Aid and the Business Environment

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Inclusive Growth and the Role of Aid

- Developing countries face multiple economic and governance constraints blocking their growth
- Should aid seek to create enabling institutional conditions (including the business environment) or solve particular problems given *existing* institutional conditions?
- This question is related to the bigger question about the feasibility of support for 'Good Governance' for ensuring efficient markets
- Tempting to focus on the *enabling* institutional and political conditions associated with efficient market economies, and in the meantime to use aid for direct anti-poverty measures
- Better than doing nothing; but this strategy may be seriously insufficient for addressing the huge challenge of achieving viable developmental transformations

Insufficiency of good governance and anti-poverty approaches

- The achievement of ‘Good Governance’ conditions for efficient markets (well-defined property rights, a rule of law, low corruption and political accountability) is *structurally constrained*
- The emergence of a broad base of high productivity organizations is a necessary condition for the achievement of sustainable ‘Weberian’ good governance states
- There is clearly a two-way causality between the growth of a broad base of productive organizations and the achievement of stable property rights and a rule of law
- However the historical evidence suggests that rapid development requires policies that can develop a broad base of productive organizations, even in contexts of poor property rights and rule of law

Inclusive Growth *is* the development of productive organizations

- Growth is inclusive if it is driven by a large number of productive organizations creating broad-based employment
- In an open and competitive global economy this means that even low technology employment opportunities have to be *competitive* if growth is to be rapid and broad-based
- The absence of well-defined property rights and a rule of law can constrain competitiveness, as can infrastructure, power supply and health and education (and aid can assist to some extent in all these areas)
- However, a further factor that is vitally important is often ignored in policy and aid discussions: developing countries lack a broad base of organizations that have the *organizational capability* to achieve competitiveness : difference between *individual* and *team* productivity

Growth accelerations always have an organizational component

- When growth is rapid and inclusive, there is always a hidden story of how broad-based organizational capabilities were achieved
- The financing of learning-by-doing through which organizational capacities are acquired is both expensive and risky, because low effort in organizational learning through experimentation can result in failed investments
- The developmental states of East Asia had strong states that had the capacity both to provide financing for learning to broad sectors but also to discipline performance by withdrawing subsidies and assets from non-performers
- Weaker, clientelist states in much of the developing world failed to achieve this and their performance in broad-based growth was much poorer, and they abandoned most of their policies supporting emerging sectors by the 1990s

The emergence of competitive sectors in clientelist states

- The evidence of high growth sectors in the developing world shows that we do not need to have East Asian states to achieve success
- The growth of garments and textiles in Bangladesh, the automobile and pharmaceutical sectors in India, the garments and electronics sectors in Vietnam were not purely market success stories: they all involved policies that assisted the transfer of organizational capabilities
- The learning of organizational capabilities by the first firms required policy-driven financing and credible conditions on the financing to induce capability transfer
- In these cases growth was particularly rapid because the organizational capabilities acquired by the first firms could be rapidly copied because other firms were close to the required capabilities

The role of policy in developing organizational capabilities

- In all the successful cases where competitive growth-generating sectors emerged in the 1980s and beyond, there were a combination of factors:
- A foreign company with the know-how of the technical *and* tacit organizational knowledge was involved, *and* it had the incentives with credible enforcement conditions to transfer this know-how
- Incentives beyond the market ones were involved because of significant market failures and contracting risks
- Technologies and organizational capabilities adopted by the first movers could be rapidly emulated given the average capabilities of potential firms in the country
- Aid for strengthening the business sector has to be re-thought in the light of this evidence

How can policy and aid help poorly performing countries?

- First, policy has to identify the most important constraints blocking broad-based growth and target those that are feasible to address *and* have a large impact on growth
- Second, policies addressing these constraints have to be designed so that the conditions attached to the support can be credibly enforced in that political settlement
- The absence of organizational capabilities in firms has to be recognized as one of the most critical constraints blocking the creation of significant job opportunities
- Aid programmes targeting the business environment should seek to create *credible* incentives for firms in advanced countries to transfer some of the tacit knowledge of organizational capabilities to firms in developing countries