The ‘New Minimalist Approach’ to Private-Sector Development: A Critical Assessment

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Recent literature on private-sector development emphasises the need to establish a ‘level playing field’ and tends to disregard selective supportive interventions. The most commonly highlighted elements are administrative simplification and effective property rights policies, with business services largely left to private providers – what we call the ‘new minimalist approach’ (NMA). However, the NMA is based on certain unrealistic assumptions and is barely backed by empirical evidence. A range of complementary public policies is needed to create competitive sectors and overcome internal constraints, especially in small-scale economies.

1 Introduction

Recent studies provide evidence of an emerging consensus among leading development institutions with regard to the design of private-sector, and specifically small to medium-sized economy (SME), policies for pro-poor development. This new consensus 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).

In keeping with its basis in neoclassical thinking, the NMA focuses on government rather than market failure. It argues that creating a level playing field through deregulation and property rights guarantees is the most important – and, according to some authors, sufficient – condition needed to boost economic growth and make it more equitable. While this is nothing new, four innovative aspects justify labelling it as the *new* minimalist approach: its explicit pro-poor reasoning; its emphasis on issues of political economy; its well-founded critique of traditional government-driven and subsidy-based private-sector support programmes; and its optimistic stance with regard to the growth potential of the informal sector.

This article critically assesses the underlying assumptions of the new paradigm and considers whether empirical evidence supports its main hypothesis: that the proposed policy focus is sufficient to unleash the growth potential of the private-sector, especially in those segments of developing economies where the poor live and work. It demonstrates that, while much of the criticism of traditional, supply-side SME policies is well founded and most of the related policy recommendations are highly relevant, the policy mix recommended is far from sufficient to stimulate a vibrant and competitive private-sector. Empirical evidence on the effectiveness of some of the core policies recommended is at best patchy.

The next section of the article elaborates the new minimalist paradigm in PSD, with a focus on four core arguments. Section 3 discusses the innovative aspects of the NMA as compared with traditional neoclassical analysis. We then proceed with a critical assessment of the NMA’s empirical relevance, scrutinising the extent to which it works in practice. The final section draws policy conclusions for private-sector development, arguing that while the NMA has its merits in highlighting the difficulties of selective interventions and shifting the emphasis towards policies designed to improve the overall business climate, it is based on a number of unrealistic assumptions. In particular, it is unlikely that guaranteeing property rights, simplifying administrative procedures, and providing micro-credit and other business development services commercially will be sufficient to cause the small-scale economy to flourish. A range of complementary public policies is needed to overcome internal constraints in the sector.

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2 A new minimalist paradigm in private-sector development

Comparing recent policy documents on PSD published by international organisations such as the World Bank, UNDP, and OECD-DAC with the mainstream discussion that preceded them, one cannot fail to note a remarkable shift in emphasis. All these documents share a highly optimistic view with regard to the inherent entrepreneurial potential of SMEs and, more specifically, the informal sector, blaming unfavorable government rules and regulations for their disappointing performance and calling for deregulation. This is a major deviation from the previous mainstream interpretation, which emphasised the *internal* shortcomings of small firms (lack of basic education and technical, managerial and marketing skills, low productivity, limited capital formation, and low levels of investment, lack of integration into clusters and value chains, etc.) and called on government institutions to provide a broad range of selective support measures to compensate for these weaknesses. What is more, the new policy documents strongly criticise the current practices of economic (and especially SME) promotion and make a strong case for privatised service delivery. Governments are no longer expected to provide comprehensive support for SMEs. Instead, they should seek primarily to ensure that business is not hampered by inappropriate rules and regulations (which implies deregulation, simplification and disengagement). Regulatory reforms which aim to establish a level playing field, it is argued, help to improve the conditions for *all* enterprises, in contrast to support for financial and business development services that usually reach only a small proportion of total enterprises, especially in times of public budget constraints (White, 2005: 11).

Although the new approach does not altogether dismiss the need for certain specific measures to support SMEs, NMA documents stress the inherent inefficiencies and risks of misuse involved in selective interventions.[1] A recent World Bank study states that ‘rather than directly subsidising SMEs and aiming for a large number of small enterprises, policy-makers should focus on creating a business environment that allows easy entry and exit for firms and assures entrepreneurs and financiers that property rights and contracts will be enforced’ (Beck and Demirgüc-Kunt, 2004: 1).

The following are key assumptions underlying the NMA:

(i) Extensive government regulations hamper the formation, registration and growth of private enterprises and therefore reduce rather than increase economic growth and welfare.

(ii) The key role of the state is to guarantee a level playing field for the private-sector. Selective, for example industry-specific, public policy interventions in markets are especially distorting and often harmful to economic development.

(iii) The exit of inefficient firms is an inevitable, and even necessary, element of structural change that should not be held back by costly efforts to preserve unsustainable entrepreneurial activities.

(iv) Entrepreneurial spirit and capabilities are ubiquitous and unfold by themselves once a climate conducive to investment is in place; this also holds for the informal sector.

(v) Entrepreneurs are willing to pay for meaningful business development services, and, apart from a very few purely public goods, these may (and should) consequently be provided on commercial terms.

The NMA has been strongly influenced by De Soto’s work (1989; 2000). It is further elaborated in World Bank documents, for example the *World Development Reports* and *Doing Business* reports,[2] and is also echoed in the UNDP’s *Unleashing Entrepreneurship* document (UNDP, 2004), in a recent OECD/DAC report on PSD and pro-poor growth (OECD/DAC, 2004), and in other multilateral policy documents (CDASED, 2001).

Many of the policy prescriptions of the PSD documents cited above are in line with current development thinking, and they are based on quite a broad consensus. This includes a call for

1. *World Development Report 2005*, for example, discusses at length what it calls the ‘basics’ of a good investment climate and devotes only a short chapter to the question ‘Going beyond the Basics?’ which is full of warnings about and references to the risks of selective interventions. (World Bank, 2004a).
2. World Bank (2004a, b; 2005); also Klein and Hadjimichael (2003); Palmade and Anayiaotos (2005).

improved monitoring and evaluation (aimed at more rigorous measurement of outcomes and increased cost-effectiveness) and therefore for more pro-poor targeting of government expenditures. There is also agreement on the suggestion of giving more voice to the private-sector (including informal and formal SMEs and workers' organisations) by setting up government-private-sector councils and advisory bodies. These are aspects which will not be discussed here. Instead, the present article considers four prominent elements of the NMA that in our view are contentious, or at least seriously overstated. The following sub-sections discuss the relevance of, and main policy conclusions for, each of these elements from the perspective of the NMA. Later on, in Section 4, we examine the extent to which the growth-enhancing and poverty-reducing impact of these elements is supported by empirical evidence.

The four controversial policy elements of the NMA to be discussed here are:

(i) *Pro-poor tenure policy.* The NMA argues that an effective property rights policy that provides title deeds to informal enterprises is crucial to increasing levels of security and to qualifying them to receive credits, thereby encouraging investment and spurring pro-poor economic growth.

(ii) *Simplification of procedures and regulations.* Unnecessary and cumbersome 'red tape' is seen as a major constraint on economic growth, especially on the upgrading of the informal sector.

(iii) *Improving poor people's access to (micro-) credit.* Micro-credit is highlighted as the most important field of economic promotion in which proactive government and donor engagement may have significant poverty-reducing impacts. However, microfinance should be commercially viable and governments should act to improve framework conditions rather than to provide funds.

(iv) *Supporting the development of competitive markets for non-financial business services.* NMA documents argue that the provision of non-financial business services should largely be left to private providers, on the assumption that most business development services are private goods and that SME customers are willing to pay for them. This goes together with strong criticism of the inefficiency of the currently dominant, highly subsidised public providers.

Before considering these four elements in detail, one critical observation is pertinent. The language used in the NMA policy documents is sometimes vague and ideological rather than analytical, and tends to obscure certain important distinctions. For instance, the documents abound in recommendations to 'abolish ineffective or arbitrary tax laws', 'red tape', or 'administrative burdens'. While these may be catchy slogans (and, indeed, tend to be picked up easily in the political discourse), they are not helpful for designing better policies. First, they fail to determine when, for instance, a tax regime is 'efficient'; where exactly the borderline lies between 'arbitrary' and 'tailor-made' provision of support for the private-sector; and when administrative procedures are unnecessary (turning them into 'red tape' or 'burdens'). Secondly, they are ideological in that they insinuate that administration tends to be dispensable (at least with regard to the regulation of markets) or that tax regimes should not be differentiated, and they therefore dismiss the potentials involved in using them to achieve more equitable income distribution, to protect vulnerable groups, to signal scarcity of public goods, etc.

2.1 Pro-poor tenure policy

NMA proponents, most prominently Hernando De Soto (1997; 2000), argue that even the poorest in the informal sector own at least something that can be called their property, ranging from shanties built on government-owned land to tools and machines. This property, however, is often not formally registered. Informal residents lack registered land titles, and other properties may often have been acquired in informal markets where it is common practice not to give a receipt or where buyers do not keep receipts. As a consequence, these properties are 'dead capital' that cannot be fully used for productive purposes.

The lack of legal tenure, combined with weak property rights enforcement, has severe disadvantages for the productive use of informal assets:

- Informal properties tend to be underrated, given that they cannot be sold (or at least generate far lower proceeds) without a legal title. Securing the rights to land and other property serves to reduce the risks of mistake and fraud when it comes to property transactions. Buyers, renters and lenders will in this case have more confidence that they will get what they were bargaining for, even if they may have to go to court to claim their rights (World Bank, 2004a: 80). Legal titles are therefore assumed to increase the value of land and property significantly, giving a boost to housing markets and creating important assets for the poor.

- Higher levels of security and formality create a strong incentive for investment. The greater the risk, the greater the profitability of a venture has to be to justify the investment. So, if risks are minimised, more investments are likely to be made (OECD/DAC, 2004: 22; World Bank, 2005: 33, 40).

- Informal properties cannot be used as collateral for credit. Property titling can therefore improve access to credit, which is one of the most crucial prerequisites for private-sector growth. Banks and other lending institutions tend to have more confidence in borrowers – and risks will decrease – if there is no doubt about the question of ownership. As a consequence, a borrower with registered property is more likely to get credit or to obtain favorable conditions (World Bank, 2004a: 81).

- Getting access to insurance services is another key element needed for the poor to escape the poverty trap (OECD/DAC, 2004: 41-5). People in the informal sector face higher-than-average risks related to expropriation, theft, damage by fire, etc. However, they usually cannot get their assets insured, and this forces them 'to adopt costly (and relatively inefficient) insurance substitutes to enable them to deal with unexpected shocks' (Deininger and Binswanger, 1999: 253). Risk-coping strategies in the formal sector – such as insurance services or the possibility of obtaining credit by providing property as collateral – are superior to those used in the informal sector, for example keeping livestock, cultivating drought-resistant crops which will not yield the highest return, or falling back on moneylenders likely to exploit situations in which people have no alternative. In sum, if the poor are not able to opt for more advanced risk-coping strategies, 'the result will be a lower contribution to growth by the poor and slower pro-poor growth' (OECD/DAC, 2004: 43).

- Infrastructure services (such as roads, electricity, and water supply) are often not delivered to informal premises, where it is difficult to collect fees.

- People tend to work harder if they can expect their greater efforts to pay off because improvements remain in their possession (World Bank, 2004a: 79-80).

In sum, the ability of the poor to access capital markets, to insure risks, and to invest is seriously constrained by the lack of effective property rights. This results in lower economic activity and a less than optimal allocation of resources. Overall economic growth, and income growth in the informal sector in particular, are held back in this way. This is a relevant issue even in macroeconomic terms, bearing in mind that the book value of informal properties (if duly registered) would be enormous. According to De Soto's calculations for the end of the 1990s, the poor in Peru would own US$74 billion, while for Egypt the equivalent value would amount to US$240 billion (De Soto, 1997). In addition, governments forgo revenues if activities are not registered and taxed accordingly. And finally, there may be negative ecological spillovers in view of the fact that cultivators have fewer incentives to use resources in a sustainable way if they have no certainty that they will be able to remain in possession of their land (World Bank, 2004a: 81).

The NMA accordingly lays strong emphasis on what it calls 'pro-poor tenure policy'. This encompasses land-titling programmes as well as reform of the legal and institutional framework for property rights enforcement (World Bank, 2005: 38).

2.2 Simplification of procedures and regulations

The NMA stresses that cumbersome registration requirements, restrictions on access to inputs (labour, financing, infrastructure), burdensome administration of taxes and regulations, as well as weak contract enforcement are some of the main causes of low efficiency in the private-sector. As

Klein and Hadjimichael put it (2003: 36), ‘excessive regulations and red tape have severely curtailed the performance of firms, be they local small and medium-sized enterprises or medium-size to large foreign firms’ and have created a serious obstacle to economic growth in developing countries. The fewer resources (time, money) an enterprise needs to complete these procedures, the more it will have left for investment. At the same time, simplifying procedures would free up government resources.[3] UNDP affirms the need for ‘a genuine commitment to reform the regulatory environment by eliminating artificial and policy induced constraints to strong economic growth’ (UNDP, 2004: 38). While most policy documents in the past called for more and more differentiated public policies to confront (presumed) market failures, the focus is now on eliminating troublesome rules and regulations.

The World Bank’s *Doing Business* report has made an important contribution to breaking down ‘regulatory burdens’ into more operational categories. In addition to improved property registers, the main areas for administrative simplification are:

- starting a business. To be able to start up a business, would-be entrepreneurs are required to obtain certain permits to operate legally. Business registration and additional requirements, such as minimum capital requirements, tend to be most cumbersome in poor countries. In order to facilitate business start-ups and induce entrepreneurs not to choose to remain informal, these regulations need to be simplified.

- hiring and firing workers. Employment regulation with regard to minimum wages, severance pay, overtime pay, etc. is considered to be a burden for enterprises. The *Doing Business* report argues that complex labour regulations make it more difficult for companies to adjust their workforce to actual demand, and may lead them to hire fewer workers or to evade employment regulations.

- getting credit. As we have seen in the previous sub-section, registered property is important to obtain credit. Easing restrictions on assets that may be used as collateral and strong creditor protection in the form of collateral and bankruptcy laws may further improve the credit market.

- closing a business. New business can start up and grow more easily if insolvency is handled efficiently. Simplified and transparent bankruptcy systems help to avoid protracted legal disputes and investor uncertainty.

Several NMA authors, most prominently the World Bank’s *Doing Business* report, accentuate the point that cumbersome regulations fall especially heavily on small firms. ‘Excessive regulation has a perverse effect on the very people it is meant to protect’ (World Bank, 2004b: xv). Heavy regulation and high taxes encourage entrepreneurs to operate in the informal sector. Market segmentation is seen as a consequence of governments imposing complex bureaucratic requirements without having the capacity to enforce them. The NMA literature argues that in the informal sector workers have few social rights and do not enjoy social security, severance pay and minimum wages. Furthermore, businesses do not pay taxes, seldom respect intellectual property rights and often provide substandard products which may even cause health hazards (see, for example, Palmade and Anayiotos, 2005: 2). While traditionally policy-makers would have concluded that enforcement of these regulations needs to be improved, the NMA calls for their simplification and in part removal.

The same applies to taxes. Excessive tax burdens on companies are seen as a strong motivation for their being informal. This has a double negative effect. First, informality tends to reduce productivity, and, second, tax evasion forces governments to collect ever more taxes from the remaining formal sector enterprises. The NMA comes to the conclusion that governments should reduce and simplify corporate taxes. The World Bank assumes that this will *increase* (!) revenues in most cases by encouraging business activities and reducing the incentive for tax evasion. If not, governments should cut spending or put other taxes in place which do not burden productive enterprises (Palmade and Anayiotos, 2005: 3).

Also, the NMA takes a very different view of the origins and determinants of the informal sector. In the structuralist perspective that used to be mainstream, a growing informal sector reflects the insufficient capacity of the modern economy to absorb (especially unskilled) labour. In the absence of social security safety-nets, the resulting labour surplus forces people to take on survival activities in

3. For example, World Bank (2004b: xv): ‘A doctor can be hired in place of every government official regulating business activity or compliance with employment laws.’

low-productivity occupations. Due to labour market segregation, salaries and profits in the formal and informal economies do not converge, contrary to the assumptions of neoclassical theory. The entry barriers separating formal and informal labour markets are mainly attributed to deficient technical and managerial skills, lack of access to capital, spatial segregation and other structural factors.

The NMA, in contrast, blames bad regulation for the existence of the informal sector. According to Palmade and Anayiotos, the root causes of informality are ‘overly stringent and expensive government regulations in the labour, product, and land markets, and an ever increasing tax burden imposed on an ever shrinking formal sector’ (ibid; see also Loayza, 1996: 129). Therefore a key element of the NMA is the recommendation to simplify procedures and regulations and to avoid imposing excessive taxes on the private-sector in order to ease the transition from the informal to the formal economy. In short, reducing administrative entry barriers is assumed to stimulate pro-poor growth.

The NMA expects large pay-offs from the simplification of procedures and regulations. The *Doing Business* database was created to collect data on existing administrative procedures related to private-sector development as well as to benchmark national regulation against the best international performers. This can help to identify unnecessary red tape and set quantitative targets for numbers of licences, processing times for certain permits, etc. One-stop shops may help further to simplify transactions.

2.3 Improving poor people’s access to (micro-) credit

In developing countries most people lack access to credit. As a consequence, they cannot invest in productive assets that would enable them to use their resources more efficiently. Low investment rates slow down economic growth and poverty reduction.

For several decades development practitioners assumed that it would be impossible to provide credit to poor people without offering substantial subsidies. This was believed for two reasons. First, transaction costs tend to be high, since poor customers borrow very small amounts of money per transaction. Second, the poor often lack collateral, a fact that increases both the risks for the lender and the costs of debt collection. Hence there was a general consensus that micro-credit schemes would not function in a commercially sustainable manner.

Today we have learned that microfinance institutions do function (see for example, Helms, 2006; Peck et al., 2006). Micro-credit schemes all over the world are operating on a cost-covering basis. Microfinance institutions have designed ways of making their customers absorb a large share of the transaction costs involved, such as the costs of project appraisal, repayment collection and coverage of risks. This is organised through self-help groups which trust their members and practically guarantee repayment. At the same time, because of the remaining transaction costs, interest rates are much higher than those in the formal banking sector, but considerably lower than those charged by moneylenders. Remarkably, poor people who are not ‘bankable’ in the traditional sense are willing and able to pay high interest rates, and default rates are much lower than those in commercial banks, especially when compared with SME credit lines.

Now that it has been shown that micro-credit schemes can function sustainably across the globe and reach out to tens of millions of poor people (while government-sponsored credit programmes are fraught with difficulties), microfinance ranks high on the agenda of NMA proponents. Based on lessons from micro-credit schemes, the NMA emphasises the need for raising interest-rate ceilings, privatising banks and reducing licensing requirements on financial institutions with the objective of increasing competition (see for example, CGAP and World Bank Financial Sector Network, 2004). It assumes that subsidised credit is not needed to increase the competitiveness and growth of firms.

2.4 Supporting the development of competitive markets for non-financial business services

One crucial condition for the competitiveness of firms in developing countries is their ability to link up with other companies or institutions that can provide them with assets which they cannot produce themselves. Many of these external linkages include some kind of non-financial service provision, for example with regard to information, R&D, product development, training, logistics and marketing.

During the last few years a new paradigm has emerged with regard to who should provide these business services and how they should be provided. The main contributions to the so-called ‘BDS paradigm’ (Business Development Services) have come from the Committee of Donor Agencies for Small Enterprise Development, which published the document *Business Development Services for Small Enterprises – Guiding Principles for Donor Intervention* (CDASED, 2001). The BDS paradigm is based on a transfer of experiences from microfinance to non-financial business services: if micro-credit can be provided on a cost-covering basis, why should this not be possible for non-financial business services? 'The ultimate vision for BDS, on which these *Guiding Principles* are based, is of a well functioning market with a diverse array of high-quality services that meet the needs of a large proportion of SEs [small enterprises] affordably.' The *Guiding Principles* further argue that 'with appropriate product design, delivery and payment mechanisms, BDS can be provided on a commercial basis even for the lowest segment of the entrepreneurial small enterprise sector' (CDASED, 2001: 1). Generally speaking, BDS are assumed to be private goods.

The new BDS market paradigm highlights the need for services to be provided at cost-covering rates and by providers who operate in a demand-driven and businesslike manner. Service providers should be either private companies or public entities organised like firms in terms of their incentive systems, personnel, culture and attitudes. Services should be regarded as commercial products, and the companies that receive services should be regarded as customers rather than beneficiaries. Providers should therefore always charge fees, and these fees should usually be high enough to secure the provider's financial sustainability. This presupposes that BDS organisations use cost-analysis systems that enable them to determine the total cost and the adequate price of each service product they provide. Competition among service providers should serve to induce them constantly to improve on performance. In any case, the aim should be to avoid intervention in well-established service markets that deliver subsidised products that may distort markets and jeopardise other providers. These principles have been adopted in many of the NMA documents (see, for example, OECD/DAC, 2004: 60-2; Klein and Hadjimichael, 2003: 82).

It is worth mentioning that a distinction is often made between *operational* business services that are needed for day-to-day operations (for example, transportation and tax administration), while *strategic* services help to upgrade a company (R&D, advanced training, market exploration, and the like). Donor interventions usually aim at promoting such *strategic* services, and these are also the main focus of the BDS approach (Klein and Hadjimichael, 2003: 1). The basic assumptions – that customers are willing to cover the full cost of services and that privatised service markets supply the amount of services needed to raise the overall competitiveness of the home economy – thus also apply to strategic services.

The NMA argues that wherever no service markets have yet evolved, governments (or donors) should seek to develop commercial BDS firms rather than deliver services on their own. This may be done through either supply-side (helping service providers to upgrade their service quality, to improve their costing, to find new customers, etc.) or demand-side measures (especially through 'market development grant funds', which assume part of the fees if SMEs buy business services).

3 What's new about the NMA?

Neoclassical theorists have always argued in favour of less interventionist governments and emphasised key aspects of the Washington Consensus such as tax reform, privatisation, deregulation and secure property rights.[4] However, the above-mentioned studies and policy papers point to four innovative aspects which go beyond traditional neoliberal thinking and call for a different set of policies:

First, the NMA's explicit *pro-poor reasoning*. While exponents of the Washington Consensus have always claimed that deregulation and a business-friendly investment climate are good for public welfare, the NMA provides convincing arguments that deregulation is especially beneficial for the poor in the informal sector. For example, De Soto and the World Bank's *Doing Business* reports argue that informality and the poor performance of micro- and small enterprises are mainly due to inappropriate overregulation and biased policies that prevent such businesses from growing. Administrative entry barriers to markets, lack of property rights for informal dwellers, and other 'unfair' regulations fall especially heavily on small firms. This is for two reasons. First, some costs to comply with laws and regulations are fixed and therefore *proportionally* greater for small firms. Second, the rich and politically connected may be able to avoid cumbersome rules, or even be protected by them.

The NMA literature also shows that government entities often use subsidies to support relatively better-off population groups. This has been demonstrated most clearly with regard to the provision of public infrastructure, where the urban middle classes typically receive water and electricity supply at subsidised rates while the rural poor are barred from access. But it also holds for private-sector

4. For the original elements of the Washington Consensus and changes over time, see Williamson (2000).

promotion, where a large proportion of government spending tends to benefit relatively privileged clients.[5]

Hence deregulation and individual property rights are highlighted as especially effective pro-poor measures. The finding that certain elements of market liberalisation benefit the poor in particular has been good news for proponents of liberalisation, who often face criticism that their proposed reform packages are socially imbalanced. This may explain the extraordinary popularity and rapid diffusion of De Soto's work, especially in Anglo-Saxon countries.

Second, the *emphasis placed on issues of political economy.* Social exclusion is mainly seen as an outcome of regulatory regimes that are deliberately distorted to protect the vested interests of non-poor groups, and emphasis is placed on the need to build pro-poor constituencies in a political process.[6] Selective policies serve to create rents, transferring resources from taxpayers and/or consumers to certain producer groups, thus weakening their incentives to perform efficiently. In doing so, they inevitably create rent-seeking behaviours.

Moreover, the NMA argues that politicians and bureaucrats may use spending on PSD programmes for political reasons (see, for example, World Bank, 2003: 7; Chang, 1996: 22ff.). Politicians may create programmes as a demonstration of public action and to gain the support of local communities or certain target groups with the ultimate goal of winning elections. This may even lead them to allocate programme funds to specific – and usually non-poor – groups with more political voice. Bureaucrats working at the level of implementing agencies may act as rational and selfish agents who are mainly interested in maximising the budgets of their offices and securing their own jobs and salaries. It would therefore be naïve to believe that political decision-makers, funding agencies, and implementing bodies are guided by efficiency criteria only.

Third, consistent, at least in part empirically backed, *criticism of traditional government-driven and subsidy-based private-sector support programmes.* Besides the allegation that such policies are often biased against the poor, proponents of the NMA argue that improper incentives often result in the inefficient use of resources. SME programmes (see Klein and Hadjimichael, 2003: 80ff.; OECD/DAC, 2004: 58-9; Gibson, 2001) often:

- do not have hard budget constraints. Many programmes use taxpayer-funded subsidies without being held accountable for results. Hence there are no strong incentives to use funds efficiently;

- neglect private-sector alternatives and underestimate the signalling function and problem-solving capacity of markets. Governments tend to overregulate markets, thereby creating unnecessary burdens for the private-sector;

- crowd-out private competitors. Service delivery at highly subsidised rates distorts markets and hampers the emergence of commercially viable service providers;

- make discretionary use of funds, for example by selectively supporting certain sectors or clusters which may not be the most promising ones;

- lack business orientation and deliver poor quality. Public service providers often operate according to the logic of public administration, for example budget allocation is not linked to programme performance, employees do not act in a businesslike fashion, and beneficiaries are not treated as clients. Since public service providers and private clients work in accordance with different incentive systems, operational routines, and even different mindsets, service delivery is often not tailored to the needs of clients;

- place too much emphasis on directly supporting small firms (training, finance, marketing) instead of cutting red tape and securing individual property rights. Taking the case of SME financing, Klein and Hadjimichael (2003: 74) claim that such subsidies may even harm economic development: 'One clear lesson has emerged from decades of attempts by public agencies to improve the flow of financing to firms. Whether the goal is to provide long-term financing or to help specific small firms with credit, programmes that subsidise such financing tend to fail. … such financing results systematically in net negative economic outcomes.'

5. The World Bank (2004a: 165) cites an example of rural credit in Brazil where the largest 2% of borrowers receive 57% of the subsidised loans.
6. See, for example, De Soto (1989). In the same vein, recent *World Development Reports* have paid increasing attention to this question.

- lack financial sustainability. Most services are delivered on a highly subsidised basis. Service providers thus depend on continuous public support. In view of the fact that most countries are cutting back on public expenditure, they are forced to cancel or substantially reduce many support measures;

- usually have little outreach, given that it is hardly possible to make subsidy-based programmes available to everyone. Even in times of high government revenues or deficit spending or substantial inflows of foreign aid, business services usually reach only a relatively small percentage of the target group.

Fourth, emphasis on the *growth potential of the informal sector.* Once micro and small entrepreneurs are operating on a more or less level playing field, the NMA expects that they will make significant contributions to economic growth and poverty reduction. In particular, De Soto (2000) argues that all that is needed to free up enormous resources and substantially increase the living standards of the large parts of the population in the informal sector is deregulation and secure property rights.

This represents a major deviation from the long-established view that the informal sector is trapped in a vicious circle in which low skills, low capital formation, low productivity and low returns on investment reinforce one another. Viewed from the traditional perspective, the *formal* sector has to be the main engine of growth, and it is more promising to try to absorb the informal labour force gradually by expanding economic activities in the formal sector.

4 Does the new minimalist approach work in practice?

The NMA has its merits when it comes to revealing some of the limitations of traditional government-driven economic development programmes, including, for example, their disregard of market forces, their often inappropriate incentive systems, their bureaucratic costs, and their lack of outreach. This criticism is quite well founded and is increasingly accepted by policy-makers and practitioners. The NMA goes one step further and offers an alternative set of policy options. However, the question remains whether this new set of policies really outmatches traditional PSD policies. More specifically, it has to be proved

- that those elements that the NMA highlights as its core innovative elements, i.e. pro-poor tenure policy as well as simplification of procedures and regulations, really do play a decisive role for PSD, especially for the development prospects of the poor; and

- that it is feasible to develop markets for financial and non-financial business services that meet the demands of globalising economies in search of international competitiveness and also reach out to the poor, and do so without having to fall back on public subsidies.

The following four sub-sections show that empirical evidence for the effectiveness of the core policy elements recommended is at best patchy.

4.1 Does pro-poor tenure policy make informal micro-firms creditworthy, stimulate economic growth, and reduce poverty?

Empirical evidence shows that land-titling and legal reforms geared to improving contract enforcement may increase the value of land; but the alleged massive increase in the supply of credit fails to materialise. De Soto's calculations of the amounts of 'dead capital' in the hands of the poor that would supposedly be brought into productive use in this way are completely unrealistic. The effects of property rights reforms on overall economic growth consequently appear to be very modest.

According to the World Bank (2004a: 79), 'studies across a broad range of countries find that the more secure the rights, the faster the growth'. While there is little doubt that security and transparency of property transactions (and the rule of law in general) are key to private investment, it is less clear how relevant land-titling programmes are in practice. Reliable estimates of the influence of property reforms on market outcomes are few and far between.

Findings from Peru and several other countries[7] question the link between legal titles and credit supply. Beginning in 1996, Peru carried out the first large-scale urban property rights reform in a developing country. Around 400 laws were amended, and over a five-year period more than 1.2 million urban households obtained legal property titles (Field, 2001: 1). In his analysis of the Peruvian case, Calderón concludes that, even after the property rights reform, 'the poor are as scared of borrowing from the banks as the banks are reluctant to lend to the poor' (2004: 300) This is also confirmed by Kagawa (2001).

The reason for this is that even receipt of a legal title may not provide absolute security of tenure. Moreover, even if legal titles exist, real estate and other properties of the poor can often not be used as collateral, because transaction costs are too high in relation to the market value of the respective property. Geographical distance, the perceived security risks of the vicinity and other factors further increase transaction costs. Banks will lend on mortgage only if the property provided as collateral can be attached within a reasonable period of time and at reasonable cost. In many developing countries this conflicts with legal traditions under which real estate cannot be attached if it serves the purpose of securing subsistence. Furthermore, banks often lack the credit-rating procedures suitable for informal firms, and they are rarely willing to lend to customers who cannot produce proper accounts. Finally, many poor people are not willing to borrow for fear that they may not be able to repay their loan (Gilbert, 2001: 10-11).

Titling tends to increase the transaction prices of land, and a number of studies show that following titling programmes there has been some increase in land-market activity (Boucher et al., 2005: 107). Some authors, however, question the assumption that liberalised land and housing markets are always good for the poor. They argue that 'the process of property titling and the use of property as collateral offer up opportunities for speculation, for the concentration of wealth, and for the accumulation of rents. … the outcome of a process of property titling and the mortgaging of property is that land and housing become even less affordable to the poor' (Mitchell, 2004: 26). Mitchell points out that throughout history dispossession has accompanied the development of formal property rights. He argues that 'property can only be turned into collateral, and from collateral into credit, if rules and powers are arranged to enable creditors to seize the property of debtors who default' (ibid.: 8). In many countries this has fuelled a 'machinery of debt and foreclosure' (ibid.: 6).

4.2 Does simplification of procedures and regulations help to upgrade the informal sector, stimulate economic growth, and reduce poverty?

In many areas, such as health and safety, environmental protection, competition and taxation, businesses and citizens are required by law to comply with certain economically and socially desirable standards. This involves certain administrative formalities which governments use to collect information, monitor compliance, and intervene in individual economic decisions. Some regulations are necessary to secure the smooth functioning of a market economy. These include rules that guarantee property rights and help to enforce them, competition laws, safety regulations at the workplace, etc. Other regulations are dispensable, or not cost-efficient, and thus unnecessarily increase the costs of doing business. Any analysis focusing on administrative simplification needs in the first place to define which rules and regulations are desirable for development and which are not. The NMA literature tends to overlook this, equating the term 'regulation' with 'administrative burden' and 'red tape'. Similarly, societies may have different preferences with regard to the appropriate level of taxation needed to finance public services.

The World Bank's *Doing Business* reports argue that unnecessary and cumbersome business regulation is particularly bad for poor people. They provide empirical cross-country evidence that cumbersome regulation is associated with lower labour productivity, and that unemployment is associated with complexity in contract enforcement (World Bank, 2004b: xii). They also show that poor countries tend to regulate business most. For example, in 2004 starting up a business in poor countries required 11 procedures that took an average of 59 days to complete and cost 122 % of an average annual per capita income. By comparison, the average in OECD countries was 6 procedures, 27 days, and 8% of per capita income (World Bank, 2005: 18). According to another World Bank study, business entry costs add up to 3 % of GDP per capita in fully industrialised countries, whereas they amount to 20 % in industrialising South-East Asia and even 94 % in Africa (Bannock, 2005: 44). The *Doing Business* report for 2005 convincingly shows that poor countries with the heaviest

7. See Field (2001) and Calderón (2004) for Peru; Boucher et al. (2005: 123) for Honduras and Nicaragua; de Laiglesia (2003) for Nicaragua; see also Gilbert (2001: 9-11) for a literature review.

regulation often 'have the least enforcement capacity and the fewest checks and balances in government to ensure that regulatory discretion is not used to abuse businesses and extract bribes' (World Bank, 2004b: xv). What is more, within poor countries small firms bear the heaviest burdens (for South Africa see Bannock, 2005: 46).

It is absolutely reasonable to assume that unnecessary regulation and inefficient or even arbitrary enforcement have a harmful effect on economic performance. In fact, empirical evidence suggests that a less bureaucratic business environment fosters economic growth. Cross-country comparisons by Beck and Demirgüc-Kunt show that '…an index incorporating information on entry and exit barriers, the protection of property rights, and the efficiency of contract enforcement is associated with the growth rate of GDP per capita' (2004: 4). Provided a certain level of growth is achieved, this can be assumed to contribute to poverty alleviation. On the other hand, Beck and Demirgüc-Kunt also establish that 'while a sound business environment tends to help the poor by accelerating aggregate growth, the results do not suggest that the business environment has an effect on poverty beyond its effect on the overall economy' (ibid.). This challenges both the NMA's assumption that red tape restricts the poor (and the informal sector) *disproportionately,* and its conclusion that deregulation of the business environment has a pro-poor impact.

Moreover, the findings tell us little about causal relationships and the relative importance of specific elements of the regulatory environment. It remains unclear how red tape, corruption, informality and growth are really interlinked. This is in part because we still lack time series that document how improvements in the regulatory environment in a given country impact on economic performance. Even though cross-country comparisons compiled in the *Doing Business* reports tell us, for example, that labour productivity decreases as the number of procedures required to start a business increase, and that unemployment is associated with complexity in contract enforcement, this does not necessarily imply a causal relationship. There may well be a third factor (for example, human capital) that pushes the indicators for both economic performance and quality of public administration in the same direction.

Moreover, a number of empirical observations challenge the NMA's assumptions with regard to the detrimental effects of procedures and regulations:

- Ayyagari et al. (2006) have analysed firm-level survey data for 80 countries to test which elements of the business environment are the most constraining for enterprise growth. They find that lack of financing, street crime, and political instability directly affect the growth rate of firms, whereas taxes and regulations have no significant effect.

- Data for Africa cast doubt on a strong correlation between 'administrative burdens' and corruption. In Africa the 'Index of Economic Freedom', which measures variables such as the 'fiscal burden of government', 'government intervention in the economy', 'property rights', 'regulation', etc., has significantly improved in the last eight years. At the same time, however, corruption levels have also increased (OECD and African Development Bank, 2005: 39-41).

- Nor is there is any support for the hypothesis that the size of the informal sector is primarily dependent on the level and quantity of 'administrative burdens'. *Prima facie*, the fact that the relative size of the informal sector (as a percentage both of GDP and of total employment) clearly increases in all regions of the world (World Bank, 2005) – despite a global trend towards deregulation and lower corporate taxes – strongly contradicts this argument. In Africa, for example, Xaba et al. (2002) find a decline or stagnation in formal sector employment and an increase in informal sector activities during the 1990s, even though the 'Index of Economic Freedom' for the region improved over the same period.

Overall, there is some evidence that simplified procedures and regulations accelerate economic growth, but there is no proof that these reforms are especially 'pro-poor'. We need to learn more about the impact of specific elements of deregulation policy. Using combined indices that lump together indicators for property rights enforcement with tax and labour issues tends to obscure the relative importance of different policies. Future research should avoid judgemental terms (for example, 'cumbersome' procedures, administrative 'burdens', 'artificial' entry barriers) and disaggregate regulatory policies in order to determine clearly and precisely what the most adequate level of regulation and mix of policies is. While there is no doubt about the need to simplify many regulations and procedures, radical dismantling of public regulatory capacities and reduction of corporate taxes need not be the most appropriate strategy. Measures may also be taken to increase institutional efficiency, for example, by setting up one-stop shops, increasing the accountability of civil servants, and exposing bureaucracies to competition.

4.3 Do micro-credit schemes help to upgrade the informal sector, stimulate economic growth, and reduce poverty?

Empirical studies of the effectiveness of micro-credit in terms of poverty reduction show that microfinance has a positive impact on poverty, especially by increasing income and reducing vulnerability.[8] India's Linkage Banking Programme (LBP) is one of the cases that has been thoroughly examined. Here several studies confirm 'that considerable socio-economic benefits are accruing from the fast growing LBP to small-scale farmers, rural micro entrepreneurs and landless labourers' (Hannover, 2005: 19ff.). Average net incomes of households that participate in self-help groups (for credit and savings) have increased, while the number of families living below the poverty line has fallen sharply. In addition, higher capacities for risk absorption and decreased vulnerability have been observed. At the same time, the outreach of microfinance programmes is impressive. India's LBF, for example, had reached out to about 16 million rural households by March 2004 (ibid.: ix).

However, micro-credit is no panacea for poverty alleviation and pro-poor economic development. Empirical evidence points to two important constraints. First, microfinance institutions rarely reach the core poor (see, for example, Mosley and Hulme, 1996; CGAP, 2000a, 2000b). Montgomery and Weiss argue (2005: 26) that microfinance institutions, 'whilst they may be flourishing in commercial terms, and providing a valuable service to microenterprises often run by poor entrepreneurs, have relatively weak impact on those at the very bottom of the income distribution'. This is because the poorest people are generally part of the subsistence economy, have little to no surplus, and may be unwilling to risk not being able to feed their families in order to start up a business. Mosley and Hulme provide evidence that poor borrowers rarely invest in technology, fixed capital, or hiring of labour. Moreover, they often lack the most basic technical and managerial skills. As a result, micro-loans seldom raise their income substantially, and may even increase their debt if they are unable to meet the repayment schedule. Moreover, some especially vulnerable groups cannot be served by micro-credit, for example, 'it is not cost-effective and sustainable … to serve highly dispersed populations that are costly to reach, populations with high degrees of mobility or instability due to violent conflict or natural disaster, those who lack social capital or social cohesion, and people with life threatening disabilities or diseases'.[9] As Hulme argues, 'MFIs and donor hype have created the impression that microfinance is a cure for poverty. … This is a potentially dangerous line of argument as it distracts attention from the fact that poverty reduction requires action on many fronts – social safety nets for the poorest and most vulnerable, an effective education system, and many other issues' (Hulme, 2000: 28).

Secondly, the track record of micro-credit programmes is less convincing when it comes to creating competitive and growth-oriented enterprises and stimulating economic growth. Empirical evidence from different developing regions shows that only a very small number of micro and small firms manage to master the transformation from family-based to more systematically organised structures that enable them to handle production beyond the threshold of about 20 employees (see, for example, Liedholm, 1992; Mead, 1994; van Biesebroeck, 2005: 577). Although there are no available systematic studies on the use of microfinance programmes to upgrade firms, anecdotal evidence suggests that such programmes are rarely successful in facilitating this transformation. There are two reasons for this:

- Because of high interest rates, micro-credit tends to be used for short-term activities, for example to acquire household assets, to improve homes, to smooth consumption, to manage emergencies and to fund social obligations (Peck et al., 2003: 6-7). Even if micro-entrepreneurs use loans for productive purposes, this tends to be largely limited to projects with very short terms of repayment (for example, to provide working capital for retailing). For projects with a longer gestation period, for example investment in technology, fixed capital, and training, a credit supply at more moderate interest rates is indispensable.

- Credit appears not to be the most critical constraint. As firms grow, the entrepreneur's role, abilities, and behaviour need to change in order to maintain competitive advantages. Changes in

8. For example, Khandker (2001) for Bangladesh. It is, however, striking that the majority of microfinance institutions 'neither determines the composition of their clientele upon intake nor evaluates the effectiveness of their program in terms of poverty reduction' (Morduch and Haley, 2002: 1).
9. http://www.trickleup.org/learnmore.asp?LM_ID=85&P_ID=277; Shaw (2004: 1262) confirms these limitations for rural Sri Lanka.

firm size require changes in management style; deepening specialisation within the firm requires transparent and efficient processes of delegation; and firms need to establish codified organisational procedures in terms of logistics, human resource development, etc.[10]

To sum up, micro-credit institutions are an important element of employment generation and risk insurance for the poor, and they have proved to be one of the most successful pro-poor policy instruments. However, they are no universal recipe for economic growth and poverty alleviation. Micro-credit programmes need to be complemented by investment in social and physical infrastructure, and they are no substitute for it (Shaw, 2004: 1262). While there is growing consensus that micro-credit requires high interest rates to guarantee sustainability, grants are needed to reach the most vulnerable population groups. And, finally, microfinance institutions cannot serve the investment needs of growing enterprises. The latter need additional and diversified financial instruments, and it may make sense to provide subsidised loans tailored to investing in long-term competitiveness.

4.4 To what extent can non-financial business services be privatised, and is this good for growth and poverty reduction?

Although the BDS debate has been under way for almost ten years and has received a lot of attention among donor agencies, there is still almost no empirical evidence of sustainable BDS programmes. It appears that, in contrast to micro-credit, owners of SMEs are rarely willing to pay cost-covering service fees, and service markets are therefore either largely underdeveloped or continue to be highly subsidised. In particular, the assumption that commercially viable business services can be provided even for the poorest entrepreneurs has no empirical backing. A recent comprehensive in-depth review of the impact assessments of 27 enterprise development projects concludes that:

> in some cases [projects] have contributed to the development of the market for business development services (increasing the demand for and supply of services) by building local consultant capacity and increasing knowledge of MSE needs and requirements. What has not really been established through these studies is the question of sustainability of the services provided or outreach of business services to the poor. … Many of the studies … do not entirely resolve the question of whether project interventions have led to the provision of quality services on a sustainable basis. … While there is overall consensus that clients should pay at least part of the cost of business services, the studies do not shed much light on what the market will bear or how much clients would or could afford to pay for services. (Zandniapour et al., 2004: xii).[11]

There is no doubt that the potential of market forces has been underestimated, or even neglected, in development co-operation in the past. The new paradigm expressed in the *Guiding Principles* has important merits in that it shows that BDS systems should operate as closely as possible to the market if they are to avoid misallocation of resources, optimise cost-benefit ratios, and avoid any crowding-out of private service providers. However, the *Guiding Principles* underestimate the degree of market failure.

It is necessary to take account of three points that restrict the leeway available for implementing the new paradigm (see Altenburg and Stamm, 2004: 8-9):

- Some business services are public goods, and an argument can be made for subsidising them. In the case of public goods, markets cannot be expected to provide the socially optimal solution. Governments are willing to subsidise many BDS schemes since they expect the social benefits to outweigh the costs. Therefore, even in industrialised countries, where service supply is usually of quite good quality and firms are able to pay sizeable fees, many services are not provided on a cost-covering basis. In developing countries market failure may be even more pervasive. Thus it is important to identify carefully which services are actually purely private goods which can and should be provided on a market basis, and cases in which governments should intervene to maximise welfare. The 'public good' content inherent in a given service depends on the specific local and historical context, for example the size and maturity of markets.

10. Trulsson (2000: 57) shows this for Tanzania, Uganda, and Zimbabwe.
11. In the same vein, an evaluation of 8 World Bank 'market development grant funds' targeted on firms that want to hire business services concludes that their performance has been weak, especially with regard to sustainability and development impact (Phillips, 2001).

- The development of private service markets is a slow and difficult interactive process. Public intervention may be needed to speed it up. In most mature economies a highly diversified private service sector has developed over time. This is the result of a cumulative and interactive process in which increasing product differentiation, shorter product cycles, emphasis on customer-specific solutions, etc. have spurred the development of business services, and vice versa. In the case of less developed countries, there is often a vicious circle in which barely differentiated, simple non-service sectors do not create demand for advanced services, the lack of which restricts competitiveness. The relevant questions here are therefore: even if a certain type of service could and should in the long run be delivered under market terms, is there not still a case for temporary intervention in order to develop markets and get the above-mentioned dynamics going? Can SMEs in developing countries wait for service markets to be created, in view of the pressures they are facing in times of market liberalisation and globalisation?

- Reforming public service providers in accordance with the criteria of the new paradigm may be a more promising approach than trying to replace them by private providers. Donors and government agencies that wish to improve SME services never start from scratch; instead, they are always forced to deal with established traditional, and often inefficient, service systems that distort the market. Even if private providers were able to guarantee an efficient and massive supply of services, in view of interest-group politics and the inertia of bureaucracies it would not be realistic to assume that these institutions would quickly disappear. For the development practitioner, this raises the question of how to manage a gradual transition from bureaucratic, supply-driven, and subsidised provision to businesslike modes of service delivery.

5 Beyond the ‘level playing field’: a case for proactive public policy

Economic liberalisation as well as the rapid spread of new technologies have made the business environment more competitive and demanding. The minimum requirements for companies to stay in business – management skills, technology, infrastructure, logistics, connectivity, etc, – are growing continuously. Companies have to invest more and more in relationships with external agents, including firms upstream and downstream in their respective value chains as well as specialised service providers. Few of the services required for the long-term competitiveness of individual firms, sectors, or local clusters are purely private goods, and some public support is needed to maximise welfare.

Public intervention is also needed to bridge the gap between medium- and large-scale formal sector companies and informal micro-enterprises. As argued earlier, empirical studies show that only a very small number of micro-enterprises ever manage to upgrade and grow into larger units. The reasons are manifold. Micro-entrepreneurs may, for instance, lack information, technical skills, managerial competence, entrepreneurial spirit, and capital; not all societies value individual entrepreneurship, and entrepreneurs may not have a strong will to accumulate capital; some, such as Muslim entrepreneurs, may not even want to borrow money; only a small number of micro-entrepreneurs have enjoyed full secondary education, and most live in social milieux which do not provide much exposure to innovative business ideas. To graduate out of informality is thus a slow and difficult process of cultural change.

The NMA correctly points out that traditional government- or donor-driven private-sector support programmes often fail to provide efficient and sustainable solutions to these problems. Its well-substantiated criticism of public service delivery, including disclosure of the often inappropriate incentive systems, is possibly the greatest merit of the NMA literature. But this does not mean that provision has to be entirely privatised and paid for by users. Such a change would take the risk that no public goods will be provided and that long-term investments in strategic assets and capabilities will be lower than the socially optimal level. In several fields of private-sector development, governments have an important role to play in defining targets and subsidising programmes for their achievement, regardless of who finally delivers the respective services.

The NMA fails to capture the complexity involved in building competitive economies and integrating the informal sector. As shown in previous sections, it acts on a number of rather simplistic assumptions which are not fully backed by empirical evidence, for example that:

- pro-poor tenure policy is a key policy that automatically sets in motion a process of credit supply, investment and growth. Empirically, the link between property rights, credit supply, investment and growth is rather weak in the micro and small-scale enterprise sector, and the supposed massive increase in credit supply has failed to materialise;

- simplification of procedures and regulations plays a decisive role for PSD, especially as a trigger for pro-poor growth. In fact, reforms aimed at reducing administrative burdens do not seem to have a particularly pro-poor outcome, and only rarely enable informal enterprises to graduate into the formal sector. Barriers to growth are manifold, so that administrative simplification is not sufficient to solve the problem of informality;

- it is feasible to develop markets for financial and non-financial business services which meet the demand of globalising economies in search of international competitiveness and also reach out to the poor without the need to fall back on public subsidies. While microfinance institutions are often very successful and achieve significant outreach, few of them reach the core poor or solve the problem of credit supply for growth-oriented firms. With regard to (non-financial) business services, the NMA fails to take note of the relevance of public goods and overestimates the ability of small entrepreneurs to anticipate the need for strategic service inputs and their willingness to pay for them. There are no best-practice cases of smoothly functioning and sustainable private service markets.

In sum, the NMA has raised some important new issues for policy-makers. It can take credit for having identified the social costs of unnecessary and unfair regulations and weak property rights systems and prompted an overdue discussion of the inefficiencies and limitations of public service provision. However, its recommendations should not be accepted at face value since they tend to be simplistic and are not fully backed by empirical evidence. Policy-makers would be well advised to pursue an eclectic approach, combining the market-friendly perspective of the NMA with selective targeted interventions where public goods are concerned. This would imply, *inter alia*,

- continuing to provide policy instruments aimed at sensitising the private-sector to important changes in its business environment and to support collective action in order to cope with new challenges. Public facilitation is important in recognising global trends in terms of technologies, markets, and governance structures at an early stage. Well-designed surveys, benchmarking studies, and a continuous stakeholder dialogue make it easier to identify such general trends, to uncover strengths, weaknesses, opportunities, and threats in a dynamic perspective, and to design adequate pro-active policies;

- carrying on with support for R&D, information services, and other activities that tend to be undersupplied under market conditions because private actors cannot fully appropriate their benefits;

- providing assistance in bridging the gap between highly productive enterprise networks, which operate on the basis of profound specialisation and division of labour, and informal small-scale enterprises. This may require incentives for large companies to enhance the transfer of know-how to small firms as well as specific upgrading support for the latter to improve their performance;

- providing incentives for enterprises to improve their environmental performance.

All this requires public engagement and allocation of funds. However, governments and donors should always check carefully whether intervention in markets is really justified. Even if this is the case, co-financing by the users should be compulsory. Public institutions should define targets and ensure independent monitoring and evaluation of performance, but leave service delivery to private providers or business associations, whenever possible. At the same time, it is important to stimulate competition among providers, encourage market-based solutions and enhance the accountability of public service providers.

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