

# CHAPTER 2

## The Right Kind of Growth



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*“Economic growth should lead to shared prosperity. The strength of an economy must be measured by the degree to which it meets the needs of people, and by how sustainably and equitably it does so. We need inclusive growth, built on decent jobs, sustainable livelihoods and rising real incomes for all, measured in ways that go beyond GDP and account for human well-being, sustainability and equity”*

Synthesis report of the Secretary-General on the post-2015 sustainable development agenda<sup>102</sup>

Every country is responsible for its own development. This point has been repeatedly emphasised in all the processes shaping the post-2015 agenda. National ownership of development strategies is a fundamental principle that has underpinned the discussions around the SDGs. Although clearly a political pre-requisite for a global agreement, it has a strong economic rationale as well. Countries need to generate and manage more of their own revenues. The international community will support, assist and cooperate on addressing global challenges but each country’s development will depend to a large extent on how effectively it can mobilise (and allocate) its own resources.

*Cohesive nationally owned sustainable development strategies, supported by integrated national financing frameworks, will be at the heart of our efforts. We reiterate that each country has primary responsibility for its own economic and social development and that the role of national policies and development strategies cannot be overemphasized.*

Outcome Document of the Third Financing for Development Conference<sup>103</sup>

This emphasis on a country’s own responsibility is a significant shift from the past. The MDGs emphasised development assistance predominantly in terms of aid transfers from richer to poorer countries. The responsibility for the use and disbursement of development aid remained with the recipient government (in principle, at least) but donor support was the primary instrument for meeting the MDGs themselves. By contrast, the SDGs place a much greater emphasis on domestic economic growth. In large part, this means an expansion in business activity, whether through the private sector – large, medium or small – or indeed through state-owned enterprises (SOEs).

If this were simply a matter of increasing GDP, it would be a relatively uncontested, if still challenging proposition. Business undoubtedly facilitates economic growth and it has been instrumental in lifting millions out of poverty. The current model has limits, however, in terms of quantity and quality. Without appropriate safeguards, it is unsustainable from an environmental perspective and, arguably, from a social one as well given concerns over rising inequality. Moreover, without fundamental changes, it is estimated that extreme poverty will continue to affect upwards of 100 million people (and possibly as many as one billion) by 2030 with the highest concentration in Sub-Saharan Africa.<sup>104</sup> But extreme poverty (defined as an income of \$1.25 a day) is only the most basic target. The SDGs aim to cut poverty in all its forms: improving access to health care and education, ensuring basic rights and freedoms and improving overall quality of life. Addressing these multi-dimensional aspects of poverty assumes not only growth *per se*, but a different kind of growth, coupled with a fairer, more equitable distribution of its proceeds. The implications for states and the private sector are profound.

These challenges present a real threat to meeting the SDGs although the extent to which they play out will vary considerably in individual countries. In addition to the difficulty of overcoming the challenges, there is obviously a danger that the proposed model will simply be ignored, perceived by some governments as conflicting with short term political self-interest and by others as constraining freedom in shaping a development strategy. It

might also be perceived as an abdication of responsibility by rich states: transferring much of the burden and the cost of development onto the shoulders of impoverished governments.<sup>105</sup> In reality, the opposite will need to be the case. Addressing these challenges is a matter of establishing the **right conditions** and the **right opportunities**.

## 1. The Right Conditions

The SDG model depends on better governance. This is stating the obvious perhaps but it is fundamental nonetheless. If business is to be an engine of growth, then it needs the right conditions. Business is especially sensitive to poor governance, more so even than aid. Unlike aid, business (at least responsible business) flows to where it is valued rather than needed. The private sector requires strong institutions, effective and fair regulation, respect for property rights and the rule of law. Without these foundations, economic activity has no platform on which to expand and diversify.

*One overarching pre-condition for business of any size, sector or nationality to operate is effective governance, rule of law and stable societies.*

International Chamber of Commerce to the UN on behalf of the Global Business Alliance (GBA) for Post-2015 for the Business and Industry Major Group<sup>106</sup>

### 1.1. Business and Fragile States

States that are unwilling or unable to foster a sound business environment will struggle to generate sufficient resources domestically to meet the ambitious targets laid out in the SDGs. This is of most concern in fragile states – countries where the government lacks capacity, accountability and often legitimacy.<sup>107</sup> Fragile states present intractable development challenges. By 2011, no low-income fragile or conflict affected country had achieved a single MDG.<sup>108</sup> By the end of 2015, only one-third are likely to meet the goal of halving extreme poverty while one-fifth will halve infant mortality.<sup>109</sup> The 50 countries on the OECD fragile states list are currently home to 37% of those living on less than \$1.25/day. This figure could rise to 75% by 2030.<sup>110</sup> Meeting the ambitious targets set out in the SDGs in these countries will prove especially demanding and will need to be the focus of dedicated attention.

Outbreaks of widespread political or criminal violence are the most obvious and devastating symptom of fragility but not the only one. Mismanagement of state resources, poor or non-existent public services and inadequate security combine to undermine development efforts, entrench poverty, drive inequality and leave societies more vulnerable to natural disasters.<sup>111</sup> Business is another casualty of fragility. Until relatively recently, the effect of weak or dysfunctional governance on the business environment received less attention than the effect on aid. In respect of business, the emphasis at both national and international policy levels has traditionally been on how companies, especially in the extractive industry, impact on fragility rather than vice-versa. This will surely change yet the interaction between business and fragility is especially complex:<sup>112</sup>

- Poor governance discourages both domestic and foreign businesses, damaging the prospects of broad-based economic growth.
- At the same time, poor governance encourages corrupt or otherwise irresponsible business, either by exercising close political control over companies or by facilitating harmful practices through weak regulation and ineffective oversight.
- Poor governance undermines the ability of responsible business to act in accordance with international standards. Few companies are equipped to navigate the management challenges posed by social tension, high rates of inequality and political or criminal violence.

If the first of these were the only challenge, the use of development assistance to stimulate business would be simple common sense. To the extent that un- and under-employment is correlated with higher risks of conflict and instability<sup>113</sup> and, conversely, a burgeoning middle class with greater pressure to improve governance<sup>114</sup>, private sector growth can be seen as an effective antidote to fragility. This understanding is certainly reflected in recent trends amongst donors. The amount of aid channelled towards the private sector has been increasing over the last decade<sup>115</sup> and the New Deal for engagement in fragile states agreed by the International Dialogue on Peacebuilding and Statebuilding in 2011 lists economic foundations (generate employment and improve livelihoods) as one of five goals, alongside legitimate politics, security, justice and revenues and services.<sup>116</sup>

The relationship between governance and business is not so straightforward, however. The impact of business is strongly influenced by the system that surrounds it. Without the proper institutions in place, business is more a double-edged sword than an unrealized good: on the one hand, a powerful instrument of economic growth; on the other, a potential development liability. This is not a new insight. The debate over natural resources in developing countries and the role of extractive industries has illustrated this dilemma.<sup>118</sup> Countries' economies can grow, and grow fast, yet still not deliver real development to the whole

*...the draft sustainable development goals (SDGs) recognize the positive role of businesses to support and drive development. At the same time, in our view, they do not sufficiently reflect the fact that governance gaps in many situations enable business activities across a range of sectors and countries to undermine respect for human rights.*

UN Working Group on the issue of human rights and transnational corporations and other business enterprises (2015)<sup>117</sup>

population. Economic mismanagement is compounded by poor corporate conduct. Companies are free to disregard the principles of good practice or else they struggle to live up to them as a result of external pressures. The extractive industry may be exceptional in terms of its size, its impact and its revenue-generating potential but its real uniqueness lies in its willingness to invest almost regardless of the operating environment.<sup>119</sup> Other industries, assuming they can be persuaded to invest on the scale demanded by the SDGs, will struggle to dodge this poor governance bullet.

A similar argument applies to the domestic private sector. The corruption and patronage that thrive in weak as well as authoritarian states privilege unscrupulous businesses over responsible ones. It is difficult in such circumstances, and in many cases impossible, to establish and grow a company without having or buying the right contacts. In countries where this kind of unhealthy relationship between business and politics exists, the development potential of business is unpredictable at best. Just as open, transparent and participative governance is a threat to unaccountable political power, a flourishing and responsible private sector is a threat to entrenched economic power, including domestic monopolies. Business prospers when granted a strong measure of independence. In order to realise the private sector's full potential, governments need to sacrifice some control over the economy.

If the problem is most acute in countries where poverty and violence combine, it is also apparent in more prosperous middle-income countries with significant pockets of deprivation. Groups excluded from the economic, political and social benefits that economic growth has delivered to their compatriots often have neither the power to be heard nor the means to develop a public voice in such debates. It is these groups who can have the most to lose from the expansion of business. Living in countries where investment is attractive and domestic finance available, they are particularly vulnerable to the appropriation of their lands and livelihoods in the name of development. Institutions may be relatively effective and the rule of law relatively strong but they must still be accompanied by protection of individual rights and measures to empower the poorest. Good governance is about more than institutions. It is also the audible voice of every citizen and the equal protection of everyone.

## 1.2. Prioritising Good Governance

Good governance is about effective, accountable and inclusive institutions that are able to regulate and govern. The real key then to strengthening the role of business in sustainable development lies in SDG 16:

*‘Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels.’*

If pursued vigorously, the inclusion of a goal on peace and governance is a real opportunity. It offers the international community and national stakeholders the incentive and perhaps the teeth to help address one of the most significant obstacles to development and it unlocks the potential of the private sector, not only by providing the right conditions but also by helping ensure that business operates in ways consistent with the other SDG targets.

The challenge of meeting this goal is as big as the opportunity. According to the OECD, only two states (Cabo Verde and Liberia) out of the 50 classified as fragile would reach the threshold for ‘acceptable’ institutional quality by 2030 based on current rates of progress.<sup>121</sup> Even a more optimistic projection based on faster than average progress adds only one more country (Cambodia) to the list.

*Global success in poverty reduction over the next 15 years will depend heavily on success in building resilient institutions and societies and on reducing conflict.*

OECD<sup>120</sup>

Nevertheless, if the problem of poor and weak governance is not properly addressed, the whole SDG project will be endangered.<sup>122</sup> Unforeseen catastrophes resulting from climate change or disease can stall or undermine progress<sup>123</sup> but the more predictable obstacles come in the form of limited political will and capacity. Trillions of dollars may be theoretically available<sup>124</sup> from a combination of domestic resources, international aid and private investment, finance and philanthropy. However, much of this will remain hypothetical without the political direction to attract and regulate the new resources and the absorptive capacity to manage and channel them where most needed. This is true of aid but far more so of business investment. Poor governance makes for poor business while attracting good companies into fragile states will require large injections of public money (either directly or through loan guarantees and risk insurance) not to mention significant time, effort and expense in oversight of individual projects.

*There is increased interest ...in how to engage with the private sector to foster inclusive growth and poverty reduction, enabling an end to aid dependency through growth and jobs. We know that economic growth is the primary driver of poverty reduction and that the private sector is the engine of that growth; promoting new jobs, opportunities, markets and prosperity.*

UK Department for International Development (DFID)<sup>125</sup>

Donors have made great progress in aligning aid with national strategies and encouraging better harmonisation in development co-operation.<sup>126</sup> But this is less evident in respect of “private sector development programmes” than in other areas of development policy<sup>127</sup> where donors have only recently started to engage in a proper debate about the challenges of the approach.<sup>128</sup> In the haste to identify the resources needed to meet the SDGs, the international community may be putting the cart before the horse.

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Efforts to stimulate the right kind of private sector growth in developing countries cannot succeed without more emphasis on creating the conditions for responsible and sustainable business to thrive. This is usually understood as “the enabling environment.” Donors expend a great deal of time, effort and money<sup>129</sup> on ‘getting policies right’.<sup>130</sup> The problem is that without accompanying efforts to improve the overall governance situation, the impacts of these interventions in the most impoverished

countries are likely to be diminished. There is considerable overlap between the bottom 50 countries in the World Bank's Ease of Doing Business ranking<sup>131</sup> and those in the OECD list of fragile states. This correlation is not a coincidence and although reducing barriers to doing business is important, it is less so than fostering strong and accountable institutions that ensure respect for the rule of law and protect human security. These are a pre-condition for genuine progress in regulatory reform even if they are more difficult to achieve. There is truth to the idea that the most easily measurable interventions are often the least transformational, while the most transformational are often the least measurable.<sup>132</sup>

Second, private sector development programmes rarely include any support to developing responsible and sustainable business practices – indicating a major missed opportunity to develop a coherent agenda around the role of business in the SDGs. With so much reliance on the private sector in meeting the SDGs and an increasing percentage of otherwise shrinking donor funding going to private sector development, those precious funds should be spent on developing the right conditions for the kinds of private sector development the SDGs define.

Donors will need to focus far more intensively on good governance both as a priority in its own right and as a means of unlocking responsible private sector investment. The argument that business drives poverty reduction through growth and employment is too simplistic in fragile states at least. An important start has been made with the New Deal for engagement in fragile states but practical support remains low.<sup>133</sup> Donors need to work together with recipient governments, businesses and civil society advocates to develop a set of principles and guidelines linking private sector development strategies with an increased focus on wider good governance. Perhaps the inclusion of Goal 16 in the SDGs provides the incentive and the legitimacy to do so while the New Deal offers the mechanism.

## 2. The Right Opportunities

The SDG model envisages a very different economic journey from developing to developed country. Every industrialising nation – from Great Britain in the nineteenth century to China today – has relied on a combination of cheap labour, abundant fossil fuels and a dose of protectionism to drive its development. While the first two remain in plentiful supply, neither corresponds to the vision outlined in the SDGs and the third is the antithesis of the free trade approach reemphasised in the Financing for Development Outcome Document. In short, poorer nations are being asked to take a greener, fairer and more open path towards industrialisation than any countries have done before.<sup>134</sup> Promoting a different model of economic development is easier than implementing one, particularly if many of the proven tools of growth are no longer considered appropriate.

The message of the SDGs is that growth alone is not the answer. In simple GDP terms, the developing world has grown strongly over the last 15 years<sup>136</sup>, even when China is discounted and notwithstanding the global financial crisis. Yet even at these relatively high levels, there has not been the kind of widespread improvements in social indicators or increases in employment that might have been expected, certainly amongst the least developed countries (LDCs). This can be explained in part by population rises and the type of growth (and presumably also by the allocation of the proceeds of economic expansion). The pattern of economic growth matters as much as the pace of it<sup>137</sup> and growth driven by overdependence on individual sectors (e.g. natural resources) has not delivered the quantity of jobs or indeed the quality needed to spur development.<sup>138</sup>

*No country has developed without fossil fuels to date, so cooperation is key to providing the technology, finance, skills and systems to create an alternative way of developing.*

Mary Robinson<sup>135</sup>

This underlines the fact that growth should be understood not as an objective in itself, but rather as a means to an end by providing decent livelihoods, increasing security and improving the welfare of all citizens.<sup>139</sup> If growth does not deliver these, it has limited value from a development perspective.

This suggests a shift of emphasis and understanding over the last 15 years: from an assumption that employment is an output of growth to a greater focus on identifying and promoting the right kind of job opportunities as an input to growth.

This is reflected in popular opinion – better job opportunities currently ranks third in the UN's My World global survey<sup>140</sup> of key issues. The SDGs have highlighted decent work<sup>141</sup> as being central to sustainable development. Good jobs offer not only income but also access to products and services. They raise living standards, support the education of dependents and enhance the dignity to individuals and families. They are a clear priority and are consistently cited as a priority for all age groups across all countries. The focus on jobs seems justified, especially in view of the financial crisis, which has had a dampening effect on employment prospects.<sup>142</sup>

The ILO estimates that some 670 million new jobs are needed by 2030 simply to contain the spread of unemployment and cope with rises in the working age population.<sup>143</sup> But bare employment statistics are a poor indicator of the real scale of the underlying problem. Although there has been a decline in the relative number of working poor since 2000 – those defined as in employment but living on less than \$2 a day – the improvement has been driven overwhelmingly by progress in East Asia.<sup>144</sup> South Asia and Sub-Saharan Africa in particular continue to be plagued by the problem of working poverty. Overall, 839 million people around the world remain trapped in insecure jobs<sup>145</sup> with low incomes, little access to social services and limited prospects for the future.

Even these figures mask the still deeper crisis of youth unemployment. In 2013, the youth-adult unemployment ratio reached an historic peak.<sup>147</sup> The problem is acute in many developed countries, especially Europe, but with over 90% of global youth<sup>148</sup> concentrated in developing countries, it is even more of a challenge in those countries that are already beset by high levels of working poverty.

In contrast to other issues such as governance and climate change, employment was an explicit target in the MDGs.<sup>149</sup> If progress in this area has been patchy<sup>150</sup>, the sin is not one of omission but of implementation. On this point, there is little that is genuinely transformational in the SDGs. New jobs are going to have to come from where they usually do – changes in domestic policy to promote entrepreneurship, investment from abroad to provide capital, expertise and technology and freer trade to reduce barriers so lowering costs, boosting exports and promoting competition. These are familiar ideas reflecting current economic orthodoxy. The transformative element of the SDGs comes in the way the jobs will have to be created driven by two main imperatives: inclusivity (specifically a focus on opportunities for the poorest) and sustainability (meaning fundamental changes in consumption and production).

Structural economic transformation is required in order to enable the transformation in sustainability of consumption and production. While some developing countries, notably in South-East Asia, have made progress in diversifying their economies and moving the workforce into more productive activities, many have not, with the highest concentration of these found in Africa.<sup>152</sup> In these countries, the opportunities are more limited for the private sector to be a driver of growth, let alone sustainable development.

Where then will new jobs come from in the short-term? This question seems to get less attention than the problem of financing but it is of no less importance, particularly given that the SDGs place so

*Achieving decent work within the post-2015 framework should be seen as a dynamic process of successive improvements in wages, working conditions, labour institutions and standards of employment and social protection that is related to the structural transformation of an economy.*

ILO<sup>146</sup>

*Therefore, meeting the new goals will require nothing short of a revolution in LDCs' economic performance. More specifically, it will necessitate their structural transformation on a scale unprecedented for these countries.*

UNCTAD<sup>151</sup>

much emphasis on domestic resource mobilisation. Besides the jobs that may flow from investments in infrastructure (should those investments materialise – see Chapter 3), the options are limited and seem to revolve around three main areas: agriculture and micro, small and medium-sized enterprises (MSMEs)<sup>153</sup> and for some countries, through participation in global value chains.

## 2.1. Agriculture

*By 2030, double the agricultural productivity and incomes of small-scale food producers, in particular women, indigenous peoples, family farmers, pastoralists and fishers, including through secure and equal access to land, other productive resources and inputs, knowledge, financial services, markets and opportunities for value addition and non-farm employment*

Target 2.3 Sustainable Development Goals

The economic history of the modern world is written in rural to urban migration. Over the course of 100 years (1800-1900), employment in agriculture fell from 73% to 11% in England.<sup>154</sup> Industrialisation drove workers from the fields to the factories with the promise of better opportunities and higher living standards. Two centuries later, the same forces have been evident in China, only accelerated. Between 1990 and 2010, China's urban population almost doubled and a further 100 million farmers are expected to migrate by 2020.<sup>155</sup> More people globally now live in cities than in the countryside. The global rural population is nearing its peak and although Africa and Asia account for nearly 90% of these, both regions are urbanising faster than elsewhere.<sup>156</sup>

In employment terms, agriculture accounts for approximately 36% of the global workforce and falling<sup>157</sup> although the figures mask huge disparities between developed and developing countries. For example, in 2010, around 2% of the American working population were engaged in agriculture. In India the percentage was approximately 50%<sup>158</sup> and over 80% for Sub-Saharan Africa (including related rural enterprises).<sup>159</sup> At the same time, however, developed countries' share of agricultural production is similar to that of the combined total for Sub-Saharan and North Africa, Latin America and West Asia (around 25%).<sup>160</sup> The reality is that agricultural employment is more often linked to poverty than to rising prosperity.

If the trends are familiar, the economic context is changing. For the farm workers of 19th Century England and late 20th Century China, the pull to the cities was at least as strong as the push from the countryside. People moved because of new employment opportunities and to fuel a manufacturing boom. For too few developing countries, especially in Sub-Saharan Africa, the push from the countryside, whether because of grinding poverty, conflict, environmental damage or climate change, is stronger than the pull to the cities where few opportunities await. Migration overseas no longer offers the same possibilities for the low skilled.<sup>161</sup>

From the perspective of inclusive economic growth, agriculture is critical to sustainable development for one overwhelming reason: there are no other options that offer the same immediate potential in terms of quantity of jobs and impact on the poorest, particularly women and in stemming the flow of migrants to cities that cannot yet offer alternatives. The reason why only 2% of the American workforce is employed on farms is obviously not because the USA no longer produces any food but because it does not need a large labour force to do it.<sup>163</sup> By contrast, a priority for many developing countries is to retain the high percentage of the workforce currently in agricultural employment while driving up productivity to improve living standards. Business can undoubtedly deliver the latter but possibly only at the expense of the former. Additionally, business will most likely focus its investments in crops that

*Reaching the SDG targets simply will not be possible without a strong and sustainable agricultural sector.*

Farming First<sup>162</sup>



deliver the best margins. These are more likely to be grown for the export market than for domestic consumption offering little help in addressing the urgent problem of local food security. Business can play a critical role in transforming agricultural productivity and increasing countries' income from agricultural exports and production but whether it can do this while also employing millions is an important question.

From a sustainable development perspective, one of the keys lies in focusing on small-scale farmers (who currently produce some 70% of the world's food<sup>164</sup>). This assumes two things at minimum: an end to (or at least reduction in) rich country subsidies for farmers in rich countries, and much greater investment (domestic and foreign). The call in the Financing for Development Outcome Document to eliminate all forms of agricultural export subsidies<sup>165</sup> seems likely to fall on deaf ears. Greater domestic support coupled with better protection from foreign competition has proved to be a successful combination elsewhere.<sup>166</sup>

Foreign investment can be as big a threat as foreign competition. Since the 2007-2008 food crisis, which saw a rise in global prices, large-scale land acquisition, particularly for agriculture – sometimes carried out through 'land grabbing' – has been on the increase. An estimated 32 million hectares of land – an area the size of Poland – is currently owned by, or on long-term lease to, foreign investors with the vast majority of the investment taking place in Sub-Saharan Africa.<sup>168</sup> The deals are driven by three factors<sup>169</sup>: food security – although not necessarily global food security (foreign companies have been investing in land and agriculture more to satisfy international or their own home markets rather than host ones); energy and specifically bio-fuels (in part driven by government consumption targets as in the European Union) and; finally, rising food prices (ensuring more attractive returns).

The investments undoubtedly bring potential benefits, not least in the prospects for (some) job creation but there are many downsides too that echo long-standing concerns around the exploitation of other natural resources such as oil, gas and minerals. The land is usually under cultivation of some farmers or communities, despite government claims to the contrary<sup>170</sup>, meaning that some people – often small-scale crop farmers or pastoralists – have to be relocated, losing their livelihoods. The familiar question of who really benefits is increasingly being directed as much at agribusiness as at the extractive sector.

*Governments concerned about stability of food supplies are promoting acquisition of farmland in foreign countries as an alternative to purchasing food from international markets. Recipient countries, welcoming the new wave of foreign investment, are implementing policy and legislative reforms to attract investors.*

FAO, IIED, IFAD<sup>167</sup>

*...where rights are not well defined, governance is weak, or those affected lack voice, there is evidence that such investment can carry considerable risks of different types. Risks include displacement of local populations, undermining or negating of existing rights, increased corruption, reduced food security, environmental damage in the project area and beyond, loss of livelihoods or opportunity for land access by the vulnerable, nutritional deprivation, social polarization and political instability.*

FAO, IFAD, UNCTAD, World Bank Group<sup>171</sup>

In recognition of these concerns, the Committee on World Food Security (CFS) has launched a set of principles designed to guide responsible investment in agriculture<sup>172</sup> that have been explicitly endorsed in the Financing for Development Outcome Document.<sup>173</sup> The principles are comprehensive, covering food security, inclusive economic development, respect for the environment and women's empowerment, and human rights, amongst other issues.<sup>174</sup> While this constitutes an important step

forward in terms of awareness of the problem, there is enough experience from similar initiatives in other industries to suggest that implementation is never guaranteed (certainly not without strict accountability mechanisms) and not always even possible.

The SDGs clearly prioritise employment and development but this disguises a complex set of political choices and economic and social reforms. Does large-scale investment in agriculture actually contribute to sustainable development or does it undermine it? In the short-term, should governments pursue agriculture to maximise GDP or maximise employment? It implies a different model of large scale foreign investment, one that prioritises the needs of smallholders over short-term profits and one that discourages the type of deals currently on the increase in Africa in favour of a different approach – one more along the lines of Thailand than Brazil.<sup>175</sup> This means foregoing some of the benefits of mechanisation and greater efficiency to avoid potential losses in employment and abandoning the current approach to land acquisitions in favour of promoting innovative models of joint equity with local communities<sup>176</sup> or other alternative models of consolidating small farms, so as to benefit from economies of scale. None of this is impossible, nor is it a quick fix to the problem of poverty. It is a long-term endeavour.

Investment in the agriculture sector needs the same scrutiny that the extractive sector has received. Perhaps more so: companies need to be held accountable not only for their specific responsibilities in terms of consultation, impact assessments, benefits and grievance mechanisms but also in relation to wider effects on sustainable development. Small scale farmers need support to ensure they are not perpetuating the kinds of practices the SDGs seek to eliminate: as child labour, exploitation of girls and women, or use of forced labour, involving day labourers even more destitute than the small farmers. Governments need to be held accountable for ensuring that small-scale farmers are at the centre not the periphery of development strategies. Transparency is needed on land deals and, individual and community land rights need to be secured and strengthened. Finally, all governments need to be held accountable for how a broad range of policies – in trade, in energy and in aid – either support or distort the objective of making agriculture work for the poorest.

## 2.2. Micro, Small and Medium-Sized Enterprises<sup>177</sup>

As in agriculture, so in other industries – the future is small. Micro, small and medium-sized enterprises (MSMEs) are seen as one of the keys to job creation and income generation.<sup>178</sup> Globally, MSMEs comprise 95% of all enterprises<sup>179</sup>, account for more than half of all jobs worldwide<sup>180</sup> and are responsible for generating the majority of new jobs.<sup>181</sup> Evidence suggests that MSMEs provide upwards of 75% of employment in low-income countries with the majority of these to be found in businesses with fewer than 20 employees<sup>182</sup>, often in the informal sector.

*Promote development-oriented policies that support productive activities, decent job creation, entrepreneurship, creativity and innovation, and encourage the formalization and growth of micro-, small- and medium-sized enterprises, including through access to financial services.*

Target 8.3 Sustainable Development Goals

Beyond their basic employment generating potential, MSMEs offer an existing base of economic activity that can be expanded and developed; they provide employment opportunities to the poorest and the most disadvantaged; they are a potential source of wealth creation, innovation and tax revenue; they often require less in the way of formal qualifications and skills; they can improve countries' resilience to external shocks and global price fluctuations through their diversity and; not least, help address some of the more multi-dimensional aspects of poverty by enhancing personal security, providing a greater sense of dignity through employment and contributing to social cohesion.<sup>183</sup> For all of these reasons, MSMEs have been highlighted as a critical component of poverty reduction and sustainable development and therefore of meeting the SDGs. As the Chinese experience shows, one

way to reduce rural poverty is by enabling the establishment of small enterprises which absorbed surplus farm labour and employed people in light manufacturing industries producing goods for exports, earning hard currency. This powered China's early growth and helped lift the rural poor out of absolute poverty through jobs which paid better than farm labour.

*In many developing countries, the expansion of the private sector, notably micro-, small- and medium- sized enterprises (MSMEs) is a powerful engine of economic growth and the main source of job creation.*

European Commission (EC)<sup>184</sup>

Not surprisingly, MSMEs are popular with donors and likely to become even more so. Over \$24 billion of development assistance is directed annually towards MSMEs<sup>185</sup> via some 300 SME focused investment vehicles.<sup>186</sup> The largest share of this (around \$21 billion in 2010<sup>187</sup>) is provided by Multi-lateral Development Banks (MDBs), with over half directed to Sub-Saharan Africa and South Asia. The bulk of this assistance is focused on financing<sup>188</sup> reflecting a wide consensus that the biggest obstacle to SME growth is access to credit.<sup>189</sup>

Are MSMEs a 'powerful engine of economic growth and job creation' or rather a symptom of a failure in the system and a brake on development?<sup>190</sup> The doubts around the real value of MSMEs in employment terms centre on questions over quantity, quality and productivity. The key justification for targeting small businesses is their effectiveness at creating new jobs.<sup>191</sup> On this, the evidence is mixed. While MSMEs are undoubtedly a prolific source of new jobs – accounting for more than 75% in developing countries where employment increased<sup>192</sup> – they are not necessarily a source of stable jobs. Survival rates for such jobs are low. In terms of their contribution to net job creation, they may be no more effective than larger companies.<sup>193</sup> A rapid growth in smaller firms is offset by a high failure rate that leaves former employees little better off than they were before.

Another challenge concerns whether MSMEs are a source of quality jobs. Few MSMEs, particularly in the informal sector, can offer decent wages, proper working conditions and access to benefits such as pensions and health and safety provisions.<sup>194</sup> Fewer still are large enough to be obliged to respect trade union rights. Larger firms pay higher wages and offer more job security.<sup>195</sup> Reducing the discrepancy between larger and smaller firms in respect of wages and working conditions is thus a key component in sustainable development.

The final concern revolves around productivity. Increases in productivity are one of the main sources of economic development and low productivity is commonly cited as a weakness of MSMEs (certainly in developing countries).<sup>196</sup> This is not to argue that MSMEs cannot be productive, but simply that they often are not and therefore their impact on wider growth is disproportionately low compared with their contribution to employment. The reasons are both economic and human. Productivity requires use of machinery and technology, both of which require capital, which MSMEs often lack. Productivity is also increased through collective organisation that allows cross-fertilisation of ideas, promotes more efficient routines and embeds institutional memories.<sup>197</sup> And although entrepreneurialism is certainly a vital component of productivity, not everybody is an entrepreneur. One of the problems in developing countries is that too many people have to start their own business because there are no other opportunities. MSMEs are often a survival option rather than a career choice.

*What really distinguishes Ecuador or Vietnam from the US or Japan is not the raw entrepreneurial energy of the people that the neo-liberals so often talk about (which you probably have more in the former group of countries) but the abilities of a society to set up and manage productive enterprises that can channel that individual energy into raising productivity.*

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While none of these concerns are unfamiliar to donors, they may be in danger of being neglected in the ‘overselling’<sup>199</sup> of small business as a large part of the answer to the problems of un- and under-employment. In low-income countries, small firms (5-19 workers) command the largest share of formal employment.<sup>200</sup> This figure, coupled with the fact that the informal sector comprises close to 50% of the labour workforce<sup>201</sup>, might lead to the conclusion that expanding small business and formalising the informal sector offer a clear path to sustainable development. More telling, however, is that it is only in low-income countries that small businesses, formal and informal, play such a dominant role in employment. It makes little sense to reinforce a dynamic that is both a cause and a symptom of under-development. Developing countries, particularly the poorest, need more medium-sized and larger firms. These firms are needed because they generate more stable jobs, pay higher wages and provide better working conditions. These firms will also be able to invest in capital equipment to manufacture goods that meet the standards of global companies, and thus prosper and hire more people. Equally important, such firms drive the productivity that is fundamental to economic growth and can offer opportunities to the best-educated individuals who will otherwise look to move abroad.

From a donor perspective, entrepreneurs should certainly be encouraged and small businesses supported. Success should be measured, however, in the speed and extent of business growth and in the quality and security of jobs created. This will mean helping to remove constraints on business growth, including improvements in the enabling environment, infrastructure, and access to finance through a properly coordinated approach at the national level.

### 2.3. Participation in Global Value Chains

Strong arguments have been made for encouraging SME growth through global value chains (GVCs). GVCs have been described as ‘factories that cross international borders’.<sup>203</sup> They offer three main advantages: encouraging much-needed economic diversification, bringing higher productivity and higher value industries and transferring technology, know-how and skills.

The problem is that manufacturing and sourcing decisions are in the large majority of cases not driven by development objectives. The poorest countries have largely been excluded from GVCs because they do not have the workforce, the organisation, the infrastructure, the internal (or regional) market or in most

*GVCs can make an important contribution to development, but GVC participation is not without risks.*

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instances the stable environment necessary to attract the interest of multinationals – at least not in diversified, high-value sectors. South-East Asia has seen significant progress in cutting poverty in recent years<sup>204</sup> through involvement in GVCs and it stands to gain the most from China’s rising prosperity (and its ageing workforce). The region offers a young labour pool, market-friendly policies and the huge advantage of proximity to China. Between 2011-2014, Myanmar’s clothing exports jumped from \$700m to \$1.7b largely on the back of production moving out of China while Thailand, Indonesia and Vietnam are all beginning to increase their presence in advanced manufacturing<sup>205</sup> to supplement their existing strengths in tourism, agriculture, natural resources and other industries.

GVCs may well drive economic growth in South-East Asia but are less likely to do so in Sub-Saharan Africa. If poorer countries (at least in some parts of the world) are likely to struggle to capture a slice of the market in higher value industries, what is left is either at the low end – the production of cheap goods in poor conditions on minimal wages or in areas related to countries’ existing strengths, often meaning primary commodities. In this way, GVCs epitomise both the successes and failings of globalisation. For the lucky, they can help drive economic diversification and create a virtuous cycle of progressively rising living standards, wages and working conditions: for the rest, they can serve to cement under-development by reinforcing dependence on the exploitation of both natural and human resources.

Harnessing the benefits of GVCs will depend on points made throughout this Report: better governance, infrastructure,<sup>206</sup> and finance<sup>207</sup> and on more effective implementation and enforcement of social, environmental and human rights frameworks at both national and international levels. While GVCs have been associated with the so-called ‘race to the bottom’, chasing cheap labour and costs, there is a renewed focus on raising standards all the way down the GVC supply chain. GVC supply chains are one of the most obvious transmission channels for driving responsible business conduct into all corners of the globe as well as to local SMEs.<sup>208</sup> Stronger environmental, social and human rights standards are not only critical from a sustainable development perspective, but are also increasingly viewed as a way for governments to attract multinationals concerned about meeting international standards.<sup>209</sup>

Progress has been made where business, civil society, trade unions and governments have come together to address key challenges in problematic supply chains (e.g. conflict minerals<sup>210</sup> and palm oil<sup>211</sup>). Moving forward, increased transparency and accountability in global supply chains will be a critical component of corporate responsibility and should become an integral part of on-going global discussions on GVCs, and indeed in the follow up to the SDGs.

## Chapter 2 Endnotes

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