficiency and economic growth, but also achieve substantial poverty reduction. The argument is, that SEs are in particular disadvantaged by excessive government regulations and imperfect markets, indicating a causal relationship working from improvements in the framework conditions for doing business to poverty reduction and economic growth. This causality is supposed to encompass not only small enterprises of the formal sector, but also micro enterprises in the informal sector. Thus: 'While not established through empirical research, many donor agencies justify their involvement in this field with the view that small enterprise development is a contributor to poverty reduction and economic growth …' (White 2004:15)

A major strategic dividing line, however, materializes: It separates those agencies – in particular the WB – that find this argumentation to be an aspect of the – trickling down – process of job creation and poverty reduction, resulting from general improvements in the business environment, from those other agencies that insist on targeting SEs directly as a precondition for achieving poverty reduction. (White 2005:14)[13]

4.1.2 A New Minimalist Approach?

Some observers of the efforts by the donor community to develop the concept of an enabling environment for PSD have found that: '… an emerging consensus among leading development institutions …' is shaping up, that '…emphasises quite a limited number of market-driven solutions and tends to disregard selective public interventions to encourage and support the private sector – what we refer to as the 'new minimalist approach' (NMA) to private-sector development (PSD).' (Altenburg and Drachenfels 2006:387) The word 'minimalist' clearly meant to give neo-classical connotations.

The NMA branding of this supposed emerging donor consensus is double edged: on the one hand it is seen to be in the 'minimalist' tradition of the neo-classical leaning towards less government interventions and deregulation and on the other hand it is not just the Washington Consensus once more, it has certain 'new' distinguishing features. The authors actually do indicate four such new departures, but in essence only two themes are the dominant ones: Firstly, an 'explicit pro-poor reasoning' in the NMA literature and secondly, a 'consistent criticism of traditional government driven and subsidy-based private-sector support programmes' (Altenburg and Drachenfels 2006: 396-398).

Both these characteristics are significant breakaways from previous support policies for PSD. In the spirit of neo-classical thinking it was not necessary in the 1990'ies to argue the case of market-led PSD being 'pro-poor' and in spite of this leading paradigm – as a notorious contradiction – a number of government programmes actually supported PSD through directly subsidised PS activities, crowding-out competitors and ignoring the capacity of markets for solving problems efficiently. This latter part of the NMA is credited by the authors for being in line with empirical findings and a valid critique of government interventions. Nevertheless, they find that to a large degree NMA policy documents are '… sometimes vague and ideological rather than analytical …' (Altenburg and

[13] This strategic dividing line and the 'making markets work for the poor' approach is the subject of section 4.2 below.

Drachenfels 2006:390) and further – in a recent analysis – that in particular WB reports are heavily biased against government actions: 'Throughout the reports, government interventions are largely perceived as 'distortions' and 'burdens' for private investors.' (Altenburg and Drachenfels 2008:8) Thus, basically, the NMA is seen as a 'minimalist' approach to the role of government in PSD.

With regard to 'pro-poor reasoning' of the NMA the authors do recognize that convincing arguments are presented in favour of deregulation and individual property rights. Excessive government regulation may harm the poor disproportionately, either because economic costs of compliance are fixed or because more well-off business people are better positioned to evade such cost, implying, too, that SEs will have an obvious incentive to keep out of touch with authorities and stay in the informal sector. Likewise, individual property rights, e.g. to informal dwellers, will enhance redistribution as far as they do not intrude on the livelihood of other poor people.

What is, however, seriously questioned is the claim that the NMA as such is pro-poor, i.e. that by itself the 'level playing field' of an enabling environment reform will trigger off a hidden economic 'growth potential of the informal sector' and SEs in general. This argument is known to be in contradiction of the well established empirical fact that the propensity for SEs to survive and grow into larger business units is low due, inter alia, to serious constraints in skills, capital, business services and entrepreneurial attitudes. Constraints found to be of particular importance in the informal sector. It is concluded accordingly that: 'The NMA fails to capture the complexity involved in building competitive economies and integrating the informal sector.' (Altenburg and Drachenfels 2006:406)

The analysis of the NMA literature highlights the already mentioned strategic dividing line in the donor community of how to achieve the poverty reduction objective in PSD. On the other hand it may, actually, be questioned if the NMA is a fact of real life. Is such a consensus among donors with regard to enabling environment programmes materializing at all?

A recent 'guideline' for donor agencies (DCED 2008) sums up the consolidated views[14] of agencies and openly presents six 'contested issues' of major importance. One of these issues goes virtually to the heart of the NMA: 'What role should government play in enterprise development?', and clearly spells out the strategic disagreement:

> 'Not all development agencies agree on the role of government in enterprise development. Some argue for a so-called 'minimalist' role in which government limits its role to reducing the regulatory burden on business and reducing the cost of doing business. Others suggest that governments need to intervene more broadly in the economy with supply-side programmes to produce the social, economic and equity outcomes they desire.' (DCED 2008:32)

This clearly confirms the evidence presented above (table 1) and limits the NMA from signalling an emerging consensus of enabling environment programmes to being the strategic PSD position of some agencies – maybe in particular the WB. This notori-

[14] The DCED 'guidelines' have been under preparation for some two years, but the process of consensus building has met with serious difficulties: 'Although every possible effort has been made to reach consensus on the text of the Guidance, it does not necessarily reflect the views of each and every agency-member of the DCED.' (p. II).

ous split in the donor community obviously has implications for the process of donor harmonization.

4.2 Pro-poor Growth through PSD: Making Markets Work for the Poor ('M4P')

Parallel with the UN passing of the MDGs poverty reduction and pro-poor growth has gained universal acceptance as an objective of PSD. Still, however, there is no consensus, neither of what is meant by pro-poor growth nor of how to achieve it. Conceptually pro-poor growth can be defined either in absolute terms, implying a simple decrease in the number of poor people or it can be put relatively, i.e. conditioned by the distributional development and presupposing at least a status quo as indicated by e.g. the Gini-coefficient. In cases of less inequality the number of poor people will usually be decreasing at a faster rate, when economic growth occurs. The major disagreement among academics and in the donor community is, however, concerned with what is often termed the 'quality' (Sida 2004: 4)[15] of the growth process, i.e. how best to achieve pro-poor growth.

4.2.1 Donor Approaches to Pro-poor Growth

The quality of growth issue forms a major strategic split among donors, spelled out in some detail as one of the 'contested issues' in the above mentioned recent donor guidelines for business environment reform:

> 'Should business environment reform focus on enterprises that are owned and managed by poor people? … Some agencies argue that general reforms of the business environment are not sufficient and there is a need to focus reforms on the specific barriers that poor women and men experience directly when operating in the business environment. Others argue that targeted approaches create additional biases and market distortions, and are not consistent with a systemic approach … that improves the system for everyone. The former approach aims to address equity issues directly, while the latter approach highlights the concern that by directly addressing equity, new market distortions will be created that dampen the benefits of an improved business environment on economic growth …' (DCED 2008:7)

On the surface this suggests to be a recap of the classical argument of the relative merits of either supporting poor people directly through health, education or other forms of social assistance, or – alternatively – relying on the 'trickling down' of the benefits from growth in the average income of society. However, this is not just another debate of social equity contra economic efficiency. On the contrary, understanding the working of the typical markets of poor people and identifying constraints to market access in order to ensure inclusion in the growth process is seen by some donors as a pathway to achieving pro-poor economic growth through PSD. Thus the proponents of targeting directly the enterprises owned and managed by poor people are in particular focusing on the markets of *agriculture* and of the *informal sector* (Sida 2004:6; Lindahl 2005:78-91).

[15] Sida, among others put strong emphasis on this aspect: '… the quality of growth is essential: its composition, distribution and sustainability are vital.' (Sida 2004:4).

This approach, initially being proposed less than ten years ago (DFID 2000), has appropriately been labelled: 'making markets work for the poor' (M4P)[16] and its essence with regard to PSD approach can be summarized very succinctly in the words of Professor Adrian Wood, University of Oxford:

> 'It is not a magical combination but it is fairly straightforward. What you need to do is to give the poor more assets and more access to markets so that they can participate in the growth process more … When I am talking about assets, fundamentally the most important asset is probably education for poor people, to increase the value of their labour and health also increases the value of their labour. Access to credit and land through reform of tenure schemes is very important. Improvements to rural infrastructure are absolutely crucial in terms of giving poor people better access to markets … Strategies that involve more poor people in the growth process are good for both growth and a reduction in inequality.' (House of Commons 2006: II, 8)[17]

This approach may not be 'magical', but being presently still being widely disputed inside the donor community it is apparently neither as simple and 'straightforward' as it looks at first glance. Key words are '*assets*' and '*access*' that will allow the poor into the growth process, implying, however, that vested political interests and complicated political decision-making may be involved. Further, diagnostics and design of support programmes will have to be firmly country-context bound and together with implementation raise pertinent questions of the kind of support initiatives to be advisable in order not to jeopardize market efficiency and risking to crowd-out other PS activities.

4.2.2 The M4P Concept

The proponents of M4P are not taking issue with enabling environment initiatives, but are – at least initially – only insisting that such reforms are not sufficient. Removing constraints to doing business will lower transactions cost to all players in the market and may, in particular, benefit SEs; but the argument is that even with generally more efficient markets there is no guarantee that the poor will actually have access. They may either have to overcome insurmountable barriers of an economic, social, cultural or related nature to entry, or the markets they need, e.g. the labour market, may actually not exist at all. Therefore, the neo-classical focus on government and market failures are only part of the business problems meeting poor people; they also have to deal with serious forms of discrimination, including, in particular, those barriers met with by women.

The analytical basis of the M4P is explicitly (Johnson 2005:6) inspired by the New Institutional Economics, taking as a point of departure the observation that other forms of organisation than markets, e.g. hierarchical structures like governments and companies, may clearly be economically rational. Therefore, also non-market solutions will be needed, either because markets effectively

[16] Several donor agencies are promoting this concept, in particular GTZ, ILO, Sida, UNIDO, USAID and DFID. The position of DFID regarding the M4P – initially MMW4P - concept was questioned by the 2006 report: 'Private Sector Development' produced by the International Development Committee of the British Parliament (House of Commons 2006:I, 18), but the concept was unequivocally accepted by DFID in its official response to the report.

[17] Professor Adrian Wood, University of Oxford, appearing as a witness for the House of Commons' International Development Committee at the hearing of the report on 'Private Sector Development'; 14 February 2006.

do not exist if transactions cost are prohibitively high or, likewise, if other factors of a non-economic nature are decisive. It will take thorough diagnostics to decide the appropriate mix of interventions needed, but the essential point of the M4P argument is that market 'access' of the poor and the 'assets' needed for empowerment of poor people, will not be forth-coming automatically. They need to be planned with a direct focus on inclusion of the poor in the economic growth process as part of an enabling environment reform for PSD.

In order to achieve such inclusive – and sustainable – pro-poor growth, the reform design will obviously have to consider a wide spectrum of possible interventions and support activities. The challenge presented to donors – and governments – can aptly be summarized as a need for being: '… prepared to *analyse constraints and opportunities in respect of PSD and to make appropriate interventions* at each system level.' (Sida 2004:7)[18]; i.e. intervene at macro-, meso- and micro levels.

Likewise, jointly donors have recently underlined that such reform will need to be 'strategic' in its focus on which sectors are of major importance for the results: 'These approaches to business environment reform allow for a deeper analysis within those sectors that are most strategic for national development or pro-poor growth.' (DCED 2008:14) Such strategic decisions are clearly the responsibility of national governments and indicate a much broader – and crucial – role of government than the WB recipe of deregulation and removal of constraints for PS activities in general. These are the kind of decisions where developing countries are supposed to take the lead.

[18] Sida's 2004 PSD policy guidelines are explicitly presented with the headline: 'Making markets work for the poor.'

4.2.3 The Strategic Role of Agriculture for Pro-poor Growth

In its 2007 report: 'Agriculture for Development', the WB sets new standards and adopts an approach of specific pro-poor interventions. Under the headline of 'New roles for the state' the previous scope for what can be seen as constraints for the proper working of markets and of the need for public interventions are extended: 'Market failures are pervasive, especially in the agriculture-based countries, and there is a need for public policy to secure desirable social outcomes. The state has a role in market development – providing core public goods, improving the investment climate for the private sector – and in better natural resource management by introducing incentives and assigning property rights.' (WB 2007:23)

This policy statement by the WB should not be seen as a universal recipe for agricultural policy in developing countries. It is primarily targeting the so-called 'agriculture-based countries'[19], where agriculture forms the economic basis and the main growth factor of the economy and where the rural poor population comprises the majority of poor people; i.e. mainly Sub-Saharan African countries, where agriculture obviously is a sector of 'strategic' importance. The WB is not directly subscribing to the concept of 'making markets work for the poor' (M4P)[20], but the alternative concept present-

[19] The WDR 2008 identifies three different groups of countries, according to the significance of agriculture for economic growth and the rural share in poverty: 'agriculture-based', 'transforming' and 'urbanized' countries.

[20] In some places the formulations used by the WDR 2008 is, however, almost identical: 'This chapter examines the new opportunities and challenges for smallholders in the markets…It highlights the broad array of private, public, and civil society initiatives that have been pursued to make markets work better for development and poverty reduction.' (WB 2007: 118).

ed: an 'agriculture for development' agenda, is in many aspects similar. Not only in its objectives of achieving economic growth and poverty reduction through a deliberate process of making markets accessible to the rural poor, but also in recognizing the essential need for governance by state authorities – national as well as local – to support this process.

The WB 'agriculture for development' agenda is developed on the background of a noted 'agro-scepticism' of donors, revealed by the fact that 'development assistance to agriculture declined dramatically' over the past two decades (WB 2007:41). Recent analysis clearly shows the neglected strategic development potential of the agricultural sector: 'That the case for using the powers of agriculture for poverty reduction and as an engine of growth for the agriculture-based countries is still very much alive today … but also coming are new challenges, particularly in pursuing a smallholder-driven approach to agricultural growth that reconciles the economic, social and environmental functions of agriculture.' (WB 2007:44). – Basically, this approach outlines a needed process of structural transformation in agriculture and – further – of rural societies as well.

Emphasizing a 'smallholder driven approach', this strategy clearly aligns itself with that part of the donor community, finding it imperative to 'focus on enterprises that are owned and managed by poor people'. In its search for the 'assets and access' needed by the rural poor in order to escape poverty, the strategy identifies three possible pathways out of poverty in rural areas: developing agricultural entrepreneurship, expanding rural labour markets and relying on migration to urban areas. To open the pathways four policy objectives are identified (WB 2007:228):

1) *Improve market access and establish efficient value chains*
2) *Enhance smallholder competitiveness and facilitate market entry*
3) *Improve livelihoods in subsistence agriculture and low-skilled rural occupations*
4) *Increase employment opportunities in rural labour markets and enhance skills*

A wide variety of functional areas and support instruments has to be mobilized in order to achieve these objectives. Basically, however, these are the same M4P instruments, indicated by professor Adrian Woods (cf. above); further, in its comprehensiveness it is in line with the – 'neo-structuralist' – approach outlined by the proponents of a 'business climate' reform in table 1 above.

Achieving pro-poor growth in rural areas must therefore be interpreted as a holistic process of rural – and complementary urban – PSD, where support for agricultural policy and development is only one of more legs necessary to enhance the assets, occupational opportunities and livelihood of the rural poor. This interpretation is supported by the fact, stressed by the report, that rural households are characterized by their heterogeneity in livelihood strategies and sources of income: 'Rural households design livelihood strategies to suit their asset endowments and account for the constraints imposed by market failures, state failures, social norms, and exposures to uninsured risks … their strategies compensate for only part of the constraints they operate under, leaving important roles for improvements in their access to assets and in the contexts for using these assets. The key, then, is to enhance collective action and mobilize public policy …' (WB 2007:72).

Accordingly support programmes ought not to be directed towards one particular category of farming poor, e.g. smallholder farmers with a commercial motivation, but should be targeting rural households, whether primarily in subsistence farming or mostly dealing with cash crops. The programme objective is to: '… serve the unique needs of all households while speeding the passage from subsistence to market-oriented farming' (WB 2007:93), i.e. to design the pathways leading out of rural poverty.

The logical implication, though not explicitly stated by the WB report, is that the agricultural sector should not be treated in isolation by narrowly specialized agricultural sector programmes, but as part of the support for PSD and societal transformation in rural areas, based on a national policy of decentralization and of clearing the pathways – farming, labour and migration – out of poverty for the rural poor. Very few donors are presently honouring this holistic pro-poor agenda for PSD.

4.2.4 Informal Sector in a Pro-poor Growth Strategy

Like agriculture the markets of the informal sector – or economy – are essential for achieving inclusive and sustainable PSD. The informal sector can be defined as: 'unregulated small-scale business in trade and manufacturing outside agriculture' (Lindahl 2005:78), but as indicated by the pathways out of rural poverty (WDR 2008:72) it is linked to agriculture through non-farm rural labour markets and the need for coping with rural migration.

Although enterprises in the informal sector are mainly urban based, the basic economic and social characteristics of their proprietors are mostly – although the informal business status may also be chosen deliberately for economic reasons – similar to those of smallholder farmers: they are poor – in many cases women – and running small, family-based businesses; subsistence is a constant challenge, calling for cautious livelihood strategies and risk aversion; their market linkages are only working on and off, meaning that their business may not always be commercially viable, but bordering to 'hidden unemployment'. Increased 'assets' and improved 'access' to markets are as essential to building pro-poor growth of informal sector enterprises as they are to transforming subsistence farming into commercial farming and therefore the M4P concept is of the same basic relevance in forming PSD.

Still, however, the M4P approach is questioned among donors and this is in particular seen in the analysis and design of support programmes, aiming at upgrading enterprises in the informal sector. Two very different – and with regard to support programmes – incompatible interpretations of the causes for having an 'informal economy' are offered: either the main reason is seen as government bureaucracy and heavy taxation, resulting in excessive transaction costs that can be evaded by enterprises staying unregistered and informal; or – alternatively – the informal sector is mainly seen as the economic space of the poor and marginalized households, implying that staying unregistered and informal is a livelihood strategy for households living on the margin of organized PS activity (Lindahl 2005:89-90; OECD 2006:18-19).

These diverging explanations of the existence of a major informal sector in the economy can be seen as the result of a basic disagreement in the donor community regarding a neo-classical and a neo-structuralist approach to PSD (Altenburg and Drachenfels 2008:11-12)[21], having obvious-

[21] The joint UNIDO and GTZ study was written by Tilman Altenburg and Christian von Drachenfels (GDI) as part of the work in the Business Environment Working Group of the DCED and prepared in particular for the conference: 'Creating Better Business Environments for Enterprise Development – African and Global Lessons for More Effective Donor Practices' held by the network in Accra, Ghana in November 2007.

ly very different policy implications for enabling environment interventions. It is not that the neo-structuralists do not accept legalization to be helpful to informal enterprises. The point is that legalization is not 'decisive' and will have to be led by: 'targeted policies for upgrading, e.g. providing management and technical training, support producer cooperatives, build linkages with formal enterprise, direct public purchases to informal sector organizations.' – 'Assets' and 'access' of poor people is once more the main point.

The argument goes to the root causes of an informal sector: is this a problem of biased markets or a matter of social exclusion? It mirrors once more the 'contested issue' among donors of whether or not public policy and an enabling environment reform should be directly targeting 'enterprises that are owned and managed by poor people'.

4.2.5 Ideological Inclinations of the Donor Community

The M4P concept has been piloted and tried out with considerable success in different contexts – rural as well as urban – since its initial presentation. The potential for application – in the spirit of the MDGs – is wide: transformation of subsistence farming; upgrading of micro enterprises; formation of value chains; tackling gender issues; building markets for financial and other kinds of service provision; also, however, learning to deal with post-disaster and post-conflict situations are part of the lessons learned (Tanburn (ILO) 2005). Recently DFID in its 2008 PSD strategy: 'Prosperity for all: making markets work', made M4P the first step in a three-pronged strategy of: 'access', 'competition' and 'engagement' (ACE)[22] for PSD (DFID 2008:24).

In general, however, the M4P approach is disputed among donors, and DFID in the new PSD strategy explicitly makes such disagreement a key risk with regard to programme impact (DFID 2008:47). Apparently, what separates donors has clear ideological inclinations.

The scepticism in parts of the WB organisation towards an active role of government with regard to PSD is evident and indicates a leaning towards a neo-classical paradigm. Neo-structuralists, in reverse, stress that: 'As the process of building competitive advantages becomes more complex and involves more actors and growing information flows, more coordination and facilitation is required. While a considerable part of this will usually be supplied by private service providers, the role of the public sector in this process necessarily also increases.' (Altenburg and Drachenfels 2008:8).

Similar results of donor divergences were obtained from the analysis in table 1 (cf. section 4.1.1 above). It should, however, be noted that the WDR 2008 on 'Agriculture for Development' clearly presents a deviating approach much more in line with agencies of the generic 'business climate' reform design. The difference in approach is repeatedly stressed in the report by referring to market failures as 'pervasive' in agriculture, but also the central role of government interventions are highlighted: 'Beyond providing these core public goods, the state has to facilitate, coordinate and regulate, although the degree of state activism is debated. The agriculture-

[22] The 'ACE' approach to PSD implies: 'access to economic opportunities by the poor – making markets work for the poor; competitive markets – to encourage private sector development; engaging with private sector companies – to help achieve the MDGs' (DFID 2008:24).

for-development agenda also assigns a strong role to public policy to promote poverty reduction and equity, including gender equity, by building productive assets and providing safety nets.' (WB 2007:247).

Clearly the approach to agricultural development and rural PSD of the WB is solidly inside a neo-structuralist paradigm, indicating a commendable ideological flexibility inside the organisation.

4.3 Corporate Social Responsibility in PSD: Sub-contracting and Propoor Value Chains

Globalization and FDI has meant that PS activities are increasingly being organized in value chains and sub-contracting has become the normal business relationship for developing country SMEs and – occasionally – even to small-holder farmers and micro enterprises. Usually one or more companies in the higher – buyer – end of the value chain have taken the lead, prescribing the standards and norms to be complied with in order to penetrate the market. This development creates a rationale for ODA support for value chain interventions as it influences profitability of individual enterprises in the value chain as well as overall employment and economic growth, and thus impacts on economic and social conditions of involved households.

4.3.1 Government Role in Value Chain Coordination

As value chains are not exclusively governed by market forces, but to a large degree influenced by the power of the organizational structure of the chain and its governors, government has an obvious role to play. The achievement of pro-poor growth presupposes government influence through public-private partnerships (PPP), which has put 'corporate social responsibility' (CSR) and codes of conduct into focus also with donors, realizing that competitiveness in the form of image-building and branding is an integral part of global – and probably also regional and even national – value chain governance. Successful PSD can only be achieved if appropriate principles of behaviour, e.g. 'triple bottom line', are accepted and adhered to by all involved enterprises.

This process will, however, only further a pro-poor development if enterprises – national as well as trans-national – are able to and can be motivated to coordinate their strategies and behaviour at all stages of the value chain, leaving thus ample scope and a major challenge for the development and implementation of non-market coordinating mechanisms as exemplified in the WDR 2008 by the need for agricultural sector policy planning and implementation:

"New state roles – coordinate, facilitate, and regulate: The need for coordination by the public sector has increased as the food supply chain has grown. Coordination failures occur when farmers or processors are isolated or disconnected, or when complementary investments are not made by others at different stages in the supply chain … In such situations coordinated public, private and civil society actions can reduce transaction costs and reduce risks for private investment in critical services for small-holder agriculture … This agenda is broadly cross-sectoral, embracing not only issues of agricultural production, but also food safety, biosafety, animal health, human health and nutrition, physical infrastructure, environmental services, trade and commerce, natural disaster management, gender equity, and safety nets." (WB 2007:247).

The task of stakeholder coordination left to government, when trying to mobilize the power of the value chains in the development process is strategically of the highest importance and is increasingly being realized as essential to successful PSD. However, the implicit challenges to the governance capacity of developing countries, regarding government planning and professional capabilities do appear stunning. Donor support to government capacity building in PSD is a major challenge.

4.3.2 Making Value Chains Work for the Poor

Basically, however, the value chain approach is a further logical development of the conceptualized M4P approach, trying to achieve pro-poor growth through PSD: 'Economic growth with poverty reduction can be achieved by targeting industries where the poor are concentrated – such as agriculture and informal sectors – promoting strategies that make the target industries more competitive, and ensuring broad distribution of benefits at all levels of these industries.' (USAID 2006: 1). But the very concept of value chains – and the notion of the 'lead firm' in charge of governance inside the chain – do transgress ordinary analysis of commodity markets and thus introduces the essence of globalisation and competitiveness into national policies for PSD.

In order to build pro-poor value chains it is thus essential both to ensure access to the value chain for enterprising poor people – be it smallholder farmers, informal sector micro-enterprises or employees – and in parallel to aim at upgrading their competitiveness to the level needed to comply with the international standards of market demand. Pro-poor value chain policy will therefore have to deal with the full length of the value chain from primary producers and all the way to the market and to the final consumer.

In some interventions – e.g. support for agri-business industry – it may be considered only to target processing or marketing enterprises at a higher level in the value chain, relying on their eventual sub-contracting of smallholder farmers and micro-enterprises. Locally sub-contracting may, however, not be a customary business relation and leaving out primary producers of the policy design mean, that market access of the poor and development of their physical, human and social assets are neglected and left to be determined by the structures and dynamics governing the particular value chain in question. There is no reason to believe that such an outcome will be pro-poor, when no incentives for the inclusion of poor people are mobilized.

In some cases such divergent approaches to value chain interventions may be disguised as an argument about whether to target SME's or MSE's – i.e. small and medium seized enterprises (SME) rather than micro- and small enterprises (MSE). This may be just an issue of terminology as sometimes the conceptual differences are not clearly defined and formulations are therefore made haphazardly. If, however, the targeted enterprises are selected on purpose it makes quite a difference if micro- enterprises are excluded in favour of medium seized ones as the pro-poor lower end of the value chain is then neglected.

Having SME's included is often of strategic importance for creating vertical linkages within a value chain, forming e.g. out-grower schemes with smallholder farmers or linking micro-enterprises to the market through outsourcing. This is, however, not an argument for leaving out micro-enterprises of the equation as the combined MSME's will be needed for a pro-poor outcome.

Further, SME's may be an important source of employment creation, e.g. when plants are processing raw farm produce in rural areas. But such processing SME's will have to rely on local primary producers and micro-enterprises for inputs or may, alternatively, be dependent on imports from foreign producers; in the latter case, they will be most sensitive to the costs of transport and other transaction costs as well as to price fluctuations of international markets in general. The employment generation of SME's will thus be unreliable and the poverty alleviation impact not sustainable if the backward linkages with local primary producers and micro-enterprises are not developed.

Therefore, donors trying to build pro-poor value chains are primarily targeting MSE's (USAID 2006:1), while those donors explicitly leaving out micro-enterprises of planned value chain interventions and solely targeting SME's thereby do indicate that the objective of creating pro-poor value chains is downgraded in favour of a short run focus on economic growth.

4.3.3 Sub-contracting and Vertical Linkages

Forming vertical linkages is vital, when trying to integrate and upgrade national enterprises in global value chains. In particular two challenges are critical: firstly, achieving competitiveness of the national enterprises in the value chain, which will reduce transaction costs and the risk facing individual entrepreneurs, while in parallel making the value chain lead firms motivated for engagement, investment and integration; secondly, ensuring joint ownership in the value chain – nationally as well as globally – of the CRS principles, which will, too, be guiding performance towards enhanced competitiveness and pro-poor growth.

Obviously, designing and implementing a pro-poor value chain intervention will have to pass a number of analytical steps, including: analysis and selection of industry/value chain; forming a competitiveness strategy for the chosen value chain(s) and then also producing an action plan with performance monitoring and impact assessment (Kuala et al. 2006:17). Donors have developed several approaches to the appropriate selection of value chains, either taking outset in the possibilities for local economic development (so-called 'territorial approach') or focusing explicitly on the potential for enhancing competitiveness and poverty reduction of particular sub-sectors or value chains (Tanburn 2005:29-30). The difference being typically one of a multi-commodity or 'diversification' approach, compared alternatively to a single-commodity or 'specialization' approach.

As for competitiveness of the chosen sub-sector/value chain the issue may in particular be whether or not the SE's have the potential for the needed upgrading. Taking Sub-Saharan Africa as an example, the lack of inter-firm specialization has been identified as a particular problem, leading to missed opportunities in learning and productivity growth between modern enterprises and indigenous small scale enterprises (Altenburg and Drachenfels 2008:44-46). Often sub-contracting SE's is not an option used by larger companies as the transaction costs are considered to be too high, unless the SE's are solidly linked together horizontally.

Donor and government support for developing vertical – so-called forward – linkages is thus an important component of value chain programmes, furthering the needed technology transfer. But it is also a way of providing the incentives for SE's to comply with higher standards of production, thereby increasing competitiveness. The likelihood of developing such linkages is, however, very much depending on the organizational structure and cooperation between SE's, determening transaction costs and thus attractiveness to enterprises higher in the value chain.

4.3.4 Associations, Clusters and Horizontal Linkages

Organizing micro- and small enterprises in supplier networks – so-called horizontal linkages – may be demanding in both economic and social terms, making government or donor support for building such networks crucial. It is a strategic investment that can reduce transaction costs and make pro-poor value chains feasible.

PPP's may form an important part of the specific government interventions in support of pro-poor value chains, thereby complementing enabling environment regulations with jointly planned value chain initiatives, e.g. CSR programmes. Further, cooperation between government, PS and other civil society stakeholders may enhance transparency and information dissemination, thereby dealing to some degree with coordination failures and missing public goods.

Such partnerships may even be instrumental in changing the status of informal microenterprises to formalized registration, thus lowering the barriers of linking up with larger firms in the value chain. This is illustrated by a recent example (August 2005), where through an agreement with the government, Kenyan informal ('jua kali') micro-enterprises formed an umbrella organization that coordinates titling for members and organizes the administration of a loan fund, while also opening up for advocacy on behalf of members (Orwa 2007). Transaction costs in dealing with 'jua kali' enterprises have probably hereby been clearly lowered.

In countries of Sub-Saharan Africa, e.g. Ghana, Kenya and South Africa, there has been quite a number of successful SE-clusters formed, e.g. in auto-repair, clothing, metal and fisheries; also agricultural associations have been vital for implementing major outgrower schemes (Altenburg and Drachenfels 2008:18, 47). Through such horizontal linkages economic cooperation and social capital have developed, enabling participating SE's to achieve the level of competitiveness needed for building sustainable vertical linkages – and for opening their way into value chains.

4.3.5 Feasibility of Pro-poor Value Chains – and PSD support?

Value chain interventions are by nature complicated due to the economic, social and organizational complexity of chain structures and the difficulties are compounded, when adding the policy objective of being pro-poor. In order to achieve this objective, interventions will have to be designed in a way that remove entry barriers and improve possibilities of value chain access for poor people; in parallel, however, it is also necessary to make the propoor objective owned by the full value chain through appropriate CSR and other standards and the incentives needed for compliance.

Therefore support for value chain interventions will be needed on a broad scale, coordinating as far as possible initiatives on micro-, meso- and macro level. As already stressed, the role of government – or state – inevitably takes on new dimensions as 'coordination and facilitation' are added to 'regulation' (cf. WDR 2008 above).

While in general government support for building and strengthening linkages – horizontally as well as vertically – is essential for the formation of pro-poor value chains, possible support policies with specific focus on pro-poor value chains are of particular interest. Donors have increasingly focused on the possibility of supporting socially inclusive standards and forms of branding, e.g. organic production, fair trade etc., that may improve market access of poor people while simultaneously adding value to their produce. This forms part of the M4P approach in so-called 'market development programmes' (DFID 2008:38), but will have to carefully respect the ability of poor producers to cope with increasing costs (Altenburg 2007:47-48):

Whether support for value chain activities should explicitly have a pro-poor objective is, however, still a contested issue in the donor community: Will the achievement of international competitiveness for the full value chain be feasible, when using a pro-poor approach? Are small scale producers able to cope with global standards of production and manage even increasing levels and the implied costs? Are global value chains the only relevant 'benchmark' for competitiveness or may local, national or regional alternatives be realistic, when aiming at market access for poor people? These are some of the unresolved – but very context specific – issues raised, when trying to analyse the position of donors, regarding support for pro-poor value chains (Altenburg 2007:51-52).

The basic issue of whether or not a pro-poor value chain approach should at all be adopted is, however, the primary issue among donors:

'… most donor approaches for supporting value chains are strongly selective with regard to sectors and target groups, often have a relatively micro-level focus on individual value chains and producer groups of limited size, and require a strong market interference by facilitators. To what extent is this consistent with previous work by the Donor Committee that emphasized non-selective policies for improving the business environment and market-led solutions? Where is the borderline between public goods which justify donor (or host country government) intervention and private goods? To what extent should donors get engaged in "engineering" value chains? Or should they rather limit their role to improving the overall policy environment and strengthening providers of specific value chain services (e.g. value chain mapping; risk management; matching grants)?' (Altenburg 2007:51).

What is at issue among donors is thus not only the rationale for donor support to value chain activities, but to PSD in general: Should interventions be limited to correcting market failures and providing public goods? Or is there a wider scope for addressing coordination failures and the objectives of societal transformation? But the argument goes even further: What is the proper role of donors in support of PSD? How far should donors involve themselves in intervention 'engineering' with PS stakeholders and where is the 'borderline' between support for PSD and support for private interests? This raises the basic issue of ODA policy in relation to PSD support.

5. PUBLIC AND/OR PRIVATE SECTOR IMPLEMENTATION: AID MODALITIES AND THE PARIS DECLARATION

Since 2005 the Paris Declaration (PD) has set the standards of 'aid effectiveness' in ODA policy. Support for PSD is no exception: The procedure to follow, when forming an enabling PSD environment, is public sector implementation with donor alignment and if possible budget support; thereby strengthening country ownership and country systems in line with the principles of the PD.

In the opinion of a considerable part of the donor community support for PSD is, however, more than just removing government ‘red tape’ and other kinds of constraints for the proper working of markets and PS activities. As demonstrated in the previous chapters the objective of pro-poor growth and its implementation through the concept of ‘making markets work for the poor’ (M4P), emphasizes the coordinating and facilitating role of government in addition to that of regulating economic activities, but in particular direct focus towards ways to target markets of the poor and make interventions at the micro level.

Realizing the importance of the reported ‘contested issues’ and the notorious disagreement in the donor community about ‘best practise’ with regard to support for PSD, the first and most obvious question is if and in what sense this lack of donor consensus has implications for the implementation of the PD and its recent Accra Agenda for Action (AAA) follow-up? Further, however, PS activities are inherently market-based and supposed to be outside government control, which raises the basic issue – also at heart of the argument among donors – how support for PSD can be implemented most effectively: either exclusively through public sector funded and executed interventions, using PD principles or through some alternative modalities, including the introduction of PS stakeholders directly in the process of implementation?

5.1 Alignment and harmonization of PSD reform initiatives

Donors unequivocally seem to support the objective of country ownership and the synergies resulting from aligning with a national PSD strategy. Still, however, there may be significant differences in the understanding of the concept of alignment and of the process leading to it.

Initially, however, the government drive for a PSD reform may be weak or almost none existent, while donors find such reform initiatives to be absolutely essential. What should then be the attitude of donors? Should they restrict themselves to only respond to a country demand for reform or should they engage actively in creating a demand for reform? This is one of the issues contested by donors as reported in the recent guide established for development agencies (DCED 2008:25): ‘Not all development agencies are comfortable with this tension and not all agree on where the limits to stimulating a demand for reform lie.’

Most probably this issue of paternity to reform strategies is of a general nature and not an isolated PSD problem: Normally minutes of high level consultations between national governments and donors will report full agreement on issues of support for reform strategies and policies; but does this reveal the real preferences on the demand-side – the receiver government? Quite often this will probably not be the case and then the PD prescription of alignment is effectively blurred.

This basic problem of the true reform ownership may, however, be of special relevance, when dealing with the division of labour – and economic interests – between the public and the private sectors. The guidance offered for such situations of potential reform has to be diffuse: ‘… development agencies can stimulate a demand. However, they must be careful not to be too prescriptive or imposing.’ (DCED 2008:24). Some soft instruments of reform promotion are suggested, including in particular opening up public-private dialogue on PS needs and matters of concern. Influencing reform demand is obviously a 'knife-edge' problem facing donors – and the PD principles.

Even supporting public-private dialogue raises an issue contested among donors. The new partners for dialogue with the government side may often be very weakly organized and will be in need of capacity building and general strengthening if they should be able to fill their advocacy role. But who should represent the PS interests and to what extent should government influence which groups and associations to be supported by donors and included in the dialogue? Smallholder farmers, informal sector enterprises, women's organisations and labour movements may typically be outside ordinary dialogue round-tables; could support for these PS associations be considered as interference with political processes? Donors do argue this issue: '… because business environment reform is a political process, this kind of support can be seen as interference with domestic politics.' (DCED 2008:28) and for dialogue to work obviously some public-private consensus is needed.

The diversity of PS stakeholders represented in the public-private dialogue is essential to the outcome of the process. In particular, the opportunity of marginalized business groups to advocate their problems is important when aiming at a pro-poor growth strategy. Therefore some inclusive understanding will have to be reached as part of the alignment process or otherwise a PSD reform will not be meaningful. However, as agreed among donors: '… care should be taken to ensure that this support is not directed toward any single issue, political agenda or political party.' (DCED 2008:28). Still, this guideline obviously leaves room for quite some political confrontation.

In accordance with PD principles harmonization of donor activities is supposed to contribute significantly to the decrease of transaction costs in development aid. But obviously serious disagreement among donors about 'best practise' in PSD may jeopardize this objective. As already mentioned altogether six 'contested issues' were reported in the recently published 'practical donor guidance' (DCED 2008). Some of them have been analysed rather detailed previously and the complete list is only summarized below:

1. Can we measure the extent to which business environment reform contributes to economic growth and poverty reduction?
2. Should business environment reform focus on enterprises that are owned and managed by poor people?
3. Should development agencies simply respond to demand for reform or should they also contribute to creating a demand for reform?
4. Should development agencies support individuals or institutions?
5. Does support for the private sector interfere with political processes?
6. What role should government play in enterprise development?

The significance for donor harmonization of what is explicitly termed: 'controversial issues' clearly differs; but based on the above analysis (cf. ch.4) in particular issue 2 and 6 are essential for the chosen objectives of a PSD reform: It obviously makes a significant difference to design and implementation of PSD interventions if market access of poor people is a central objective of the operation and, further, a PSD reform with government in charge of coordination and facilitation of PS stakeholder activities is very different from an exercise exclusively focusing on deregulation of government bureaucracy.

The concept of donor harmonization will easily loose any operative substance when extended between such divergent approaches; and having to give in on harmonization it may obviously be questioned if alignment is then possible for all PSD donors. This is not only a matter of divergences among donors. Alignment is only possible if the demand for PSD reform is clearly articulated and the process owned by the government in question. Too often this appears not to be the case.

5.2 Public and/or private sector implementation

A central theme of PD principles is to use country systems for programme implementation and as far as possible avoid parallel structures. Government based financial modalities – be it general or sector budget support – should be preferred and government agencies should be in the lead of programme execution. This way public sector capacity is maintained and developed, while national ownership is created.

It should be realized that sometimes government agencies are driven by conflicting interests that may jeopardize central aid objectives, e.g. the headquarters opposition to a drive for economic decentralization and support for rural growth and poverty alleviation. Such 'turf battles' are, however, a bureaucratic fact of life and not reserved for PSD interventions.

Apart for such problems of public sector coherence the PD principles may appear logical when dealing with a well defined sector of public policy, forming a natural part of government responsibility. With PS activities this is, however, not the case. Activities are sector cross-cutting, supposed to be inherently market-based and fully outside government control. Any PSD reform will have to work with PS stakeholders and respect and develop the economic rationale guiding their activities.

Implementation modalities for PSD reforms are therefore crucial. Reform elements which are targeting institutions and capacity building in the PS should preferably not be implemented by government agencies, which will often be guided by a non-market based economic rationale and possibly influenced by interests conflicting with those of PS stakeholders: '… within many of DFID's partner countries, we cannot assume the state is a neutral and rational arbiter' (DFID 2008:17).

Clearly non-governmental implementing agencies will be better positioned to support the development of PS institutions that are meant to counterbalance government influence, e.g. independent labour market organisations. Likewise capacity building of market-based institutions, e.g. development of a rural credit market, will probably be more effective when executed by a contracted operating financial institution than by the local Ministry of Finance. In essence this is a matter of ensuring that implementation is guided by the needs and principles of the supported PS institutions – that it is demand-driven.

It is therefore not surprising that PSD interventions are in general not guided by PD principles. The aid modalities actually followed by donors differ extensively and often a mixture is used by individual agencies. A list of stylized PSD implementation or facilitation models would comprise at least five items:

- Government agency implementation
- Donor agency implementation
- Sub-contracted company implementation
- PS enterprise-driven implementation ('cost-sharing models')
- PS enterprise support and linkage facilitation ('commercial support')

These implementation set-ups would then have to be linked with one of the following funding mechanisms or some combination; perhaps also with some earmarking or attached conditionalities:

- General budget support (GBS)
- Sector budget support (SBS)/basket funding
- Direct funding
- Tied direct funding (national enterprises of donor)

Usually donors will declare that their PSD initiatives are aligned and using country systems as far as market-based PS activities allow. For some programmes this is, however, not the reality. When using direct support for commercial ventures, agencies will normally have to restrict themselves to being only facilitators in order to avoid major distortions of market operations (OECD 2006:27). In relation to PD principles such programmes represent a particular problem as obviously programme alignment is problematic if interventions are only facilitated by the donor agency and left to be implemented commercially by grant receiving enterprises. The lack of PD compatibility of such PSD programmes should be analysed by involved agencies and the rationale for maintaining this particular design and its aid modalities be clarified. Basically, direct support for individual enterprises should be avoided unless the development impact is evident and sustainable (cf. p.4 above).

In general there is agreement that when government agencies are responsible for programme implementation some kind of either GBS or SBS should as far as possible be resorted to. This will typically be the case, when forming an enabling business environment as part of a PSD reform, aiming at public sector capacity building both in servicing the PS and in making improvements of government market regulation (cf. 'the business environment' approach, table 1 above). Also PPP's, including public sector sponsored 'cost-sharing' initiatives with PS enterprises in the form of challenge funds or comparable procedures may preferably be funded this way.

Contested among donors is, however, which instruments and aid modalities are the most effective when implementing PSD initiatives that aim directly at capacity building and institutional developments inside the PS. With regard to GBS the DAC commissioned joint evaluation in 2006 discussed if critiques were right in finding GBS biased towards public sector expansion, while at the same time neglecting PSD and its implications for growth and poverty reduction. The finding of the critiques was largely sustained (IDD and ass.:S 10, 18).

Although DFID has been a strong supporter of GBS, the merits of this funding mechanism was questioned by the British Parliament, when strategies and policies of UK support for PSD was reviewed in 2006. The concern communicated from the hearings by the parliamentary reviewers was, that an: '… increase in the role of budget support in PSD would risk neglecting the systemic development of the private sector and markets.' (House of Commons 2006:19); among others, the critical attitude was based on a testimony by one of the pioneers of the M4P approach, the UK based Springfield Centre, maintaining that: 'Budget support may well allow DFID to shift large amounts of money in a relatively easy manner but – by itself – has limited efficacy in relation to private sector development outcomes.' (House of Commons 2006: Ev 266).

In its response the UK Government maintains that GBS – so-called Poverty Reduction Budget Support (PRBS) in the DFID vocabulary – has supported PSD through investment climate improvements; but basically the contention of Parliament is supported: 'We agree. While improvements in the investment climate will underpin growth, a complementary focus on making markets work for the poor is also needed.' (House of Commons (S) 2006:1). – It has to be accepted that a basic separation of the institutions of 'state' and 'market' is needed in order to achieve PSD.

Once again referring to the different donor approaches to an 'enabling environment' reform (cf. table 1 above), the UK government response is emphasizing the essential difference between the public sector dominated implementation of an 'investment climate' reform and the PS focus of a M4P intervention – much more in line with the comprehensive 'business climate' approach (cf. likewise table 1) – underlining that other aid modalities than budget support is needed when market access and empowerment of the poor is a major objective.

In essence, PSD can not be supported effectively through budget support if the objective of the reform extends beyond public sector capacity building and the improvement of the framework – the investment climate – for PS activities. Government can not substitute for PS stakeholders. The same experience was summarized in a recent evaluation of PD implementation by the Ugandan government: 'Promoting a single modality, e.g. budget support, is not ideal practice given the risk of marginalising salient issues such as innovation, environment, demand-side governance and the private sector.' (RoU 2008:69). Aid modalities must allow for some implementation outside government systems – i.e. through parallel structures – if the objectives of comprehensive PSD reforms should be achieved.

5.3 Myopia of the Paris Declaration implementation

Considering the importance generally assigned to PSD by donor agencies it is surprising that the implementation of such programmes and the serious complications already since long identified have not been a matter of real analysis and concern in the follow-up process of the PD.

Already the 2006 OECD/DAC donor guideline on promoting private investment stressed: 'Care should be taken to ensure that key priorities are agreed on and that reform programmes are harmonised, in accordance with the principles set out in the "Paris Declaration on Aid Effectiveness" (OECD 2006:25) and that markets are made to work better for the poor (OECD 2006:22). It was also noted that: 'Currently, in many developing countries, development agencies act too independently, sometimes competing to fund projects, and donor co-ordination fora serve only as a vehicle for sharing information on new activities.' (OECD 2006:25)

Nevertheless, though the 2007 OECD/DAC guidelines on promoting pro-poor growth has a section on PSD it gives no guidance regarding comprehensive reforms aiming at market access and empowerment of the poor; further, any complications for the compliance with PD principles, that might stem from PSD interventions, are neglected in the guidelines.

Also, the most recent 2008 evaluation of the PD implementation as well as the AAA follow-up document do side step any PSD issues. Actually, the above mentioned Uganda evaluation of the implementation of the PD clearly hits a universal problem, when stating: 'The PD is in reality jointly owned by governments and the donor community but appears to have left out the private sector in the whole equation.' (RoU 2008:10). There seems to be some PS repression or myopia among donors – and maybe also governments – with regard to the ongoing PD implementation process.

Taken verbally the PD principles conceal a contradiction in terms when it comes to support for PSD: While according to PD principles parallel implementation units should be avoided, the general opinion is that PSD reform modalities should not be based exclusively on country systems like e.g. budget support. Rather they should rely on a 'hybrid' programme implementation approach where a mixture of public sector and direct PS implementation and funding modalities are used. Actually, this was also the tentative conclusion emanating from the review process of the British parliament, where DFID agreed on a two-pronged – or hybrid – strategy for its PSD interventions: 'DFID will continue to ensure that its support to investment climate reform and market development is complementary, and that the increased profile of investment climate work and budget support is not at the expense of MMWP[23] work.' (House of Commons (S) 2006:9).

DFID recently (January 2009) launched its new PSD strategy, 'Prosperity for all: making markets work', emphasizing the focus on: Access, Competition and Engagement (ACE). The 'hybrid' approach of the strategy is clear, anticipating to work both through government systems and directly with PS stakeholders. In the strategy DFID states frankly what the agency feels has been the main problem of donor support to PSD: 'A key challenge to PSD has been weak focus and prioritisation within the development community.' (DFID 2008:46). DFID expects to get enhanced impact from its new strategy, but also openly states two key risks that have the potential to 'undermine' the programme (DFID 2008:47):

- An inability to effectively influence other development partners to adopt market development approach.
- Potential risks to reputation from working directly with the private sector.

'Development partners' referring to other donors, this risk scenario is a clear indication of the difficulties presently facing the donor community, engaging in PSD support. It highlights the problems of achieving the supposed donor harmonization in line with PD principles; and it, too, makes it obvious that the modalities for working directly with PS stakeholders and still staying clear of biasing commercial involvement need to be thoroughly scrutinized by the donor community, in particular paying attention to clear exit strategies and sustainability of interventions (OECD 2006:27).

The donor community has repeatedly singled out PSD as a preferred ODA strategy for achieving economic growth and poverty reduction. Therefore, a continued repression of PS issues in the work on aid effectiveness may jeopardize PD principles.

6. CONCLUSION: NEXT ON THE PSD-AGENDA

The above analysis, focusing on 'rationale', 'practise' and 'policy coherence' of ODA support for PSD, has demonstrated that the development community is still far from a common understanding of the task at hand. The conclusions so far may be summarized as follows:

[23] 'MMW4P' was the initially used abbreviation for 'making markets work for the poor' – now: 'M4P'.

- Basically, it is possible to establish a theoretical rationale for the need of supporting PS activities as economic markets are not self-sustaining and the achievement of PSD objectives are only possible through support to carefully planned interventions. However, different development paradigms lead to different 'legitimating' rationales for support.
- In principle donors agree on the need for a rationale, but some donors want to focus on a narrow agenda of removing constraints for the working of the markets of the PS and increasing the supply of public goods, while others insist on further including the essential government role of taking responsibility for economic and social coordination and the interventions needed to achieve poverty reduction and transformation of society. Ideological differences are making donors diverge.
- Even with the agreement on the need for a 'legitimating' rationale, donors often do support individual enterprises directly without concern for the theoretical rationale, for problems of market distortion and for clear evidence of sustainable development impact.
- Increasingly there is an understanding in parts of the donor community of the possibilities for achieving pro-poor growth by way of PSD through interventions that on the micro level focus on 'making markets work for the poor' (M4P) – mainly in agriculture and the informal sector. Poor people are included in the growth process through market access and empowering assets.
- Recommendations are available, making it possible to match the increased focus on poverty reduction through pro-poor growth and PSD with the need for enhanced competitiveness of SEs and their integration in global value chains.
- Essentially, a hybrid approach relying on both public and private implementation modalities, which respects the necessary separation of state and market, is needed to achieve the objectives of PSD support. Such hybrid programmes do not comply with the PD principles of using country systems and avoiding parallel implementation structures.
- In practice, donors have shown little interest in harmonizing their approaches to support for PSD and the development community as such, in its drive for a policy of aid effectiveness, has neglected the problems of coordination between PD principles and the approaches to PSD.

When looking at the magnitude of private financial flows – micro-credit, FDI, remittances etc. – it is obvious that PSD is not exclusively or even predominantly shaped by ODA. To some observers, e.g. the Danish micro-finance company MYC4, this is seen as a point in favour of leaving PSD to the forces of global markets and the local PS stakeholders, terminating any ODA support. To others, e.g. DFID – and the recent report of the Danish Africa Commission – the conclusion is the opposite: Support for PSD is imperative in order to achieve development objectives, but it has to 'engage' PS companies. As underlined by DFID interventions should, however, stop when sub-sectors, as is the case with micro-finance, mature (DFID 2008:46). An exit strategy ought always to be available, but it is a must when directly supporting PS activities.

The case of state-controlled FDIs, like the Chinese investments in resource-rich countries, forms a special development in international financial flows that might be more prominent in the future. The official Chinese policy with regard to both foreign aid and FDI has been to gain economic benefits from initiated development programmes in the context of 'win-win situations', but with a heavy leaning towards resource-rich co-operation partners. With the governments of partner countries Chinese engagement has been quite popular as programmes have been launched with rhetoric of 'no strings attached' and in particular the lack of conditionalities regarding good governance, anti-corruption and standards has been noticed. Nor is there, however, any focus on poverty reduction and ownership in programmes and aid is mainly tied to Chinese enterprise procurement (Lönnqvist 2008:4)

Further weight on such state-engineered ODA may jeopardize the achievement of PSD objectives, as considerations for political influence in bilateral agreements will tend to crowd-out the drive for market-based principles. However, also the PD principles are at stake as: '… China seems to foster 'government ownership' rather than 'citizen ownership' and channels for mutual accountability are unclear.' (Lönnqvist 2008:5) (Western) donors may thus have to find ways of 'engaging' not only companies, but also states to achieve PSD and aid effectiveness. Looking for the appropriate forum of cooperation this may set a new agenda for multilateral development organizations.

The magnitude of ODA compared to other financial flows of developing countries is clearly inferior. It is thus the *'strategic'* role of ODA for achieving PSD objectives, which is essential.

Still, however, PSD objectives need to be agreed upon; and a further major challenge is then to clarify which strategic interventions will be effective?

On the surface and taken verbally all parties – partner countries and donors alike – seem to agree on the objectives for PSD interventions: economic growth, employment and poverty reduction. Scratching the surface just an inch, it is, however, obvious that the donor community does not agree about the development paradigm to use in support for PSD and therefore diverge on the order of priority given to objectives. Seen from a neo-classical angle, economic growth will be the immediate objective resulting in enhanced employment and poverty reduction; while using a neo-structural approach all three objectives will be targeted in a holistic process of pro-poor growth and transformation of society.

Not subscribing to an articulated paradigm of PSD it is not clear where the recent report of the Danish Africa Commission and its announced initiatives should be placed in this ideological controversy. Design and implementation of the initiatives will therefore have to reveal the Danish position and the rationale for support.

From the disagreement on paradigm also follows divergent ideas of effective design of PSD support programmes and models of implementation leading to 'contested issues' in the donor community (DCED 2008) and the 'weak focus and prioritisation within the development community' identified by DFID as a key challenge to PSD (DFID 2008:46).

If the support for PSD should be able to exploit its potential strategic role – continuously stressed by donors – there is an essential need for both a better understanding and agreement on the relevant development paradigm and a general overhaul of objectives, programmes and instruments. This process will obviously have to include partner countries. In particular there is a need to agree on:

- The role of government in PSD
- The importance of 'markets of the poor' – in particular agriculture and the infor-

mal sector – and the meaning of 'inclusive growth'
- The position of the borderline between supply of public goods and direct support for commercial activities ('private goods')

As long as the donor community diverge on these issues donor harmonisation and reduced transaction costs in PSD programme implementation will not be operational. And how should alignment with country policies and systems be possible if donors are not able to harmonize? Is it realistic to expect governments in partner countries to take the lead in the drive for PSD, when realizing the inherent differences of interests and principles between state and market? This impasse may jeopardize the basic principles of the PD.

It is high time that the global intentions of support for both PSD and the PD principles are coordinated.

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