# ROLE OF THE PRIVATE SECTOR

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The principal aim of development is to alleviate poverty. Most people do not think of the private sector and poverty alleviation in one breath. Yet, the most expeditious way to reduce poverty is growth, pro-poor growth. Economies must grow at a pace and level sufficient to provide for the minimum needs of society, and the benefits of this growth must reach the poor.

## Inclusion and Contestability

Since the financial and economic crisis, poverty has remained Asia's most urgent and fundamental problem. This is where the private sector comes in. Although Asia has done better than other regions with respect to growth, at least two important questions remain. How can we give the poor full access to the capitalist system so that they can enjoy the benefits of private wealth creation? And how can we ensure that the poor enjoy the fruits of growth? Or to combine them, how can we ensure that the inclusion of the poor and the contestability of capitalism lead to a capitalist system with a human face, or a capitalist system for the poor?

Here I consider three provocative topics: privatization and the poor; governance, anticorruption, and the poor; and access by the poor to credit and entrepreneurial opportunities.

## Privatization and the Poor

Privatization is the current buzz word in Asia and elsewhere. The evolving role of government is to facilitate the process of production rather than to own the means of production. Like other multilateral organizations, ADB promotes privatization as a vehicle for improving efficiency and for releasing much-needed public resources for alternative uses, especially for pressing social requirements.

Where ownership is concentrated in the hands of dominant interests, a private monopoly can generate more negative and unintended consequences than a public one. The public, especially the disadvantaged elements of society, must be protected through an appropriate legal and regulatory structure in which consumer concerns, fair trade practices, and regulation of monopolies and quasi-monopolies are addressed. Regulatory frameworks should deal with unlawful restraints and anticompetitive practices, and do away with barriers to entry and exit. Equally important, labor concerns should be satisfactorily addressed either through adequate social safety nets or through retraining and redeployment.

But one must go further. How do countries go about privatization? What do the communities of economists in multilateral banks recommend on privatization? The answers do not lie in clinical or technical considerations alone. In Russia, privatization into the hands of a concentrated few has fundamentally changed the balance of power. A new "mafia-capitalism" has challenged the power and legitimacy of the state, cheating the average citizen of both wealth and voice. Hastily privatized banks have failed, causing deposit freezes and losses. In fact, most of the new poor in Russia are people who have lost out through mismanaged privatization, which, especially in the case of banks, initiated the loss of their savings and pensions.

In Asia, the distribution of income is also relevant to privatization and how to go about it. Here, the extremely wealthy rich, or the highest tenth decile on the scale, have very much more than the ninth decile, the just plain rich. This is not the case in other parts of the world. In Asia, economic power is extremely concentrated and this is relevant when planning for privatization.

Some Latin American countries that also face distributional inequities have created a "popular capitalism", trying to broaden stakeholders in the capitalist system. They share the Asian concern of political sustainability of reform and privatization programs. In Chile, pension reform transformed literally millions of pensioners (including some of the poor albeit not the poorest) into shareholders and thereby stakeholders in the market economy, through the creation of a funded pension system. Argentina is experimenting along these lines, while a voucher system is the instrument of choice in eastern Europe, although not without problems.

In Asia, there has been a good deal of concern about keeping assets out of the hands of foreign "bottom-fishers." This is an important concern. However, perhaps we should also think about ways in which local people—who have borne the brunt of the crisis—can get a share and a stake. This might mean foregoing some revenue in the privatizing process. It also calls for identifying who is going to get the new economic wealth. Will the economy become more or less contestable, more or less exclusionary, and more or less friendly to the poor in civil society? This goes back to the starting theme: contestability and access to the market economy along with the fruits of its growth for all participants, including the poorest.

**Governance and Anticorruption**

Until recently, one rarely heard or could even say the famous "C" word: corruption. Yet it affects the poor in many ways: it slows the rate of economic growth and increases the gap between the haves and have-nots. It skews the incentive structure, with adverse consequences on the poor by, for example, depriving them of income-generation opportunities or favoring capital-intensive projects as against labor-intensive ones, where bribery is not so profitable. It inclines public spending toward infrastructure projects and away from social spending for the same reason. Corruption can affect the targeting of social programs to the truly needy, because funds are siphoned off from poverty programs by well-connected people in the public and private sectors.

How large is the effect of corruption on the poor? Some think this is a soft, mushy question, but the evidence is quite hard. In a recent International Monetary Fund study[1], cross-country regressions showed considerable impact of corruption. 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 reducing education at the secondary level by three years, a large effect indeed.

A 1 percent increase in the rate of corruption reduces the income growth of the poorest (bottom 20 percent) by almost 8 percent per annum. This is serious. It is important and no one should underestimate how important corruption, anticorruption, and good governance are for the most disadvantaged people in this region. Increasing public and private accountability will pay handsome dividends for the poor.

What can we do? Many things are possible, but only a few of them can be mentioned here—donor support for better tax administration and for transparent public procurement. The involvement of NGOs as watchdogs can help. Another possibility is to try to "import" good governance and regulation. For example, by allowing foreign banks to operate, one can import

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[1] Gupta, Sanjeev, Hamid Dawoodi, and Rosa Alonso-Terme. 1998. Does Corruption Affect Income Inequality and Poverty? Working Paper WP/98/76. Washington DC: International Monetary Fund.

the banking standards associated with a foreign bank. And, if the market is contestable, this can help force domestic banks to a higher standard of performance. This way, one piggybacks on the regulatory standards of the foreign country.

A zero tolerance policy on the part of multinationals is another approach. Others have suggested a list of "most corrupt private companies" as a good addition to country corruption ratings produced by Transparency International. It takes a mosaic of approaches. But the bottom line is that the poor cannot wait and that better governance really matters for them.

### Financing Small- and Medium-Scale Enterprises and Microequity

The private sector can accelerate financial and entrepreneurial opportunities for the poor. Private-sector financial institutions assist directly in poverty reduction by providing easy access to financing on reasonable terms to small- and medium-scale enterprises, tiny industries, and even individual entrepreneurs.

Microcredit is quite a recent phenomenon, the first initiatives having been taken in Bangladesh by the well-known Grameen Bank. In Viet Nam, there is the Bank for the Poor, and there exist many people's credit funds providing support to small farmers for production credits. In the Philippines, NGOs play an active role. Microcredit offers special opportunities in the aftermath of the Asian crisis, given the need to provide assistance to a sector that employs the largest number of people. There is a great interest today in small-scale financing. The availability of credit on reasonable terms can make a huge difference to low-income families. Each person engaged in microfinance has his or her favorite stories. Mine include "Knitting Together Nations," a project in which Benetton out-sourced knitting to refugee women in Bosnia. In Ahmedabad, a Rs100 loan for an orange juice press allowed a widowed street vendor to pay her children's school fees. While many challenges remain in microfinance, experience has shown that poor people can be a good credit risk if the right environment can be created. In short, microcredit works.

Government and multilateral agencies can assist by helping create the necessary policy framework. In the Philippines, for example, there is a law on small and medium enterprises. Thailand is about to legislate one. But beyond that lies a major challenge: making microcredit "bankable" or commercially viable. Further in the future is the prospect of 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 ago with a US$250,000 placement in New York.

Much less familiar is microequity. 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, microequity funds are now being piloted, first in Eastern Europe and then Latin America. These involve equity investments in the range of US$50,000 to US$250,000.

These, too, are not without problems. Overheads rise due to the small size of such funds. Fees are high, given a hands-on management approach. Donor or concessional funds are typically needed for start-ups. A heavy dose of entrepreneurial support is usually required to help microentrepreneurs make best use of the funds, calling in turn for reliable NGOs to run them on behalf of private investors. Because small and medium enterprises represent the largest source of employment in Asia, their access to microequity finance can make a huge difference for the betterment of many lives in the region.

## Conclusion

The private sector has a great deal 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, ADB will continue to forge partnerships with the private sector and governments in advancing the cause of eliminating poverty wherever and however it can.