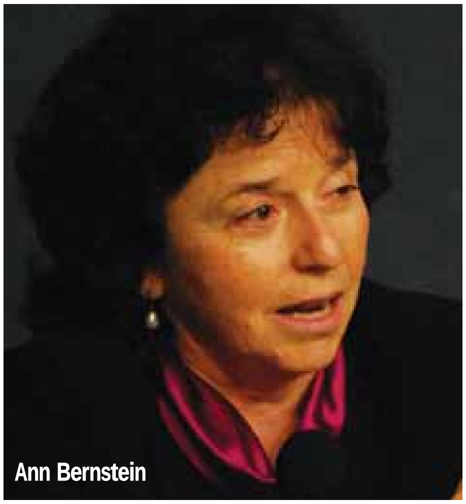
Global Development and the Benefits of Business

With the right institutions in place, free markets provide the potential for enormous economic growth. But establishing those institutions, especially in countries without a history of good governance and the rule of law, has proved notoriously difficult. Some developing nations have successfully taken advantage of market-driven prosperity, while others fail to thrive. In September Ann Bernstein, founding director of the Centre for Development and Enterprise in Johannesburg, spoke about the need for businesses to stand up to anti-market activists. That same month, Ejaz Ghani, economic adviser to the World Bank, discussed the growth of the service sector in India and what other countries can learn from it. And in October, Greg Mills, director of the Brenthurst Foundation in South Africa, told of his experiences working in Africa and the roadblocks that still inhibit African economic progress.

ANN BERNSTEIN: I spent some time in Washington a few years ago and was struck by what I heard. It soon became apparent that a "good" company was one that complied with so called global standards (labor, environmental, and social issues), devised by activists/interests/governments in some of the world's richest countries, on how companies should behave in poorer countries. You can participate in conversations in London, Brussels, Washington, or New York, and it is taken for granted that global standards are a good thing. No one wants to hear the ex-president of Mexico who argued that, just as goods and services from poorer countries are starting to become globally competitive, rich countries want poorer countries to conform to standards that have taken the rich centuries to reach. People don't want to listen to more than 2,000 trade unions in India, who oppose these labor standards. Nobel Laureate Paul Krugman and others have argued that it's important to understand that the alternative to low-paying jobs is not high-paying jobs—it's no jobs at all.


Ann Bernstein

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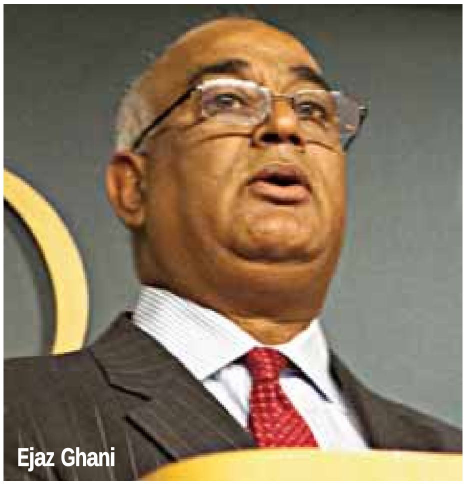
Companies are continually pressured to "do more," to demonstrate what benefits they provide society in addition to "just making money." It's as though profit-making has to be redeemed through good works; and companies must pay reparations for their existence. The current conversation about business is fundamentally flawed. The debate about "responsible" corporations takes for granted the everyday activities of companies and their contribution to society. This then makes it possible to focus so much attention on what else a company must do to contribute to society. These attitudes have led to the development of the "corporate social responsibility" industry. In almost all cases, business leaders have given in to these attacks without a struggle and accepted the general charge that companies need to do more than "just business" to contribute to society. Instead of a bold and persuasive case for business, we have seen a process of appeasement.

Any conversation about business, what it does, and what it should do needs to take place within a comprehensive understanding of what "just doing business" actually contributes to society. You can divide normal company activities into direct and indirect impacts. What are the direct impacts? Modern business is the most powerful engine of innovation, large-scale organization, and transmission of know-how across frontiers. That's in addition to "minor" things like creating wealth and jobs, and paying taxes—things we all depend on. The limited liability corporation has been called the greatest single accomplishment of modern times. It is the mechanism through which companies increase the pool of capital available for productive investment and allow investors to spread their risk by purchasing small, easily marketable shares in several enterprises. It provides a way of imposing effective management structures on large organizations and has the capacity to fail with relatively low social costs.

Companies are uniquely effective in making human effort productive. Specialized resources in the form of labor, raw material, capital, and knowledge come together in a remarkable process that transforms those components into goods and services of greater value. By doing this, companies make a revolutionary contribution to the world. Participation in private enterprise is an important source of intangible but vital benefits such as openness to ideas, innovation, opportunity, and empowerment. When dynamic enterprises are allowed to flourish, they tap into people's initiative, ingenuity, and self-reliance. When people participate in an economy by creating or joining an enterprise, they gain voice.

Modern businesses also have indirect impacts, predominantly positive, on the societies in which they operate. I call this invisible corporate citizenship. It's not discussed in company board rooms, it's not what they intend to do. But if you look at the inadvertent impact of enterprise and corporate activity you can discern a number of profoundly important phenomena. Walmart's everyday low prices bring down inflation; Toyota's just-in-time productivity changes the Western world's production curve; Infosys becomes a global competitor out of Bangalore and redefines what is possible for India. The so-called sweatshops in Asia turn out to be the best possible opportunity for empowerment for mainly rural women, changing their lives and those of their daughters. If you go into so-called sweat shops in Asia you find that it is disproportionately women working in often unpleasant conditions in what we would see as horrible jobs. But they often ask to work longer hours and overtime. They know that the number of years they can do these jobs is limited. They intend to save money and either go back to their rural areas—where they are now independent, no longer under the thumb of a husband, father, brother—or they start small businesses servicing workers in factories or rural areas. The opportunity to get a job that to us looks awful is, in fact, the best alternative open to them; a first step on the ladder of opportunity and modernity.

Through the unintended consequences of its everyday activities, business can transform the future of national economies (think Mauritius), fuel the forces and dynamics of modernization (China, Vietnam), expand and strengthen civil society (companies investing in new markets need certainty, resulting in their lawyers/accountants influencing the shape of emerging markets), expand human rights, and unleash pressures for democratization (apartheid South Africa saw companies recognize black trade unions and start to operate on a more equal basis in the workplace before democratization).



Ejaz Ghani

"The old idea of services being non-tradable and non-scalable no longer holds for a host of modern services."

There's a lot of pressure on companies to get involved in doing something about global poverty. This is a rather strange conversation, both about the nature of development and the obligations people want to put on business. Well-known companies sign on to the Millennium Development Goals and tell us how they are contributing to their achievement. But companies should stop signing on to other people's agendas. They should work out what their agenda is with respect to development and promote that. If you were to ask any multinational corporation wanting to work or invest in Africa "what are the top three issues you think should be dealt with to make you more likely to risk investing money in that continent?" they would talk to you about infrastructure for growth and how to improve the environment for business. These aren't mentioned in the millennium development goals. And countries can only have a limited number of priorities.

The ongoing conversation about business and society is dominated by activists who live in rich countries. Most of them, living in formal houses with hot and cold running water, do not grasp the realities of poverty in developing countries and the hard choices of development outside the rich world. As a result, the debate about business responsibility, corporate involvement, and development is distorted, and few voices from developing countries are heard. We need a new discourse on how to think about business and the public good. The current approaches are not effective and have dangerous consequences.

Business has a profound interest in how societies understand capitalism and business. Recent research by a *Newsweek* journalist on German textbooks and what they say about capitalism and business produced stunning results. Whether in an ordinary school in Germany, or a reputable university, textbooks ascribe all manner of evils to companies and capitalism. Companies should take more interest in that issue.

Companies, businesses leaders, and their organizations need to play a more thoughtful, strategic role in the societies in which they operate. The past 40 years have seen smart states opening their societies to more enterprise and more competition from local and foreign firms, with phenomenal results: more people have moved out of poverty than ever before, and more quickly then we have ever seen. Businesses leaders should recognize the importance of the battle of ideas. Business is good for societies and essential for sustained development. The question is how companies can become more effective at making this case. They should stop apologizing for their very existence and stand up for what they do every day. The facts are on their side.

EJAZ GHANI: The growth experienced by India in the 21st century is remarkable because it contradicts a seemingly ironclad law of development, one that has held true for almost 200 years. That law, which is now conventional wisdom, says that industrialization is the only route to rapid economic development and that, as a result of globalization, the pace of development can be explosive. But the potential for explosive growth is no longer distinctive only to manufacturing. India's growth patterns suggest that service is as dynamic. This service revolution fundamentally changes the pattern of development for many developing countries and for Africa.

The service revolution upset three long-held tenets of economic development. First, services have long been thought to be driven only by domestic demand. They could not by themselves drive growth, but instead follow growth. In the classical treatment of services, any attempt to expand the volume of service production beyond the limits of domestic demand would quickly lead to a deterioration in the price of services, a reduction in profitability, and the impulse to choke off expanded production.

Second, services were considered to have lower productivity than industry. It is hard to improve the labor productivity of a symphony, or as it turns out, of a government. As economies began to become more service oriented, their growth would slow down. For rich and advanced countries with high demand for various services, the slowdown in growth was an acceptable consequence of the higher welfare achieved by the shift toward services. But for developing countries, this tradeoff was thought to be inappropriate.

Third, service jobs in developing countries were thought of as menial, and for the most part poorly paid, especially for low-skilled workers. As such, service jobs could not be an effective pathway out of poverty.

India's growth pattern upsets all three of those beliefs. Growth in India has in fact been led by service's labor productivity. Levels in services productivity are above industry—and productivity growth in services matches labor productivity growth in manufacturing in China. Services are the largest contributor to GDP growth in India. The service sector accounts for more than 50 percent of GDP growth in all South Asian countries. Its contribution to GDP growth is nearly twice that of industry. Further, contribution of services to overall GDP growth has increased over time in India. This is in sharp contrast to the situation in China, South Korea, and Japan, where industry contributes much more


Greg Mills

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than services to GDP growth.

Given that the process of development is one of transferring resources—largely labor from low- productivity areas to high-productivity areas—it makes sense to interpret rapid growth in India as the result of moving labor from low-productivity agriculture to high-productivity services. India has experienced an exponential increase in service exports at a rate that exceeds even the rapid growth of China in manufacturing exports. This suggests that service exports are a key component of service-led growth.

Can service growth reduce poverty? Does it create jobs? Does it contribute to gender parity? Our results show that trend growth in the service sector among Indian states is associated with a decrease in the poverty rate. In fact the service sector is the only sector showing a statistically significant association with poverty reduction. And service-sector growth is strongly associated with the reduction of both urban and rural poverty rates. Service jobs are good jobs. Wage growth has been higher in the service sector than in manufacturing and agriculture in recent years in India.

The old idea of services being non-tradable and non-scalable no longer holds for a host of modern services. Under the right circumstances, the service sector can demonstrate significant labor and productivity growth.

Is there hope for the "bottom billion"? India's experience offers hope that globalization of service can indeed be a force for development in many more countries. The marginalization of Africa during a period when China and other East Asian countries grew rapidly led some to wonder whether latecomers to development were doomed to failure. The process of globalization in the 20th century led to a divergence of incomes between those who industrialized and broke into global markets and the bottom billion in some 60 countries where incomes stagnated for 20 years. It seemed as if the bottom billion would have to wait their turn for development until after the giant industrializers like China became rich and uncompetitive in labor-intensive manufacturing.

The promise of service revolution is that countries do not need to wait to get started with rapid development. There is a new boat that development latecomers can take. As the number of services produced and traded across the world expands with globalization, the possibilities for all countries, developed and developing, are enormous.

GREG MILLS: Let me give two very short examples of some of the potential Africa has to move in the right direction.

In Rwanda, I met a man named Frank Butara who had a great idea for a taxi business. He was looking to access finance for it but he was not able to put together a business proposal. For all of the money spent by the World Bank and other institutions in Rwanda, there was no place Frank Butara—who was almost illiterate—could take his idea and get it turned into a business plan,

Continued on page 17

Continued from page 11

get some accounting injected into it, and then go away and raise some capital.

I helped him with this, putting together a business plan with him staring over my shoulder. He had the difficult job of getting some money. He had some cars that he'd bought from Uganda, where he had been in exile for 30 years, and he offered some of those cars as a down payment, but he still needed extra cash. I went to the head of a bank, whose CEO I used to let beat me at tennis on a regular basis. I managed to get a loan from him, but Frank was still short. At the end of the day, I became a rather reluctant investor in a Rwandan taxi business.

But really this should never have happened. There should have been a system out there to take Frank's idea forward, to provide him with the incubation and innovation processes necessary to take his idea and make it happen. But that's only half of Frank's problem. He is focusing on tourism, the movement of tourists around the country, and the numbers are always going to be limited. Tourism in Rwanda maxes out at the number of people who can see gorillas, which is just under 20,000 people a year.

To develop other tourism products Rwanda needs to liberalize the airspace and hotel accommodations and allow foreign investors in. Don't just give them the rhetorical welcome and then squeeze them out again, which has happened on a number of occasions. But actually go through with the ideas, remain open, liberalize the airspace, and stop protecting the very small and frankly inefficient assets that they have.

This is a problem for many African countries. They are caught between the desire to retain control and the realization that the only way they are going to have long-term stability is by letting go. This tension between control and liberalization remains all the time. Of course tourism is one of the comparative areas of advantage that Africa possesses. The global tourism business is a nearly one- billion-visitor industry. Yet Africa as a whole gets only 4 percent of this total. We need to change the things we can change in order to access a much larger slice of the pie. Even if we increased it by just 50 percent, we'd be transforming life for many Africans. We need to change visa regimes as well. Members of OECD countries richer than we are, with a higher per capita income, shouldn't need visas to visit Africa because they are unlikely to stay. People from those countries shouldn't need work permits either for the same reason.

My second example comes from the root diagnostics that we have conducted throughout Africa. A root diagnostic is not some painful piece of invasive surgery. It's sitting on a truck and doing motion studies. We've done them from Johannesburg to the Congo, in East Africa, and through a Kasabonika border post where Dante's *Inferno* meets *Mad Max* on steroids. The results are always the same. The trucks stop for one-third of the time for the driver—eating, sleeping, and so on. One-third of the time is spent actually driving. And one-third of the time the truck is stopped at border posts.

The sheer inefficiency of that explains why, for example, it costs $5,000 to move a container from Kinkaili to Mombassa, and only one-third of that to move it from Mombassa to Rotterdam. Things can be changed, for a positive impact, with relatively little work. But it means that African governments have to give up a lot of their control.

The former British foreign secretary Malcolm Rifkind once said that the only thing dark about Africa was our ignorance of it. We need to stimulate more debate as we seek the means to help my continent find its global place and put people, rather than narrow-minded politics, first.