

Role of the Private Sector **In Poverty Reduction**

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What's new; and what's different?

THE ROLE OF THE PRIVATE SECTOR IN POVERTY REDUCTION

1. **Good Morning! My task this morning is to show the role private sector can play in reducing poverty. We don't often think of poverty and privatization in some breath --- so you may wonder why I'm here --- I'll try to explain. I will also try to provoke and raise issues --- but offer you few answers.**

2. **I am sure you will agree with me that the principal aim of the MDB's engaged in development is to reduce poverty. And that the most expeditious way is for economies to grow at a pace sufficient to provide for the minimum needs of society. And we want the benefits of this growth to reach the poor.**

3. **After the crisis, poverty remains Asia's most urgent and fundamental problem. Asia has done better than other regions with respect to growth. But two questions remain: How can we provide the poor full access to the capitalist system, so they enjoy the**

benefits of private sector wealth creation? How can we ensure that the poor enjoy the fruits of growth? In sum, how can we ensure inclusion, and the contestability of the system for the poor?

4. This morning, I will touch on three areas: privatization and the poor; governance --- or corruption --- and the poor; and the poor's access to credit and entrepreneurial opportunities.

PRIVATIZATION

5. Today, the buzz word is: "privatization". The evolving role of governments is to facilitate the process of production, rather than own the means of production.

6. The Bank promotes privatization as a vehicle for improving efficiency and releasing much needed public resources for alternative uses, especially for pressing social requirements.

7. However, privatization is not a panacea. A private monopoly can be worse than a public one. Thus, privatization, carried

out when ownership is concentrated, or where there are dominant interests, can have negative and unintended effects. Thus, it is important to ensure that public interest is protected, particularly for the disadvantaged elements of society, through an appropriate legal and regulatory structure and framework which addresses consumer concerns, establishes fair trade practices, and the like, regulates monopolies and quasi-monopolies, deals with unlawful restraints and anti-competitive practices, and does away with barriers to entry and exit. Further, that the regulatory authority must be well equipped to enforce regulations.

8. Equally important, labor concerns must be adequately addressed either through adequate social safety nets or through retraining and redeployment.

9. But, I'd like to go further: How countries go about privatization – what we in the MDBs recommend is not just a clinical, or a technical matter. Take Russia. Privatization – into the hands of a concentrated few – has changed the balance of power, and created a “Mafia capitalism” which has at times even challenged the legitimacy

of the state. The average citizen has been cheated of wealth and voice. Hastily privatized banks have failed, causing deposit freezes and losses. The “new poor” in Russia are those who lost their assets, savings and pensions as a result, in part, of this privatization crisis.

10. Closer to home, here in Asia, the distribution of income is also relevant; “Gini coefficients” for the region tell us that the rich have a lot more than the poor. And that the very rich -- the “10th decile”-- are a lot richer than the 9th decile -- the “just plain rich”. Economic power is concentrated, and this is relevant when one thinks about privatization.

11. Some countries in Latin America, also facing distributional inequities, have created a “popular capitalism”, trying to broaden stake-holders in the capitalist system. In Chile, this was done through pension reform, in which literally millions of pensioners (including some poor, albeit not the poorest) were transformed into shareholders, and thereby stakeholders in the market economy, through the creation of a funded pension system. In Argentina, there

is a similar experiment underway. Vouchers were the instrument of choice in Eastern Europe, although not without problems.

12. Here in the region, there has been a lot of concern about keeping assets out of the hands of foreign “bottom-fishers”. With privatization and denationalization, perhaps we should also think about how to let local people – who have born the brunt of the crisis – get a share and a stake. This would mean, perhaps foregoing some revenue.

13. So when we advise on privatization, we need to reflect for a moment on who will get the new economic wealth; whether the economy will become more, or less contestable; more or less exclusionary; more or less friendly to the poor in civil society.

14. This goes back to the theme we began with: Contestability, and access to the market economy and the fruits of its growth for all its participants.

SOUND GOVERNANCE and ANTI-CORRUPTION

15. Now the second point – sound governance and anti corruption. Corruption affects the poor because it slows the rate of economic growth. Corruption also increases the gap between the haves and the have-nots.

16. Corruption skews the incentive structure, with adverse consequences on the poor, favoring, for example, capital intensive projects vis-à-vis labor intensive ones, depriving the poor of income generating opportunities. It inclines spending to infrastructure projects and away from social sectors, where bribery is less profitable.

17. Corruption can affect the targeting of social programs to the truly needy --as funds are siphoned from poverty programs, by well-connected people.

18. Here are some other thoughts from an IMF paper (1998) which links corruption to increases in poverty: “In a society where asset ownership is concentrated, the elite can use their wealth to lobby the government for favorable trade policies, including exchange rate, spending programs, and preferential tax treatment of their assets. These policies will result in higher returns to assets owned by the wealthy and lower returns to the assets owned by the less well-to-do, thereby increasing income inequality.”

19. How large is the effect of corruption on the poor? Some think this a soft relationship. In fact, there is quite hard-evidence. Cross-country regressions show that the impact of corruption is considerable. A worsening of the corruption index by 2.5 points (on a scale of 1 to 10) is associated with an increase in inequality equivalent to a three-year reduction in secondary schooling.

[Chart 1]

20. A 1 percentage point increase in the rate of corruption reduces income growth of the poorest (bottom 20%) by almost 8 percent per annum. [Chart 2]

21. In sum, increasing public accountability will indeed pay handsome dividends for the poor.

22. What can we do? Donor support for better tax administration, for transparent public procurement, involvement of NGOs as watchdogs can help. Another possibility is to try “import” good governance and regulation and regulation. By allowing foreign banks to operate on the territory, one can import the banking standard associated with a foreign bank. And, if the market is contestable, this can help force domestic banks to a higher standard. This way, one piggy backs on the regulatory standards of the foreign country.

23. A zero tolerance policy (such as Shell has) on the part of multinationals is another approach.

24. Others have also suggested a list of “most corrupt private companies” would be good addition to country corruption ratings, produced by “Transparency International”.

25. It will take a mosaic of approaches. But the bottom line is that, the poor can't wait and that better governance matters for them - -- a lot.

FINANCING SMALL AND MEDIUM SCALE ENTERPRISES AND MICRO-INDUSTRIES

26. Private sector financial institutions can assist in poverty reduction in more direct ways – by providing easy access to financing on reasonable terms to SMEs and tiny industries and even individual entrepreneurs.

27. However, microcredit is a quite recent phenomenon -- the first initiatives having been taken in Bangladesh by the Grameen Bank. In Viet Nam, there is the Bank for the Poor, and there exist a large number of peoples' credit funds providing credit to small farmers for production credits.

28. In the Philippines, NGOs play an active role. German-designed schemes have been successfully coursed through local chamber of commerce.

29. There is great interest today in SME and microcredit financing, particularly in the aftermath of the Asian crisis, given the need to provide assistance to sectors which employ the largest number of people -- and that is a very good thing.

30. The availability of credit on reasonable terms can make a huge difference for low-income families. Each of us has our favorite stories. (Mine are “knitting together nations” – a project Benetton supported that outsourced knitting to refugee women in Bosnia. A 100 rupee loan for an orange juice press that allowed a widowed street vendor in Ahmedabad to pay her children’s school fees.) While there are many challenges in micro-finance, experience has shown that poor people can be a good credit risk and will conscientiously repay their loans, if the right environment can be created. In short, “micro-credit works”.

31. Governments and multilateral agencies can assist by helping create the necessary policy framework. In the Philippines for example, there is a law on SMEs. Thailand is about to legislate one.

32. A major challenge, going forward, is making micro-credit “bankable”, i.e., commercially viable. Another – further in the future -- is getting these enterprises capital market access. Can we securitize a microcredit portfolio and reduce dependence on donors? Women’s World Banking did just that a year or so back with a \$250,000 placement in New York.

33. Much less familiar is “Micro Equity”. Venture capital funds have traditionally not reached the smallest companies and certainly not the poorer families and individuals in need of credit to finance productive activities and improve the quality of their lives. However, micro-equity funds are also being piloted and also working – first in Eastern Europe and Latin America. These make equity investments in the range of US\$50,000 to US\$250,000.

34. They are not without problems. Overheads are high due to small fund size. Fees are high due to hands-on approach. Donor funds are typically needed for start-ups. A heavy dose of “entrepreneurial support” is needed, as is a financially seasoned NGO to run the funds on behalf of private investors. SMEs are the largest source of employment in Asia. Their access to finance could make a real difference for the betterment of many lives in the region.

CLOSING

35. In closing, let me say that indeed the private sector has a lot to contribute to poverty reduction. By fostering the growth of competitive markets, practicing good governance and exercising vigilance in the enforcement of laws and regulations, and through direct assistance programs for the poor, the Bank will continue to forge partnerships with the private sector and governments in advancing the cause of eliminating poverty wherever and however we can.

Thanks and have a good day!

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