DONOR COMMITTEE FOR ENTERPRISE DEVELOPMENT

STUDY REPORT

# Promoting Economic Transformation through Market Systems Development

MARKET SYSTEMS DEVELOPMENT WORKING GROUP

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**Promoting Economic Transformation through Market Systems Development**

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# Executive summary

The Donor Committee for Enterprise Development (DCED) Working Group on Market Systems Development is interested in understanding how donors can better support economic transformation using a market systems development (MSD) approach. To-date there has been no comprehensive examination of how the MSD approach might be useful in promoting economic transformation: that is, in supporting the re-allocation of resources from low-productivity to high-productivity activities. This report seeks to understand the role that MSD currently plays in promoting transformational change, and how the MSD approach could be adapted or modified to better promote economic transformation in future.

Findings are based on a desk review of academic and grey literature, focusing on Sub-Saharan Africa, and 26 telephone interviews with all members of the Working Group and a number of their colleagues.

MSD has many points of intersection with economic transformation at the micro, meso and macro levels. Available evidence shows that MSD programming is currently contributing to economic transformation processes, with 85% of MSD programmes broadly aligned to transformational change objectives. However, these programmes primarily support within-sector productivity, especially in agriculture.

In the context of Africa, it is clear that raising agricultural productivity is – and will continue to need to be – an important component of any strategy for *inclusive* economic transformation. There is, however, an opportunity for MSD to play a number of other roles in supporting different types of transformational change:

- **Seeding** innovation in new and emerging sectors, or addressing 'rules of the game' constraints to allow these innovations to prosper.
- **Scaling** modern sectors that are already showing promise for economic transformation, such as the so-called 'industries without smokestacks', helping to ensure that opportunities are equitably distributed and can translate into lasting pro-poor impact.
- **Supporting** economic livelihoods in sectors where people in poverty are currently engaged, including through raising on-farm productivity, at the same time as diversifying rural employment opportunities in complementary sectors, such as tourism.

In order to realise a greater role for MSD in supporting economic transformation, a number of adjustments can be made to the approach, both conceptually and operationally. These include:

- Adapting how sector selection criteria are applied in practice in order to align with structural change objectives,
- Engaging more in the 'rules of the game' and addressing political economy constraints to inclusive economic transformation processes,
- Getting clarity and consistency about what systemic change means in the context of transformational economic change,
- Introducing a more strategic approach to portfolio management both within and between programmes,
- Utilising a broader range of facilitation tools.

There are a number of immediate actions that donors and development agencies can take to respond to these findings. These include setting clear expectations for how they want MSD programmes to 'work politically'; ensuring the 'enabling conditions' are in place for MSD programmes to support economic transformation; and commissioning in-depth research and case studies on systemic change, inclusive growth and competition/value-addition in the context of economic transformation.

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# Introduction

The Donor Committee for Enterprise Development (DCED) Working Group on Market Systems Development is interested to learn how donors can support economic transformation using a market systems development (MSD) approach[1].

To-date there has been no comprehensive examination of how the MSD approach might be useful in promoting economic transformation: that is, in supporting the re-allocation of resources from low-productivity to high-productivity activities. Nor has the role that donors and development agencies might play in using the MSD approach to support economic transformation been examined.

Given the potential alignment of MSD and economic objectives, the Working Group would like to address six core questions, clustered around two lines of inquiry:

(1) What does current evidence suggest about the role that donor-funded MSD programming plays in promoting both structural and intra-sectoral economic transformation?

- What are the particular challenges that confront donors in promoting economic transformation?
- What aspects of the MSD approach have potential to support economic transformation?
- What are the limitations of the MSD approach in relation to support for economic transformation?

(2) How could the MSD approach be modified or adapted, including through combinations with other forms of support, in order to better promote economic transformation?

- What are the implications of an economic transformation agenda for MSD programming?
- Are additional criteria needed for MSD sector selection? If so, what are they?
- Where is the greatest potential for coordinating MSD with other forms of support to PSD?

[1] This work is being carried out in parallel and coordinated with a related study commissioned by the DCED Business Environment Working Group (BEWG) examining how Business Environment Reform can support economic transformation. This study is referenced through the text as Gelb, et al., 2019

The report presents detailed findings based on a desk review and interviews with donor agencies. This introduction is followed by four sections, discussing:

- Drivers of economic transformation and alignment with market systems development.
- Donor and development agency perspectives on using MSD to promote economic transformation
- How MSD practice could be modified or adapted to better promote economic transformation
- Conclusions and recommendations, focusing on practical implications and guidance for donors.

A full list of study deliverables is outlined in **Annex 1**. The list of key informants interviewed is in **Annex 2** and the methodology in **Annex 3.** The Terms of Reference are included in **Annex 4.**

# 1. Drivers of Economic Transformation and the role of Market Systems Development

This section first provides clarity on the definitions of economic transformation and Market Systems Development (MSD). It then summarises what we know about the link between MSD and economic transformation based on a review of academic and grey (programme documents and online) literature, focusing on Sub-Saharan Africa. The section also discusses whether and how MSD is currently focused on activities that can be considered transformational.

## 1.1 Why focus on Economic Transformation – and what is it?

While not a new concept, there has recently been revived interest in the issue of economic transformation[2]. When governments united behind a Common African Position to input into the formulation of the Sustainable Development Goals (SDGs), for example, economic transformation was the first of six priority pillars they identified[3]. There is consensus that Africa needs more than just economic growth, and that it is not only the *quantity* of growth that matters, but its *quality*. Such concerns are driven by the fact that much of Africa's recent growth has been fuelled by commodities, particularly oil and mineral extraction, and gains have not been 'broad-based' but reliant on a narrow set of sectors[4]. As a result, issues of low productivity, stagnant wages and high youth unemployment persist in many African countries that have recorded high growth[5].

Available literature provides a range of definitions of the term 'Economic Transformation'. For the purposes of this study, we align with the definition by McMillan (2017), which is also used by the parallel paper on *Promoting Economic Transformation through Business Environment Reform (ODI, 2019)*[6]. This defines economic transformation as the process of moving factors of production from low to high productivity activities. It includes both the *structural* reallocation of resources towards higher-productivity sectors to raise aggregate productivity in the economy, and *within-sector* (or *intra-sectoral)* shifts towards higher-productivity activities, within and between firms.

In short, structural change is usually seen as moving labour out of 'traditional' sectors – namely agriculture – into more 'modern' and more productive sectors, such as manufacturing and services[7]. Sector productivity improvements, on the other hand, entail the adoption of new technologies, management practices and production methods that increase output efficiency. These can come

[2] There is also renewed interest in the closely connected topic of 'industrial policy', conceived as active promotion of structural change and new economic activities of high potential in all sectors (e.g. Chang, 2015; Rodrik, 2007).

[3] AU, 2014; Ansu, 2014

[4] 14 of the 17 highest growth African countries between 2008-13 can be classified as resource-dependent (Finnan, 2018; Tarp, 2018)

[5] Ansu, 2014

[6] Appendix A of the Gelb, et al. 2019, paper provides an overview of theoretical definitions of concepts related to transformation

[7] Gelb, et al., 2019

about as a result of innovations within firms, or as a result of the reallocation of resources away from the least productive firms towards more productive firms[8].

Productivity is a key factor in determining the competitiveness of individual firms, industries and the economy as a whole - and therefore in shaping the prosperity of a country. There has long been efforts among policymakers and in international development circles to attempt to understand and influence shifts in the share of output and employment and the role they play in sustained improvements in economic welfare[9]. In the words of one of the leading development economists associated with 'new structuralist' thinking, Dani Rodrik writes that:

> *"One of the earliest and most central insights of the literature on economic development is that development entails structural change. The countries that manage to pull out of poverty and get richer are those that are able to diversify away from agriculture and other traditional products. As labour and other resources move from agriculture into modern economic activities, overall productivity rises and incomes expand. The speed with which this structural transformation takes place is the key factor that differentiates successful countries from unsuccessful ones"* [10].

Africa, however, has a productivity problem[11]. While it is true that in many countries around the world labour productivity has remained stagnant over the past decade, productivity in Sub-Saharan Africa is particularly low – and remains the region which has the greatest differences in productivity between sectors[12].

The World Bank Chief Economist for Africa attributes low levels of productivity to both inefficiencies in the use of technologies (misallocation) and low stock of human and financial capital (undercapitalization)[13]. This, in turn, negatively affects decisions by farms and firms to invest in new technologies or methods of production (perpetuating the low-productivity problem); and is further compounded by weak institutions and inadequate policies that lead to an inefficient allocation of talent and bad occupational choices[14].

While there has been signs in Africa since the turn of the millennium of nascent structural transformation out of agriculture, this has mostly been into the services sector, not manufacturing (see Box 1). According to Fox et al (2017), the shift has actually *lowered* relative productivity in services, "in part because much of the movement was into lower-productivity nonwage

[8] Breisinger and Diao, 2008

[9] Fox, et al., 2017

[10] McMillan, et al., 2017

[11] Here we refer to both single factor productivity measures (labour and capital) and multi-factor productivity. For more, see OECD, 2001

[12] Tarp, 2018

[13] World Bank, 2018

[14] For example the overwhelming aspiration – and expectation - among youth that they can secure jobs in the civil service and see the private sector as a temporary 'stop gap' solution. See the ILO's School to Work Transition surveys.

employment"[15]. Consequently, many economies in Africa remain characterised by high levels of informality, a large number of inefficient micro-enterprises and a 'missing middle' with very few medium-sized firms that provide opportunity for specialisation. Informality is a particularly critical issue, not least as the most unproductive enterprises tend to be the smallest, but also because surveys from Africa show that even among the smallest of enterprises, the productivity of formal enterprises is 120 per cent higher than that of informal enterprises, while wages are 130 per cent higher[16].

On the other hand, this productivity gap presents a significant economic transformation opportunity in Africa. Figure 1, below, sets out a high-level Theory of Change (ToC) for economic transformation[17]. Here we do not seek to replicate or summarise the vast literature on economic transformation, but to briefly frame 'what we want to see happen' (and what is reflected in national development plans and donor support strategies) - before exploring 'how can we help make this happen' using a market systems development approach.

The drivers of economic transformation are well summarised in Gelb, et al. (2019), and reflected in the ToC in Panel A. The non-exhaustive set of framework conditions as well as both the stock and flow of resources that need to be in place to kick-start transformation processes include:

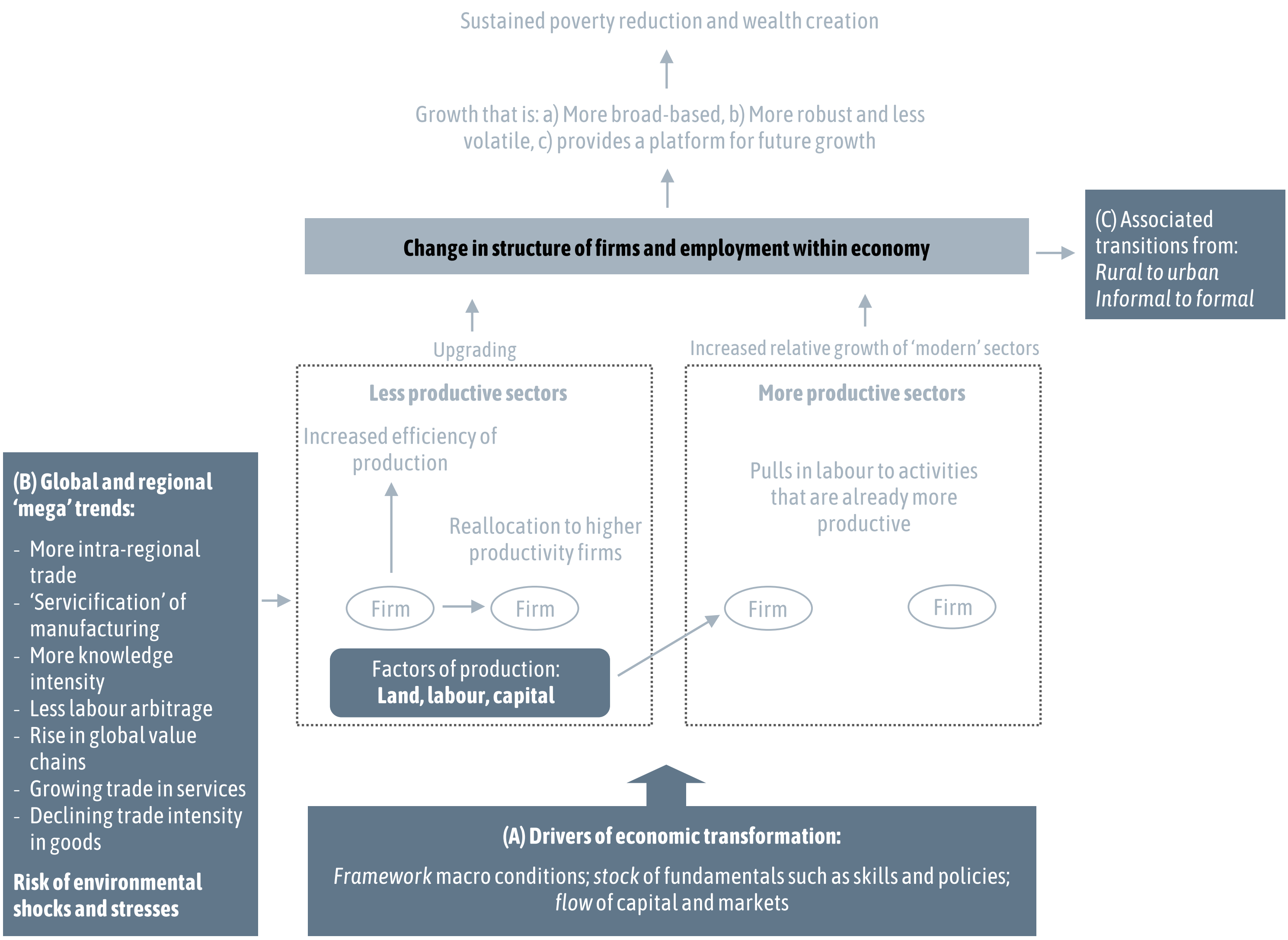
- *Framework conditions:* A stable political and macro-economic environment and a degree of autonomy of the State from business, i.e. close but arms-length so as not to protect industries at any cost
- *Stock of 'fundamentals*' such as rule of law, regulatory environment and property rights; along with adequate education, skills and infrastructure
- *Flows of foreign direct investment* (FDI) and firm participation in international trade and global value chains; so as to provide access to higher value-added markets, alongside the knowledge and networks and exposure to new technologies

Panel B shows how country-based economic transformation is influenced by global mega trends[18]. Some trends such as digitisation will provide an opportunity for African economies to 'leapfrog' straight to more transformative technologies – in the same way as many consumers in Africa leaped from having no phones to having mobile phones, avoiding a landline – especially with increased levels of integration into regional and global trade flows. At the same time, other exogenous factors such as climate shocks and security or geo-political shocks - of which many countries are particularly vulnerable - may pose a threat to the success of transformation efforts.

[15] Fox, et al., 2017
[16] ILO, 2015; R. La Porta and A. Shleifer, 2011
[17] Based on IMF, 2014, Gelb, et al., 2019 and McMillan, et al., 2017
[18] McKinsey, 2019 and Pritchett, 2018

If successful, the process of economic transformation can "set in motion many virtuous circles or positive feedback loops"[19]. Technological advances and productivity growth in agriculture can reduce rural poverty rates and decrease the vulnerability to climate shocks[20]. Seen in Panel C, Transformation is also associated with other aspects resulting from the declining share of agriculture in employment, such as demographic shifts, urbanization and an increase in the number of registered enterprises that, in turn, can increase tax revenues for public expenditure[21].

*Figure 1: A Theory of Change for Economic Transformation*[22]




[19] Brahmbhatt, et al., 2016
[20] Ibid.
[21] Timmer and Akkus, 2008
[22] Based on McMillan, et al., 2017

**Box 1: Recent experiences of economic transformation in Africa**

In Sub-Saharan Africa, manufacturing growth has remained modest (Brahmbhatt, et al., 2016)[1]. Data shows that Africa's share of global manufacturing is in fact smaller today than in 1980; leading commentators to claim the continent is experiencing a 'deindustrialisation' (Tarp, 2018).

According to Newfarmer et al, the movement of workers from low- to high-productivity employment has contributed far less to growth in Africa than in other fast-growing developing regions. They state that Africa's higher productivity sectors, including manufacturing, "failed to generate enough jobs to absorb a rapidly growing labour force, and the share of workers employed in high productivity sectors declined, reducing aggregate growth of output per worker".

Their publication, 'Industries without Smokestacks', calls for a broader definition of the 'modern sector' when thinking about structural transformation in Africa, noting that in today's global economy the lines between manufacturing, services and agriculture are becoming increasingly blurred. Sectors such as horticulture, agro-processing and tourism, along with a suite of service industries such as business services, transport services and tradable services (such as ICT) share many of the same characteristics of traditional manufacturing when viewed through a transformation lens. This includes the potential to employ large numbers of unskilled workers, place a premium on innovation, and are often integrated into international trade. These 'industries without smokestacks' have the potential for "strong within-sector productivity change and contribute to raising productivity in other sectors of the economy".

## 1.2 The Market Systems Development approach

A market system refers to an arrangement of actors (organizations and individuals) who produce and exchange a similar type of product, good or service or provide various market-supporting functions, such as access to information or finance. These actors may include both public agencies and the private sector. They operate within a set of formal rules and informal norms that shape actors' behaviours and influence the overall performance of the system[23].

Market Systems Development (MSD), in turn, seeks to address the root causes of *why* market systems often fail to meet the needs of people living in poverty[24]. MSD programmes aim to catalyze systemic changes that improve the participation of target groups (such as people living in poverty, youth, marginalized groups) within the market system[25].

[23] This section is adapted from the BEAM Exchange: The market systems development approach, A brief definition & description
[24] See https://beamexchange.org/market-systems/key-features-market-systems-approach.
[25] BEAM Exchange, 2015. Also referred to as 'systemic change' or 'system-level change'

MSD does not prescribe a set of 'blueprint' interventions or a menu of policy prescriptions. Rather it is an *approach*: a suite of principles and practices to help understand contextual market systems, and to guide practical interventions that can lead to enduring pro-poor market system change. The three central features are[26]:

- *Analysis-led*. Undertaking a thorough analysis of how and why systems function as they do – identifying the changes that appear to be key to reducing poverty;
- *Intervention through facilitation.* Catalysing desired behaviour changes that build on genuine incentives and capabilities of permanent market actors to succeed in the long-term;
- *Embracing complexity*. Systemic change is neither straightforward nor predictable, so finding viable pathways to pro-poor change requires time, curiosity and experimentation. This means deploying flexible and adaptive management techniques, alongside a commitment to ongoing learning.

The ultimate concern of MSD programming is to work towards the:

- *Sustainability of change*: so that people living in poverty continue to derive social and economic benefits beyond the period of intervention
- *Scale of impact*: change leads to improvements in the livelihoods or well-being of large numbers of women and men living in poverty beyond the initial intervention locations

MSD is a *targeted* approach in that it focuses on constraints to more inclusive growth in specific sectors, addressing under-performing 'functions' (supporting markets such as skills, finance and infrastructure) and 'rules' (formal rules and regulations and informal norms).

## 1.3 Links between Economic Transformation and Market Systems Development

The aim of this section is to understand how MSD aligns with economic transformation objectives of shifting resources to high-productivity activities. It is based on theoretical literature on economic transformation, as well as the conceptual underpinnings of MSD and an emerging body of knowledge on how these concepts have been translated into MSD in practice[27].

First, it is important to stress that MSD is an explicitly pro-poor approach, concerned with improving the performance and position of disadvantaged groups within market systems. A central focus in our discussion of economic transformation therefore needs to on aspects of *inclusive* economic transformation; paying attention to how productivity gains are shared and distributed throughout

[26] As such, the approach shares many similarities to other initiatives that look to eschew simple or predetermined recipes to solve the complex challenges of poverty reduction and sustainable development. For example: Doing Development Differently, Problem-Driven Iterative Adaptation, Thinking and Working Politically

[27] We note, however, that there is currently very sparse literature formally linking MSD with economic transformation. The section is therefore based on the authors' own interpretation of the potential connections.

the economy. There is, as noted by the Gelb, et al. (2019) study, “genuine concerns that economic transformation may fail to reach the poor… [as] there are different types of [transformation processes] with different effects on the poorest within society,”.

Second, it is helpful to differentiate between MSD as an over-arching poverty reduction *approach* and the particular *areas* where MSD has been used. MSD can be flexibly applied across a variety of sectors, value chains and industries. It has been deployed in thematic areas such as private sector development, WASH and education; for specific market functions or rules such as infrastructure, finance and skills; and towards diverse programming areas such as refugee livelihoods and child labour. Here, we focus on the alignment of MSD as an approach (‘how to intervene’), rather than the almost limitless applications of MSD (‘what/where to intervene’).

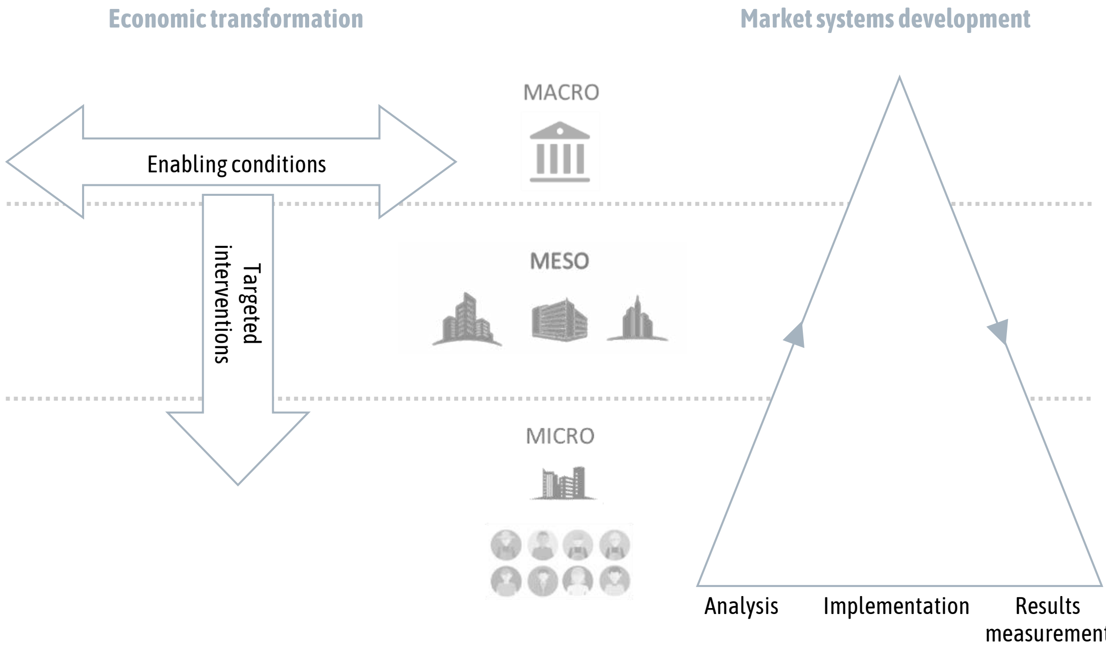
### 1.3.1 Alignment of focus: What are the entry points?

There are thought to be two ways to support economic transformation processes[28]. The first are ‘enabling’ policies. For structural change, these seek to establish conditions to catalyse investment and promote the movement of resources from lower-productivity to higher-productivity employment. For sector productivity, enablers include putting fundamentals of infrastructure, skills and institutions in place. The second is interventions that ‘target’ a specific segment of economic activity. For structural transformation these are measures to support higher-productivity sectors, such as tax incentives and export promotion. Within sectors, ‘targeted’ interventions can help firms to step-up their productivity by accessing enhanced technologies and adopting improved management practices such as ‘just in time’ inventory management.

The Gelb, et al. (2019) study concludes that economic transformation covers productivity change at macro, meso and micro levels[29]. This leads to **many points of intersection with MSD**. MSD starts and ends with an understanding of the performance and position of (groups of) disadvantaged individuals within market systems[30]. MSD, however, ‘zooms out’ to focus on a variety of under-performing rules and functions, such as social norms, standards and services. These so-called ‘interconnected’ systems may take the programme beyond their initial narrow sectoral boundaries to ‘meso’ issues affecting clusters of industries, such as infrastructure or logistics, or even to ‘macro’ issues affecting the whole of an economy, such as the investment climate or public procurement. Eventually, however, MSD programmes have to ‘zoom in’ again to trace how changes in the wider market system are affecting micro-level changes in firms and target groups. As shown in Figure 2, below, the dynamic focus of MSD programming means it has the potential to cut across many different ‘levels’ of economic transformation, depending on the context.

[28] McMillan, et al., 2017
[29] Gelb, et al., 2019
[30] Groups can be defined in many ways such as by sex, poverty status, youth or geography.

*Figure 2: Simplified and stylised focus of MSD and economic transformation*




In sum, economic transformation can be both sector agnostic (enabling) or targeted (to specific sectors), while MSD is always targeted – it can tackle issues that go beyond the boundaries of specific sectors. Therefore, even though economic transformation is typically more focused on changes in the structure of economy over time, this is not incompatible with MSD. There is also increased attention on linking transformation issues to the micro-level of firms and households, in particular on their new productivity capabilities and their ability to compete in "larger and more distant markets on a growing scale"[31]. Table 1 summarises the points of intersection, providing illustrative examples of notable MSD programmes.

*Table 1: Points of intersection between MSD and economic transformation[32]*

| Level | Economic transformation focus | MSD focus | Where illustrative MSD programmes have had a notable impact |
|---|---|---|---|
| Macro | Enabling conditions and economic fundamentals | Functions and rules at the level of policy and economy | ▪ ENABLE, Nigeria: *Improving public-private dialogue*<br>▪ FSD Africa: *Financial Sector development* |
| Meso | Sector-specific conditions and targeted interventions | Sector-specific functions and rules | ▪ MDF, Pakistan*: Improved skills for local leather manufacturing*<br>▪ M4C, Bangladesh: *Improved services for geographically vulnerable farmers* |
| Micro | Determinants of growth and productivity at the firm level | Business models and practices; target groups | ▪ BIF, Myanmar: *Modern management practices in garment manufacturers*<br>▪ Katalyst, Bangladesh: *Smaller seed pack sizes for farmers* |

[31] As noted in McMillan, et al., 2017
[32] Source: Ibid. and Bekkers and Zulfiqar, 2018

### 1.3.2 Alignment of objectives: Is transformation inclusive?

No modern economy has been able to develop and prosper without undergoing a process of structural transformation. The theory of successful transformation, according a study by the Centre for Global Development, is that:

> *"A dynamic agriculture raises labour productivity in the rural economy, pulls up wages, and gradually eliminates the worst dimensions of absolute poverty. Somewhat paradoxically, the process also leads to a decline in the relative importance of agriculture to the overall economy, as the industrial and service sectors grow even more rapidly, partly through stimulus from a modernizing agriculture and migration of rural workers to urban jobs"*[33]

This is been borne out by empirical experience, where data shows that a declining share of employment in agriculture is positively associated with increases in GDP – which translates into higher standards of living and sustained reductions in poverty. Evidence from academic literature and policy papers is clear: "the long-run success of poverty reduction hinges directly on a successful structural transformation" [34].

However, there is significant tension between long-term and short-term impacts, and the trade-off between them. A recent paper by the UK's The Independent Commission for Aid Impact, for example, noted that economic transformation "may not immediately benefit the poor, while the contribution to poverty reduction through employment creation may be long and uncertain"[35].

Indeed, historical data shows that there is a "pattern of worsening income distribution between rural and urban economies during the initial stages of the structural transformation"[36]. During periods of rapid growth, the share of agriculture in GDP falls faster than the share of agricultural labour in the overall labour force. In other words, farm incomes fall even further behind incomes being earned in the rest of the economy[37]. Unless growth is sustained, the result is income divergence and growing inequality – a particular problem for Africa where growth tends to be 'start-stop', with periods of rapid expansion followed by stagnation (see section 1.3.3) [38]. As research has shown, wide income disparities among sections of the population are hampering human development in Africa, creating a vicious cycle where worsening inequality hampering prospects for further sustained transformation[39].

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[33] Timmer and Akkus, 2008
[34] Ibid.
[35] ICAI, 2017
[36] Timmer and Akkus, 2008
[37] Timmer and Akkus, 2008
[38] Ibid. This risks a 'Dual Economy': For example, Mexico in 1950's and 60s, where transformation bypassed small farmers vs broad-based smallholder growth in Thailand, combined with the gradual development of a labour-intensive, export-oriented manufacturing sector
[39] UNDP, 2015

Effects are also felt differently at the aggregate and individual levels. People adapt and behave differently in the face of new economic opportunities (and threats)[40]. Labour market frictions, social norms, level of skills and personal preferences mean that workers cannot move "costlessly from one industry to another, or from one region to another"[41]. As Fox (2017) writes, "not all transformations are the same"; and whether transformation translates into increased opportunities for people living in poverty will be contextual. However, it cannot be assumed that benefits are automatically or equitably shared. People risk being 'left behind' by economic progress, fuelling not only continued poverty but increased resentment and unrest. Transformation, in short, can create both winners and losers[42].

The core challenge is that, as noted by Lin (2009), many developing country governments currently do little to compensate the losers. There is consensus in the literature that resisting or trying to reverse transformation does not work (and in fact can worsen impacts on the poor), but there is less agreement about 'what works' to ameliorate the distribution consequences of transformation:

- Poverty reduction will be faster if there is growth in sectors with a high demand for unskilled labour, such as manufacturing and construction [43]
- Government interventions to keep staple foods cheap and accessible can help households 'hang in'[44]
- Investing in better local education and health can boost the capacity of the poor to cope with change and to participate in its benefits
- Successfully integrating rural and urban sectors, including developing modern cross-sectoral services (including for agriculture) and connecting rural laborers to urban jobs

There is no generally accepted definition of what can be considered *inclusive* economic transformation. However, we can extract some key features from the literature.

USAID's market systems framework defines inclusion as "delivering a sustainable flow of benefits to a range of actors, including the poor and otherwise marginalized, as well as to society as a whole" [45]. In order to be inclusive, therefore, any transformation process has to reflect – and balance - both short-term and long-term needs. The World Bank definition of inclusive growth is economic growth that is "inclusive of the large part of the country's labour force[46]. As jobs are a main driver of development and pathway out of poverty; the 'job rich' nature of transformational change is therefore of central importance. These should also not be any kind of jobs, but move people towards productive

[40] Fox ,2016
[41] Lin and Chang, 2009
[42] Fox, 2016, and ICAI, 2017
[43] Brahmbhatt,et al, 2016
[44] Timmer and Akkus, 2008
[45] USAID, 2014
[46] Ianchovichina and Lundstrom, 2009

employment, defined by the ILO as "employment yielding sufficient returns to labour to permit the worker and her/his dependents a level of consumption above the poverty line"[47].

The nature of inclusion can also be defined by its antonym; that fewer people are excluded from economic opportunities. Multiple layers of exclusion can be applied: by gender, ethnicity, religion, age or geography. According to the World Bank, "exclusion occurs when individuals or groups are systematically side-lined from…decisions that affect their interests"[48]. In this sense, issues of power and agency need to be considered to ensure broader participation in structural change, and to guard against elite capture of productivity gains. Here, we can learn from the experience of more advanced economies in not replacing one problem (low productivity) with another (high inequality). According to Giridharadas (2018), the average American worker grew 72 per cent more productive between 1973 and 2014, but the median worker's pay rose only about 9 per cent in this time. As a result, "America doesn't have a problem of lagging productivity so much as a problem of the gains from productivity being captured by elites"[49]. In the words of the NGO, ActionAid, with reference to women's economic empowerment:

> *"Achieving inclusive economic transformation means revisiting how economic resources are generated, distributed and who has control over them. It implies an overhaul in what counts as 'work', how we value work, who does what work and how we share workloads. It means revisiting who benefits from economic activity, who participates, under what terms, and who decides. Critically, it demands a shift of power, opportunities and entitlements in favour of the poor and marginalised"[50].*

For the purposes of this paper, a working definition of what constitutes an inclusive process of economic transformation is one that *incorporates productive capacities to create employment and sustain livelihoods for the poor and excluded, both today and in future* (adapted from UNDP, 2015)[51].

Economic transformation therefore has the *potential* to be inclusive, but only if the right conditions are in place and if the process is curated by a set of policies and practices that increase equality of opportunity and can guide structural change onto "a path of inclusive and sustainable job-rich growth"[52]. This provides a natural entry point for MSD to necessary to alleviate specific barriers to people in poverty or groups such as gender and youth participating in and benefiting from transformation change[53]. Fox (2016a), however, also sounds a note of caution – already familiar to MSD practitioners – that some of these barriers to opportunity may be extremely hard to overcome, and effective policies difficult to identify.

[47] ILO, 2012
[48] Mahmood and Ait Ali Slimane, 2018
[49] Giridharadas (2018)
[50] ActionAid, 2013
[51] UNDP, 2015
[52] ILO, 2012
[53] Fox, **2016a**

### 1.3.3 Alignment of timeframes: How long for change?

Both the process of economic transformation and the systemic changes sought by market systems programmes take place over long time horizons.

Economic transformation is about establishing growth patterns in ways that favour long-term, sustainable development, not simply short-term growth[54]. Indeed, according to one theory, the reason "behind the differing levels of economic success across countries such as Denmark and Somalia is not due to Denmark having grown particularly fast, but just that Denmark has grown steadily for a long time"[55]. In part due to over-reliance on commodities and raw material resources which are exposed to extreme price volatility, many developing countries experience boom-bust cycles of rapid growth accelerations followed by growth decelerations or collapses[56].

Economic transformation has been described as a "nation-building project" with shared commitments extending well beyond a single electoral term[57]. Some have even referred to economic transformation as a process that is always *ongoing*, which that never really ends until the (idealised and theoretical) state is reached in an economy where different economic activities have no distinguishing characteristics from each other, at least in terms of the productivity of labour and capital[58]. The challenge here is that in both the spheres of political and business decision-making, current incentive structures tend to reward immediate (quarter to quarter) or at most medium-run (five to ten year) growth.

MSD also explicitly recognises that systemic change and impact comes late and may peek several years after project closure However, these systemic changes are always timebound, and are often 'projectized' in order be achieved within a pre-defined period. The typical MSD programme phase lasts for 3-5 years, while a systemic change – as a very broad rule of thumb – expecting to take around 5-10 years to catalyse.

In this sense, both MSD and economic transformation face challenges aligning the long-term nature of change with pressures of short-termism.

### 1.3.4 Alignment of principles

A central feature of MSD is the set of key principles and frameworks which guide the process of effective intervention in – and development of – market systems[59]. These share a broad alignment with the underlying theory of economic transformation.

[54] Ansu, 2014
[55] Pritchett, 2018
[56] Ibid.
[57] Ansu et al. (2016a
[58] Timmer and Akkus 2008
[59] BEAM Exchange, 2015

First, economic transformation calls for **active intervention in market systems**. The narrative of 'Africa rising' - high growth rates, a burgeoning middle class and increased investor confidence - may give the impression that economic transformation is inevitable[60]. However, structural transformation does not occur automatically: It must be deliberately brought about[61]. According to the IMF, countries must have the 'right' conditions in place with a "structural and institutional setting that is conducive for productivity growth and labour mobility"[62]. Their empirical review of 15 years of experience of economic reform in low income countries led to identifying a number of policy measures that can remove distortions and provide the short-term impulse to sectoral productivity and shifts, such as reforming the financial sector, and improving education, infrastructure, and the regulatory framework. They note, however, that the specific challenges facing each sector may require a different focus.

The state plays a central role in driving economic transformation[63]. As transformation is therefore a political agenda, not merely a technical one, it means embracing the **political economy of change**, and addressing vested interests in both the government and private sector that can hinder the adoption or prevent the pursuit of economic transformation policies[64].

Key factors that contribute to a conductive political economy for economic transformation, as identified by McMillan, et al., 2017 (based on Sen and Rodrik), are:

- The willingness and ability of the state to make *credible commitments* to potential investors that their assets and profits will not be expropriated, and expected profits are not only credible today but also likely to be renewed in future years, e.g. through formal protection of property rights and other legally binding rules, including on taxation.
- The *public goods* needed to make private enterprise profitable. This includes the investments in public health and education required for the development of an employable labour force as well as the provision of sufficient transport and power infrastructure.
- The ability of the state (or other actors) to correct *coordination failures* in high potential sectors where the country has a comparative advantage to ensure supportive trade, tax and credit policies that allow simultaneous investment across the value chain, such as in both production and processing.

This strongly resonates with the origins of MSD in, amongst other disciplines, institutional economics which sees markets as constructs that exist to facilitate exchange and reduce the cost of carrying out transactions[65]. The implication is that markets can be altered to make them work more favourably - for the disadvantaged (in MSD), or more broad-based growth (for economic transformation). Hence

[60] Ansu, 2014
[61] Ansu, 2014; IMF, 2014
[62] IMF, 2014
[63] ICAI, 2017
[64] McMillan, et al., 2017
[65] Springfield Centre, 2008

the importance placed both in MSD – and in the economic transformation literature – on the institutions that shapes the 'the rules of the game' and the role they place in determining the pace and pattern of economic growth[66].

Successful economic transformation requires numerous enablers to 'come together' like energy, roads, water, labour, research, inputs, markets, investment, tax, regulation and finance[67]. Interventions into markets therefore need to be **interdependent and mutually reinforcing**. For economic transformation there is increasing recognition of the merit in bringing several sets of public actions together into 'strategic clusters'[68]. This resonates with the MSD focus on prioritising sets of under-performing market systems functions and rules which have to be addressed together to unlock pro-poor outcomes.

In order to prioritise 'where' and 'how' to intervene, both economic transformation and MSD emphasise a diagnostic process that is focused on **understanding the constraints to higher quality growth**. McMillan, et al. (2017) calls this identifying the 'transformation deficit'. It involves a careful appraisal of the degree to which a "country's economy has already experienced some transformation and what remains to be done"[69]. The idea – much like MSD - is to avoid 'quick fixes' that lead to only incremental poverty reduction and have "limited success in addressing the underlying structural limitations facing most African economies"[70]. Literature on both economic transformation and MSD cite Rodrik's 'growth diagnostics' as inspiration in their processes of moving from the 'symptoms' to 'root causes' of sub-optimal growth.

The implication is that both economic transformation and MSD stress **contextual strategies**. This means drawing inspiration from comparable global or regional experiences, but building country-specific visions and pathways to overcome political-economic obstacles[71]. Interventions are not about 'solving everything', or being 'remote reformers' seeking to push one-size-fits all policy prescriptions, which are often ideologically-driven. The 'Asian Tiger' model of mass job creation through industrialisation, for example, cannot be 'copy-pasted' into the African context. Not least because global market has changed since the 1990s and the conditions are different from those that faced previous 'late industrializers'[72]; but also because in Asia the share of employment in the lowest-productivity sectors declined rapidly because of low labour force growth (meaning that there was less labour for the economy to absorb), which is precisely the opposite of the current situation faced by Africa[73].

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[66] Acemoglu, et al., 2001
[67] Said et al, 2016. In reality, this has happened very rarely, and often only where there have been strong government coordination mechanisms, such as in China, Singapore and the Republic of Korea. It is beyond the scope of this paper to examine trade-offs between successful transformation strategies and political freedoms.
[68] McMillan, et al., 2017
[69] McMillan, et al., 2017
[70] African Center for Economic Transformation, http://acetforafrica.org
[71] McMillan, et al., 2017
[72] Pritchett, 2018
[73] Fox, et al., 2017

With a lens of inclusive economic transformation, it is clear that not all transformational change processes are equally beneficial for people in poverty, underlining the importance of understanding ongoing processes of transformation. As shown in Box 2, there are some recent sector success stories in Africa, such cut flowers in Ethiopia and ICT in Kenya, but other examples – such as the growth of Tanzania service through informality – raise potential red flags. Experience from Asia also tells us to be wary of too much focus on the "highest-productivity sectors because they employ too few people"[74]. In agriculture, for example, when the sector reaches a level of sophistication where production becomes fully mechanised and processing relies on automation, technology and machinery to drive productivity gains, job losses will be inevitable.

### Box 2: Examples of economic transformation in Africa

Over the past two decades, **Ethiopia** achieved impressive results in diversifying and commercialising floriculture. The success was a result of private entrepreneurs' experimentation, supported by active government efforts to identify and remove bottlenecks to the sector's growth. A dedicated Horticulture Development Agency was set up to coordinate and facilitate investment in the sector and provide institutional support to meet ambitious targets for export of flowers laid out in the Growth and Transformation Plan. The number of flower plantations grew as a result of influx of foreign direct investment, as well as dedicated schemes for local large-scale and smallholder farmers. In 2016, cut flower export generated USD 225 million in profit, making Ethiopia one of the world leaders and the second largest exporter of cut flowers in Africa (Pritchett, 2018).

The ICT sector is a leading driver and enabler of economic growth in **Kenya**. The flourishing IT sector make it possible to boost productivity and generate higher income at scale. In its Vision 2030 the government identified six priority sectors, of which IT-enabled services was one. The strategy set out to ensure accessible, efficient, reliable and affordable ICT services. Its implementation was supported by heavy investment in infrastructure, skills development, supporting regulatory environment, and subsidies to firms in a hope to galvanise development in the sector. The ICT automation in delivery of government services has led to better control over state budget and reduction in corruption (Ibid).

**Tanzania's** economy experienced unprecedented dynamism in the first decade of the 21st century. Sustained economic growth can to some extent be attributed to productivity gains in agriculture, but mostly to a shift in employment share in favour of non-agricultural activities, i.e. structural transformation. Nine out of ten new jobs were created outside of agriculture, primarily by small firms in manufacturing and trade services (Ibid). These firms, especially in trade services (retail, wholesale, sale of food and beverages) have absorbed large numbers of unskilled youth and those leaving agriculture. However, A vast majority of these small private firms operated in the informal economy.

Rather than promoting 'best practice' reforms, therefore, the challenge is to figure out which are 'best fit' through a **process of iterative learning**[75]. According to McMillan, et al (2017), emerging empirical evidence shows that it is not necessary for whole institutions and power structures to

[74] In India. Fox, et al., 2017
[75] Ramalingam, et al.,2014

change comprehensively for transformative economic change to take place[76]. In fact, economic transformation is best approached with a "pragmatic reformism" approach that tackles "specific institutional blockages, a few at a time, learning in the process how to do this effectively"[77]. Market system practitioners will recognise this as essentially describing the adaptive management process, which places trial-and-error, 'flexibility contained by principles' and the ability to adapt to changing circumstances at the heart of programme management[78].

## 1.4 How does MSD currently contribute to ET?

The section provides an overview of whether and how MSD is focused on activities that can be considered transformational. It is based on a mapping of how MSD programme objectives currently align with a typology of economic transformation interventions (see Box 3), using the *BEAM Programme Index* – a directory of 59 programmes around the world using a market systems approach[79].

### Box 3: Interventions for economic transformation

McMillan, et al. (2017) developed a typology of public actions to support economic transformation, which we have used as a proxy for assessing the alignment of MSD programmes with activities that can be considered transformational. These are divided into general enabling ('horizontal') and targeted (e.g. aimed at specific economic activities) interventions.

| **Structural change** | |
|---|---|
| *Enabling policies:*<br>▪ Investment climate reform<br>▪ Financial sector development<br>▪ State-business relations | *Targeted interventions:*<br>▪ Export push<br>▪ Exchange rate protection<br>▪ Selective and spatial industrial policies<br>▪ National development banks |
| **Within-sector productivity growth** | |
| *Enabling policies:*<br>▪ Building fundamentals (infrastructure, skills, institutional capacities)<br>▪ Investments in basic production knowledge (managerial good practices as public goods, agricultural innovations)<br>▪ Promoting competition | *Targeted interventions:*<br>▪ Management training<br>▪ Attracting FDI<br>▪ Export diversification<br>▪ Developing global value chains (e.g. higher value end-markets)<br>▪ Increasing agricultural productivity (e.g. improved inputs) |

[76] McMillan, et al., 2017. Measures "To promote 'better governance across the board are likely to be less successful than more targeted and pragmatic measures aimed at creating small breakthroughs that release economic potential"

[77] McMillan, et al., 2017

[78] See https://beamexchange.org/guidance/management/adaptive-management/ and Messiness Series

[79] We based this section on an analysis of all 59 entries in the BEAM Programme Index. Note that the Index is not an exhaustive list of all MSD programmes. The analysis was based on the listing description, rather than detailed programme documents, and so may not reflect the full range of activities or focus of the programme. Where programmes aligned with one or more ET objective, the primary alignment was recorded.

### 1.4.1 Findings of the programme mapping

Of the 59 programmes in the BEAM Programme Index, 85% (n=50) could be linked to broad economic transformation objectives. 15% had no explicit link to economic transformation as they were mostly focused on interventions other programme areas, such as WASH. Of the programmes that could be thought of as contributing to economic transformation, 80% (n=40) were aligned to within-sector productivity interventions, and 20% (n=10) to structural change interventions.

*Figure 3: Alignment of MSD programmes with economic transformation objectives*

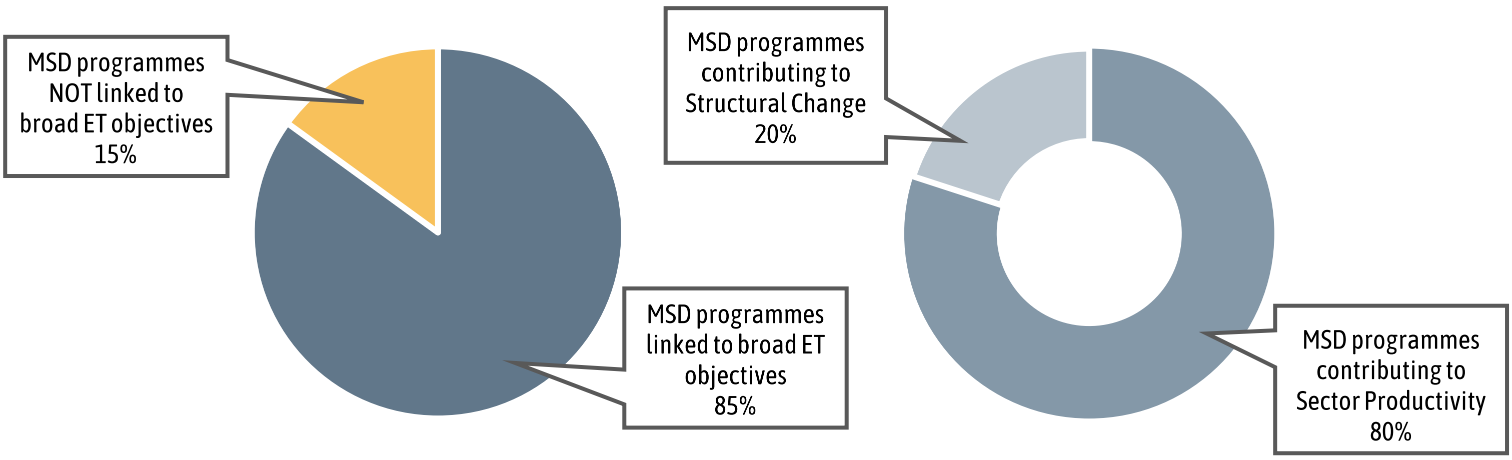
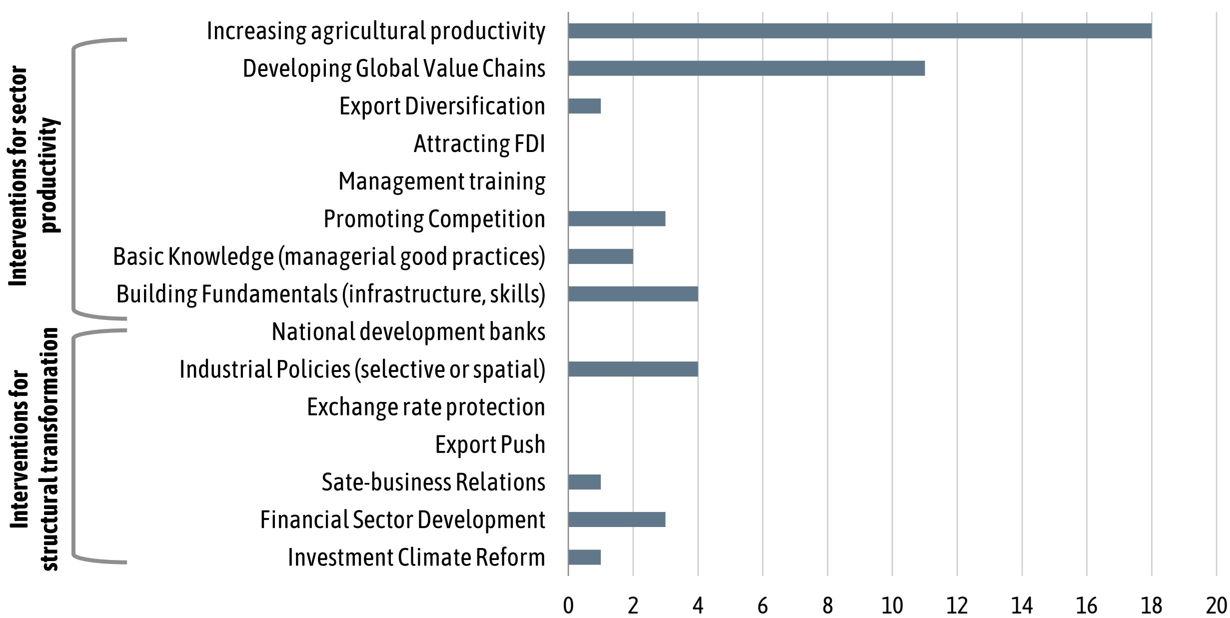



Figure 4, below, presents a breakdown by type of intervention. This shows that the vast majority of MSD programmes are aligned to the economic transformation objective of increased agricultural productivity (n=18).

*Figure 4: Number of MSD programmes aligning with actions to support economic transformation*



Finally, of the 50 projects contributing to economic transformation, only 30% (15) mentioned that working with the government or on policy issues was a key component of their interventions[80].

### 1.4.2 Conclusions

This preliminary mapping shows that MSD programming is highly aligned to economic transformation objectives of sector productivity. However, MSD activities are concentrated in agricultural productivity and value chain development, with much more limited use for supporting structural change.

Nonetheless, MSD programmes do contribute to a diverse range of intervention types, cutting across 'enabling' interventions such as investment climate reform and financial sector development to more targeted interventions in industrial policy and export diversification. Thus, while MSD is sometimes characterised as sitting at the 'micro' level of interventions to improve firm capabilities - such as market access, knowledge and skills - both in theory and in practice the MSD approach has much wider applicability for economic transformation.

[80] Again, this was based on the programme description page in the BEAM Programme Index, and programmes may have omitted government engagement in the overview. There is a risk this figure is under-reporting.

# 2. Donor and development agency perspectives on using MSD to promote economic transformation

The section examines how donors and development agencies see MSD as contributing to economic transformation – both in current practice and its potential. This is based on 26 interviews with all members of the DCED Working Group on MSD and a number of their agency colleagues. A full set of interviewees is included in Annex 2. To allow for more insightful responses, all respondents were offered anonymity, meaning that opinion and practices cannot be attributed to individual agencies.

## 2.1 Definitions of MSD and economic transformation

Interviewees were not explicitly asked to define MSD, but some differences in interpretation of the approach were noted during answers to other questions. This is largely due to different institutional contexts and histories; as some Working Group members have longstanding MSD programming, while others were relatively new to the approach. As a result, some saw MSD through a narrow lens - as focusing only on smallholder farmers - while others viewed it more expansively as a synonym for 'adaptive management' and as applicable to almost any topic in international development.

In short, interviewees clearly alluded to the fact that MSD is an approach not a 'methodology' or 'technical area'. They also had a shared understanding of what these guiding principles were: A focus on achieving large-scale, sustainable pro-poor change through facilitation that addresses the 'root cause' reason(s) for why market systems under-perform.

While there was consensus around the definition of MSD – if not always consistency in how it is interpreted from a programming perspective - there was much less agreement about what economic transformation is. Most respondents were equipped with a general understanding of the term, viewing it as synonymous with long-term economic growth. The adjective most used to describe economic transformation is 'macro', highlighting the scale of change - and the aim bring to economic benefits to vast numbers of people - as a key attribute of transformation.

The lack of clarity led one respondent to note that: "*There is too little capacity both among the donors and implementers to understand and define what inclusive economic transformation means in a specific setting and to determine how development actors can support it.*" Another referred to economic transformation as a "black box", into which people are layering different interpretations and expectations.

Economic transformation is not an explicit programmatic or strategic objective for most donors/development agencies and therefore few had the need to conceptualise or tightly define the term. Regardless of the definition, however, the majority see it as in principle aligned to their agency's guiding objectives, whether the Sustainable Development Goals or economic development, or at least not contradicting them. Some agencies intentionally bring in an ‘inclusiveness’ lens into the discourse of economic transformation in order to make it more explicitly relevant to the goal of poverty reduction.

When defined in more specific terms, economic transformation is primarily associated with structural transformation, seen as the diversification and shift in relative importance of sectors, invariably towards modern sectors. Other than that, the within-sector dimension of economic transformation is almost always overlooked, with the exception of select few acquainted with within- and between-sector dimensions of economic transformation. For them, the commercialisation of agriculture is viewed as an important part of economic transformation.

## 2.2 Using MSD for economic transformation

The consensus among respondents familiar with the MSD approach is that market systems development is highly appropriate to deliver systemic change in a sustainable way and contribute to economic transformation. However, those who have not been exposed to the MSD approach in practice struggled to recognise its relevance to economic transformation. When it comes to the utility of market systems development as a contributor to economic transformation, respondents therefore fell into two main camps – sceptics and advocates.

The *sceptics* perceive market systems development as a micro approach, sharply focused on a specific target group, or a value chain, and in essence delinked from the wide aims of economic transformation. It was therefore seen as insufficient to galvanise economic transformation: “MSD may lead to economic transformation but does not have to” and “there is no direct correlation between MSD and economic transformation”. This was in part due to a narrow understanding of economic transformation as structural transformation. When prompted to consider the intra-sectoral dimension of transformational change, this group can acknowledge that MSD may indeed be part of the economic transformation process as it leads to improvements in productivity within a sector. Nonetheless, MSD was still perceived as “lacking in consideration of and influence” over the regulatory framework and hence limited in its ability to deliver economic transformation.

The *advocates*, on the other hand, viewed the MSD approach as relevant to almost any type of programme. MSD encapsulates objectives of sustainability and reaching scale, basing interventions on a deep-dive analysis that should be “common-sense” for any programme. If implemented well, “it is exceptionally well suited to contribute to economic transformation” and “to bring systemic changes”. MSD is “a very appropriate approach to make a sustainable change to markets that are not functioning well.” As far as this group is concerned, “the MSD approach has no limitations” if it is properly understood. “It’s spot on when it comes to sustainably shifting activities towards more productive livelihoods”. But advocates “need to have realistic expectations” and understand both the strengths and the limits of the MSD, so as not to ‘oversell’ the approach.

A number of interviewees, when considering the potential of MSD to contribute to economic transformation, noted that a particular strength of the approach was its inherent pragmatism, and the ability to see markets a pluralistic construct bringing together diverse stakeholders and a holistic set of functions and rules:

> *"MSD is about balancing contributions between public and private players. You are pragmatically assessing the capacity of players and building on what you have rather than taking an ideological stand. [The] MSD approach can be instrumental to promote the concept of mixed economy where public and private sectors can work together in a sustainable way with the view to achieve economic transformation."*

In this light, others stressed that MSD could help bridge the gap between *taking about things* and *doing things*. As one respondent quipped, "Market systems is the art of the possible: economic transformation is the political hyperbole". Another noted that industrial policy - the strategic effort of the state to encourage the development and growth of certain segments of the economy - often leads to academic recommendations, but "MSD can help put those into practice".

This resonates with literature on economic transformation, which states that current problem is less knowing what to do, but rather knowing how to do it:

> *"The mechanisms for doing [economic transformation] are well known in principle if difficult to implement in practice. They include the utilization of improved technologies, investment in higher educational and skill levels for the labour force, lower transactions costs to connect and integrate economic activities, and more efficient allocation of resources. The process of actually implementing these mechanisms over time is the process of economic development"*[81].

However, almost all respondents struggled to come up with many concrete examples of MSD programmes that had successfully contributed to economic transformation. This was in part because of definitional issues (defining economic transformation narrowly as structural change), and in part because attention to this area is more recent[82]. Box 4 summarises the few cases that were mentioned by respondents - and the type of activities the programmes engaged in and how these support transformation processes.

Moving forward, it will be important to generate case-specific knowledge about how market systems success can contribute to economic transformation processes. Examples do exist, but they will need to be pro-actively discovered, documented and disseminated. Box 5, for example, sets out how FSD Kenya used a market systems approach to catalyse the rapid growth of mobile money in Kenya, one of Africa's biggest recent success stories and a critical new business services sector for the country (and region).

[81] Timmer and Akkus, 2008
[82] This echoes findings in Gelb, et al., 2019

**Box 4: Illustrative programme examples**

- Fundación Chile (FC) is a non-profit public-private partnership between the government of Chile and an American conglomerate that has been active since 1970s. FC offsets innovation costs in target industries by proactively introducing new technologies and transferring cutting edge knowledge and business practices. Successes included innovative methods of food storage that reduced spoilage and opened producers' access to international markets. FC sets up incubators, where opportunities identified as having a high potential and fit for local context are supported and scaled up. FC is run as a corporation, relying on revenues from the sale of its products, public contracts and revenues from private companies.

- The Alliances Caucasus Programme Georgia (ALCP) is an MSD programme by the Swiss Agency for Development Cooperation that intends to deliver poverty reduction to rural communities through increased income and employment opportunities in the livestock and honey value chains. The implementation of the programme in several phases and varying formats spans from 2008 to 2021. During this time, the project engaged with rural businesses, local consumers and the national food authorities as a facilitator to gradually build up commercial markets for goods and services. The programme is acknowledged as having benefited over half a million households, over time improving incomes of local farmers, firms and workers.

- LI-WAY is a Sida-funded project in Ethiopia that is novel in that it is not sector-focused but is cross-sectoral. The programme was conceived based on the results of a review of Sida's portfolio of Private Sector Development projects. Using an MSD approach, LI-WAY "supports transformation by stimulating urban job opportunities for youth and women where migrants come from over-satiated rural subsistence farming environments. It also has a focus on finding solutions (e.g. child care) helping women out of unproductive household traps".

- Sida-funded Livelihood Support Mejang Biosphere programme in Ethiopia started in 2016 and is supporting transformation to more productive sectors by incentivizing forest population away from destructive illegal deforestation and charcoal incomes to high-yielding practices in more effective production of coffee, honey and spices. It also channels women into backyard beekeeping, where honey production was earlier just accessed by men due to the dangers in traditional forest-based hives.

- DFAT-funded Australia-Indonesia Partnership for Rural Economic Development (AIP-Rural) started in 2013 with the aim to increase rural incomes in agriculture. Completed in 2018, the project has led to around 500,000 farmers adopting innovative agricultural practices that improved their productivity; this in turn led to greater crop sales and higher income.

- In Fiji through the DFAT-funded Market Development Facility (2011-2017), farmers have successfully diversified from low-return sugar cane growing to horticulture and other non-traditional crops, thanks to a partnership with an agribusiness that is able to procure, store and process throughout the year.

- DFAT-funded CAVAC project aimed to improve value addition in rice-based farming and income of small-holder farmers in three Cambodian provinces. As a result, partnerships with input supply companies helped make information on correct input use much more accessible to farmers (primarily through small retail outlets) – which has made input use more effective and improved farm productivity.

*(continued on next page)*

- Growth in Employment in States (GEMS) is a joint World Bank and DFID-funded programme in Nigeria that aims to boost growth and employment in the states of operation, also contributing to the government's agricultural transformation agenda. The DFID-funded segment of the programme (USD 75 million) applied an MSD approach across three themes: meat and leather, wholesale retail and the business environment / investment climate. By its close, GEMS had supported the raising of over 2 million incomes and 30,000 jobs. These came from market system changes such as innovations within agricultural value chains, more direct support to potentially replicable business models within high potential markets such as waste recycling, or cross cutting business environment reforms. A key lesson from GEMS was that impact can be achieved at very large scale through market systems approaches, but that this takes time beyond the scope of normal five-year project cycles. The project was launched in 2011 and initially designed as a 7-year intervention; a ten-year long successor programme has been developed. Continuity of some MSD-related activities will be sustained to amplify impact and bring the total duration of the interventions to nearly 20 years.

## 2.3 Challenges in using MSD for economic transformation

This section briefly summaries the major challenges identified by Working Group members in using MSD to support economic transformation. These provide one source for areas to focus on when considering how MSD might be adapted or modified in Section 3.

### MSD as marginal (not transformational) change

Some respondents felt that MSD was almost exclusively deployed to 'fix' existing sectors that are struggling, rather than to accelerate the emergence of new competitive sectors. The tendency of MSD programmes to emphasise poverty reduction based on marginal income increases "now" can distract from the search for and efforts to deliver long-term transformative changes. As one interviewee noted:

> *"There is a very real risk that MSD programmes constrain the ambition of governments and stakeholders, with a lack of focus on where the real opportunities for long-term transformative growth lie, instead seeking incremental improvements that will perhaps never deliver transformation"*

### Sector selection

A common opinion was that MSD can indeed trigger a transformation within a target sector, most often agriculture, but that the approach itself does not always succeed in focusing on the sector of most strategic importance for the economy. As a result, "MSD programmes just tend to reflect the economic structure of the country they are in". Implied in this was a view that sector selection for MSD has become rather 'mechanical' or 'political' (driven by donor interests, team preferences and in-build incentives to ensure impact targets are 'hit'), rather than based on a consideration of the 'transformational' potential of sectors. It is therefore believed that, as currently practiced, sector selection inhibits MSD focusing more on structural transformation.

**Box 5: Creating the enabling conditions for mobile money innovation in Kenya**

Kenya has been a global leader in pioneering mobile money payments that are revolutionizing cross-border financial flows (Tarp, 2018). With more than 20 million accounts and 95% of the market share by active money wallet users, M-Pesa dominates the market. M-Pesa has exerted a dramatic impact on financial services in Kenya, and globally. Not only is it the primary reason for the increase in overall access to finance but it has also changed the essential rules of the game in finance, introducing new ways in which to reach consumers with finance-related services.

FSD Kenya – an organisation with a mission to facilitate financial inclusion using a market systems approach - has played a unique if often unrecognised role in the story of M-Pesa. Initially this focused on creating the regulatory space to allow M-Pesa to happen. But, over many years, it has engaged in other ways to mitigate M-Pesa's influence and shape a better, fairer market system for all players. The objective of FSD Kenya's intervention here has been to nudge the environment around M-Pesa – the information, regulations, coordination and product development functions – so that the market system as a whole encourages more and better innovation and service quality.

M-Pesa initially posed a quandary for regulators – as a financial service it was not clear how it fitted with existing banking regulations. When faced with the new mobile money challenge, most central banks around the world followed their instinct to 'just say no' to a new financial service. That this didn't happen in Kenya is, in large part, due to the close relationship FSD Kenya held with the Central Bank of Kenya (CBK) and the influence it was able to exert. FSD Kenya played a major role in convening discussions with CBK, Vodaphone (the mobile network) and CBA (the bank), which was critically important in swaying the internal debate within CBK "and winning over the conservatives, including the Governor", providing CBK with the confidence it needed to bring in "innovation from a regulation perspective".

As M-Pesa grew, FSD Kenya's role has been – standing outside the market – to intervene selectively to:

- Advise the Competition Authority of Kenya (CAK) on more transparent pricing and access to M-Pesa's communications layer of infrastructure, or alternatives to it such as USSD
- Support the development of new product innovations (M-Shwari primarily), encouraging the development of new applications that use (and collaborate with) M-Pesa to provide new financial solutions to customers
- Under the auspices of the CBK and the Kenya Bankers Association (KBA), coordinating the main industry players in developing shared infrastructure that will allow interoperability between banks payments systems and effectively create an alternative to M-Pesa

FSD Kenya's inputs took a variety of forms including technical assistance to individual organisations, coordinating different players in tasks of mutual benefit, and studies (and informal advice) as evidence to regulators/policy makers.

A review by the Springfield Centre concluded that it was very unlikely that M-Pesa's remarkable growth would have been achieved without FSD Kenya – more likely, with a less supportive regulatory space, is that digital finance would have taken the slower, more cautious path to development found in most other countries; and Kenya would not have become a leader on digital finance.

*Source: Extracted and adapted from Gibson, A. 2016*

### Time scales

The time scales of market systems programmes are a fundamental issue. According to respondents, a standard MSD programme is judged on a five-year scale, when in essence it would be more appropriate to view it as a three-year programme: the first year is getting going and the last year is winding down. Some agencies acknowledged that multiple project extensions were often given to bring the total duration of MSD programmes to 10 years, while others noted that such piecemeal programming risked multiple changes in direction and lacked the stability of timeframes required to build towards sustainability. As one respondent noted: "*There is no way of achieving transformation other than long term interventions. First, it takes a few years to build a foundation, truly understand the businesses, the sector, get to know the actors, build trust and relationships, understand the institutions and advance institutional change to support market systems*".

A common thread connecting issues of transformational change, sector selection, and the long time horizons for systemic change is that of the Future of Work – and how to know which sectors and skillsets will be important in future, given vast changes to the social and economic fabric caused by technology (see Box 6).

### Political economy

The way donors allocate funding and the way they engage with governments contributes to the problem of sector bias in development efforts. While in the words of one respondent, "economic transformation implies that developing country governments are in charge", the 'projectized' nature of aid with discrete bounded logframes and demands for attribution and upwards accountability back to donors (and not to developing country governments) sends a message that "donors are in charge".

Donors tend to engage in dialogue with governments along the confines of specific sectors, regardless of who dictates the sector preference. This, in addition to internal government problems with coordination across ministries in developing countries, inhibits a holistic approach to inclusive economic transformation and growth, perpetuating the problem of a 'myopic' sector focus. Unsurprisingly, implementers and consultants respond to this demand by offering even more sector-focused expertise, providing more 'technical' fixes, and working around governments in-country. As a result, even when encouraged to approach a market assessment broadly and holistically, consultants default towards familiar sectors. This results in a "piecemeal approach" to the problem of low productivity and poverty.

**Balancing innovation and evidence**

Capturing the full impact of market systems development programmes is a long-standing challenge. The timescale for systemic change and indirect nature of impact makes it difficult to link changes to a specific intervention, or even to a programme.

Donors and implementers alike yearn for more robust evidence for a number of reasons. There is a growing trend to fund evidence-based interventions that rely on empirical proof that a particular strategy 'works'. Another important - but often overlooked - reason is evidence can help build local stakeholder buy-in for a taking a more facilitative approach; this way, evidence forms the basis for a dialogue with the government and the private sector. Raising awareness about the MSD approach and building trust with partners is much easier with the availability of convincing evidence of success. In the absence of a solid evidence base, development actors rely on the logic of the approach, but this leaves them vulnerable to varied capacity levels of stakeholders to comprehend what can be seen as a complex theoretical approach.

The flipside, however, is that a dependency on evidence stifles innovation. Whether in fintech or financial services, digital access or productivity of small-holder farms – there are currently many exciting and potentially transformational innovations happening which are driven or co-invested in by entrepreneurs and businesses. As one interviewee noted: "*In development we play a catch-up game…The danger is that we base our programmes entirely on evidence, whereas the entrepreneurs go with their gut feeling. John Harvey Kellogg didn't collect evidence on breakfast cereals before he invented cornflakes*".

Where people sit on the 'evidence versus innovation' spectrum cause a bias in their use of MSD for economic transformation. 'Evidence followers' want to back interventions that have previously been proved to be effective, so they tend to look at sectors that are already important in the economy; leading to a focus on sector productivity (mainly in agriculture). 'Evidence leaders', on the other hand, go into new sectors and economic segments precisely because there have been few previous interventions and therefore little evidence, creating more scope for structural change[83].

[83] Riina, 2016

**Box 6: Life 3.0: Economic transformation and the Future of Work**

In his recent book, cosmologist Max Tegmark imagines a future where emerging technology may someday be able to design both its own hardware and internal structures (software) – and considers a range of potential outcomes once machine has exceeded human intelligence, both positive and negative. While the precise future scenario for humanity is unknown, what is clear that technological advances – artificial intelligence, automation and robotics – will bring about profound changes to our social and economic structures.

This will create new jobs, but those who lose their jobs in this transition may be the least equipped to seize the new opportunities (ILO, 2019). Today's skills will not match the jobs of tomorrow, and even today's high potential sectors may one day be considered 'old industries'. Within sectors, there are important considerations as to which roles will become obsolete, and who this might affect. For MSD, this has implications for which sectors to focus on for inclusive economic transformation. For example, garment production has been supported across a number of African countries, including Ethiopia, as a manufacturing industry that can absorb a large number of low- or semi-skilled workers, particularly women. Yet across Asia, the ILO recently calculated that 85% of jobs in Vietnam's garment and textile sector and 88% in Cambodia are vulnerable to being replaced by robots. The highest value segments of the chain such as design, branding and marketing are likely to be insulated from job losses; it is the production and processing activities – where majority of low-income groups are engaged – that will be impacted.

For long-term structural change, there is a risk in backing sectors that are labour intensive now, but where the pathway to future productivity gains is through automation. People may be encouraged to diversify and 'step into' sectors where large swathes end up being redundant due to technological innovation.

The ongoing emergence of the green economy will also create millions of jobs, but other jobs will disappear as countries scale back their carbon- and resource-intensive industries and invest in clean technologies. The environmental sustainability of sectors is also a key concern, as there is no point in building growth strategies around sectors that will be under extreme pressure in future because of climate change.

*Source: ILO, 2019*

# 3. How MSD practice could be modified or adapted to better promote economic transformation

This section considers the implications of an economic transformation agenda for MSD programming. It sets out how the MSD approach could be used, adapted and complemented to better promote both within and between sector economic transformation, with a particular focus on practical actions. It builds on the Working Group interviews to integrate findings from both the literature review and perspectives from the authors' own experiences.

This section will look at the key components of MSD through an economic transformation lens to see whether the approach is fit for purpose, or whether any adaptations are required. We will cover:

- Theory: *What ideas and principles underpin action?*
- Strategy: *Choices about where and when to intervene?*
- Tactics: *How to intervene?*

Five key areas of MSD are focused on: Sector selection, rules of the game, systemic change, portfolio management and facilitation tools.

For each area, we frame a hypothesis about what the current problem is, what needs to change for MSD to better contribute to economic transformation, and which objective (whether structural or sectoral productivity) the change is relevant to.

## 3.1 Sector selection

| | |
|---|---|
| Hypothesis: | The way in which sector selection criteria are applied pushes programmes to focus on 'where the poor' are now, which, coupled with the pressure to show results in a short time frame, creates disincentives to work in sectors with the potential for significantly higher productivity gains. |
| What needs to change: | Place more emphasis on the *opportunity* criteria (including using improved tools to assess the opportunity for inclusive economic transformation); and understand how programme design and donor pressure are impacting *feasibility* considerations. |
| Relevant to: | Structural change objectives |

At its core, successful economic transformation is about identifying the 'correct' economic opportunities to pursue, which are often concentrated at the sector level[84]. The core challenge for structural change is therefore one of sector selection. With a lens of *inclusive* transformation, the aim is to build more competitive sectors that have the potential to become employment rich.

The conundrum is, as noted by ILO (2012): "The sectors, occupations and geographical areas with the greatest potential for growth change over time, but they seldom coincide with those where the majority of the working poor are [currently] to be found."[85]

Identifying high potential sectors needs to be a context- and country-specific exercise. However, some broad considerations relevant to the situation in Africa that need to be taken into account, and which have been raised earlier in this report, include:

- In the long term, increases in agricultural productivity imply a reduction in employment in agriculture
- Manufacturing is unlikely to be the job creation engine for Africa, especially given the continent's rapidly expanding labour force
- The global growth of the knowledge economy and service sector successes in Africa offer opportunities, but also challenges – primary around continuing informality
- Many modern sectors may not seem obviously pro-poor, but they can bring about many indirect impacts that also raise productivity in sectors where people are currently engaged, such as agriculture (such as through mobile money transactions, smart logistic services etc.)

MSD uses a criteria-based approach when selecting which sectors to intervene. This is designed to make decision-making more transparent, and to aid constructive dialogue between funder and implementer on why decisions have been made[86].

The Operational Guide calls for sectors to be assessed for their relative potential to: (a) affect large numbers of poor people, (b) increase the poor's performance in markets that are growing or their access to basic services, and (c) stimulate system-level changes.

Table 2, below, sets out indicative sector selection criteria. Strong emphasis is placed on the need to explore future opportunities at the same time as defining the current needs of target group. The sector selection criteria themselves therefore appear to allow a consideration of the transformational potential of sectors, but there is a need to re-visit how they are applied in practice.

[84] Gelb, et al., 2019

[85] ILO, 2012

[86] Springfield Centre, 2015

*Table 2: Sector selection criteria as suggested by The Springfield Centre (2015)*

| | |
|---|---|
| Relevance | Number of poor women/men with potential to be active in the market system |
| | Scope for poor women/men to improve their incomes or access basic services |
| | Ability to address vulnerability and/or disadvantage |
| Opportunity | Economic and/or social value of the market system |
| | Previous and forecast growth of market or access trajectory of service |
| | Likelihood of economic growth/service access being genuinely pro-poor |
| | Apparent dynamism/robustness of the market system |
| | Prospects for attracting public and/or private sector investment |
| Feasibility | Availability of market player 'drivers' with leverage |
| | Prospects for attracting more players or services |
| | Conduciveness of political economy (e.g. absence of conflicts, barriers to reform etc) |
| | Willingness of market players to change business model/adopt new practice |
| | Likelihood of distortion/inability to apply market system development principles |

First, the three criteria are deemed of equal importance (both by projects, and codified in the Operational Guide), but for structural change, the opportunity criterion may need to be weighted more heavily. After all, the sector should still have potential to be relevant to a large "number of poor men/women", but above all it is about the opportunity to drive investment towards sector(s) that have outsized-value in terms of contributing to economy-wide employment and output in the long-term.

Second, echoing the findings of the Gelb, et al. (2019) study, a broader range of methods and tools may be required to assess the economic transformation potential of a given sector[87]. Data availability is a perennial issue, but better tools and predictive analysis can be deployed to assess 'opportunity' criteria. This also needs pay due attention to mega trends such as the Future of Work. It is beyond the scope of this paper to identify specific tools, but Gelb, et al. (2019) mentions a number, including those designed to assess productivity gaps and comparative advantages.

Third, while the opportunity criteria leads projects to 'think big', the feasibility criteria brings them 'back down to earth', and to focus on sectors where it is easiest to catalyse change – but may not

[87] Gelb, et al., 2019

have most economic transformation impact. The way in which donors structure and set incentives for implementers (see section 4) creates boundaries for what is and is not deemed feasible. As we have seen, however, transformation might mean tackling more difficult, deep-seated issues. It is important that MSD remains feasible, pragmatic and realistic – but depending on the level of ambition and specific transformation objective, the feasibility criteria need to be carefully reviewed to ensure they are not overly prohibitive in 'screening out' sectors. The lack of a "conductive political economy", for example, may be the reason a 'typical' MSD programme chooses not to select a sector, but for economic transformation, it is precisely the need to improve elements of the political economy in order to unlock the growth of critical high-productivity sectors, which may be a reason to intervene in the sector.

## 3.2 Rules of the game

| | |
|---|---|
| Hypothesis: | Most MSD programmes have neither the incentive or capacity to work on rules and regulations |
| What needs to change: | Greater emphasis on political engagement and how to engage with (not work around) governments; including the need to improve the knowledge base on how MSD can address political economy constraints. |
| Relevant to: | Both structural change and sector productivity objectives |

A focus on economic transformation provides the opportunity to re-examine the role of MSD in supporting public actors. Economic transformation implies a large element of state intervention in markets: It is as national policy issue that requires public actions to accelerate the movement of land, labour or capital resources into higher productivity activities – or to seek to change the fundamental composition of the economy[88].

The theory of market systems development acknowledges the critical role of the government in the performance of market system[89]. The foundational *M4P Perspectives* paper places the efficacy of the political decision-making process – in particular its responsiveness to the genuine needs of the poor – as a central concern in MSD programming. Hence the focus in MSD on the incentives, rules, information and coordination of political market systems.

However, in practice MSD programmes have tended to work 'around' political institutions rather than engaging 'with' or working 'through' governments to achieve systemic change. As one Working Group respondent noted, "There is a natural tendency to look at governments as an impediment rather than an enabler of MSD". Some MSD programmes have tackled issues of policy, regulation, standards and public service delivery; yet a great many more simply ignore these issues or accept

[88] McMillan, et al., 2017
[89] Springfield Centre, 2008

them a priori ("the fertilizer subsidy policy is bad, but it's not feasible to do anything about it") and go straight into business innovations. However, seen through the perspective of economic transformation, this means that MSD programmes often seek to fix 'today's' constraints themselves within (relatively short) project lifecycles, rather than to figure out how public institutions can be better equipped to fix both 'today's' and 'tomorrow's' constraints over the much longer timeframe implied by a transformation agenda.

In the context of Africa, this may mean addressing some tricky political economy issues, including resource capture and clientelism, which have been identified by the World Bank[90]:

- Formal or informal regulatory barriers to entry in some sectors that protects incumbents or discretionary allocation of permits and licenses to benefit a few and limit competition.
- Complex regulatory environment and discretionary enforcement of regulations that privileges non-productive skills (e.g. through connections to government officials).
- Ineffective government interventions of all sorts (sector policies, land policies, finance policies, incentives and subsidies, and trade barriers) that are distorted or captured to benefit a privileged few.
- Regulatory compliance enforcement that is used by government agencies to protect dominant incumbents, for example, tax audits, labour inspections etc.
- Weak competition framework and weak enforcement capacity that limits the ability of governments to identify non-competitive behaviour and dismantle monopolistic positions

This does not mean re-tooling MSD to exclusively focus on public policy or that it has to address all of the many political economy constraints that exist in some developing countries. Indeed, according to McMillan, et al. (2017), the kind of sweeping and comprehensive government reforms that have been attempted in Sub-Saharan Africa over the last quarter-century have led to disappointing outcomes. Instead, they note, "most success stories start in a single sector, with a single politically empowered public agency"[91].

As the M-Pesa case in Box 5 shows, MSD can exert positive influence on the rules of the game. However, there is a currently a very limited stock of examples of how MSD has tackled political economy constraints; as a result the knowledge-base in this area is weak. Improving collective understanding of the importance of – and strategies to – work politically seems to be a priority area to further MSD's contribution to economic transformation[92].

[90] Adapted from Mahmood and Ait Ali Slimane, 2018
[91] McMillan, et al., 2017
[92] DeCosse and Van Pelt, 2017

## 3.3 Systemic change

| | |
|---|---|
| **Hypothesis:** | The systemic change vision pursued by MSD programmes is often about incremental innovation rather than the disruptive innovation required for economic transformation |
| **What needs to change:** | Longer term programming; if not, more modest impact expectations and greater clarity as to what systemic change means in the context of economic transformation |
| **Relevant to:** | Both structural change and sector productivity objectives |

Some respondents in the Working Group interviews noted that appropriate goal-setting is a challenge for MSD programmes. If a donor puts a too-strong focus on poverty reduction, then it will limit a programme's ability to focus on drivers of change that could be more transformative and meaningful in the long-term. This is especially the case given the current evidence paradigm that demands quantifiable programme impact on the poor in terms of incomes, jobs and livelihoods. Some felt that the goals of programmes also need to be more ambitious – all too often targets are to change incomes by 10% when only a 200% increase in net income will just bring someone up towards middle income status and away from serious vulnerability of sliding back into poverty. Focusing on what a sector needs to look like for all stakeholders to 'graduate' to middle income level would lead to a very different approach, with perhaps more indirect and much longer-term pathways to pro-poor change. This implies that donors may need to accept 'intermediate outcomes' as evidence of ultimate programme success[93]. Even if longer implementation periods for MSD programmes are possible; conceptually, an economic transformation focus means that MSD programmes can only ever *contribute* to wider transformational processes.

Underpinning this is the ongoing challenge of defining (and measuring) 'systemic change'. While the theory is that systemic changes often take place beyond the life span of a project, in practice systemic change targets are frequently baked into Logframes and included in bids. Projects come under pressure to quantify, demonstrate and report on achieved 'systemic changes' – including in some instances to get paid[94]. Not surprisingly, this has led projects to define systemic change more narrowly – focusing on elements of systemic change (sustainability, scale, resilience), rather than thinking about what kind of changes can actually be considered systemic, which entails more of a value judgement. Under a *technocratic* approach to setting systemic change goals, an innovation is introduced (like a mini-seed pack), a partner adopts it, and others crowd-in to offer or variants thereof. Yet nothing realty changes in the system structure, or in the underlying way that the market system for inputs functions as a whole.

[93] This could include more qualitative measures, or deploying participatory methods to reach stakeholder consensus that change is on the 'right pathway' (i.e. mid way up a theory of change) but that is is too early to assess ultimate impact on incomes
[94] Under Payment-by-Results (PbR) structures

Clearly, these kind of changes can be radically important for farmers, and lead to step-changes in productivity. One Working Group member referred to this as the strategy of 'keeping the lid on the pressure cooker'; seeking to make livelihoods better in the short- to medium-term, while figuring out pathways to long-term economic prosperity.

From an economic transformation perspective, however, such changes can be considered as *incremental* innovations (small tweaks to existing products or services) rather than the disruptive innovations (change that transforms existing markets or industries, or even creates new ones) required for economic transformation. A more transformational definition of systemic change would be rooted in issues of participation, power, politics and policies; including the removal of barriers to people moving into higher value-added roles, whether that is 'stepping up' within agriculture, or 'stepping into' more modern productive sectors. This is consistent with the roots of the term 'systemic change' in political activism, from civil rights to universal suffrage: "Systemic change means that change has to be fundamental and affects how the whole system functions"[95].

There have been many studies that have unpacked systemic change, including recent initiatives funded by BEAM Exchange looking at the concept from an evolutionary and complexity economics perspective[96]. However, it would be useful to get greater clarity on what systemic change refers to in the context of economic transformation. Introducing seed mini-packs (which took place over a period of a few years) is a qualitatively different type of change to supporting a whole new market for mobile money (which took place over a decade). MSD programmes can of course intervene to both 'keep the lid on the pressure cooker' as well as to support the emergence of modern sectors; the two are not mutually exclusive. An important starting point is to better align timeframes for programmes with a more nuanced understanding of systemic change expectations.

## 3.4 Portfolio management

| | |
|---|---|
| Hypothesis: | The way in which MSD is currently being used to support economic transformation is scattergun, not strategic |
| What needs to change: | Build more strategic portfolios to focus on different aspects of economic transformation, both within and between programmes; and be explicit about trade-offs being made |
| Relevant to: | Both structural change and sector productivity objectives |

A central theme of the economic transformation literature is that transformation cannot take place without both structural change *and* within-sector productivity growth. Structural transformation can

[95] Narberhaus, 2016

[96] Cunningham and Jenal, 2016

fuel rapid growth, but if it is not accompanied up by within-sector productivity change, this growth will not be sustained[97]. Productivity gains without structural change leads to decreased competitiveness over time.

From an *inclusive* economic transformation perspective, donors need to choose *between* these broad themes and decide whether to allocate more aid resources to one area (e.g. increasing productivity in sectors with large numbers of people in poverty) or to another (e.g., development of modern sectors)[98]. There is, however, an opportunity cost inherent in this choice: that using more of the available resources for one purpose implies having *less* available for another. In the words of Fields (2013), "the cost of using resources to help the poor where they are is to *not* have those resources available to help the poor get out of where they are".

This is more than an academic consideration, as it affects decisions about which programmes to commission and which sectors to focus on. Lifting up productivity in sectors where people in poverty are already engaged may 'guarantee' that jobs, incomes and livelihoods are improved. But these changes may be small-scale, short-lived and fall far short of what is required to truly impact on sustained poverty reduction. A focus on structural change may lead to more transformational impacts, but there is less certainty of success of modern sector development, and a higher chance that no impact will be recorded at all.

This implies the need to build more strategic portfolios to focus on different aspects of economic transformation, both within and between programmes. Balanced portfolios may entail:

> *(1) Different programmes to respond to different transformation objectives*
> This likely means combining or 'twinning' MSD programmes with other private sector development approaches, such as business environment reform, investment promotion or skills development. More 'joined up' programming, for example between economic development and governance teams, will be important to equip teams to work politically[99]. Beyond economic growth, better connections could be built with health and education programmes – two sectors which will be important to sustainably manage any shifts in rural-to-urban jobs. In this sense, MSD can both contribute to how wider programme portfolios are constructed, and as well as to introduce a more 'holistic' approach to other programme teams. As one Working Group respondent noted, "it can't all be on MSD's shoulders" – but MSD can be a piece of the puzzle.

[97] ODI
[98] Adapted from Fields, 2013
[99] ICAI, 2017

(2) B*uilding diversity into the sector portfolio of MSD programmes*
Within a given MSD programme, portfolios can be made up of different sector mixes, and different intervention mixes within the same sector. This may lead MSD programmes to explore new points of entry into familiar markets.

After all, an economic transformation objective does not mean abandoning agriculture. Indeed, as shown in Box 7, according to one theory of structural transformation, improving productivity growth in agriculture is critical to actually catalyse labour movements out of agriculture. A focus on transformation, however, would likely lead to more emphasis on supporting productivity increases through increased value-addition and processing, and a more overt focus on export-oriented sub-sectors.

To expand the range of options for structural change in Africa beyond manufacturing, the so-called 'industries without smokestacks' provide a set of potentially competitive activities such as tourism, business and tradeable services.

Recent evidence also shows the importance of strong business associations in supporting dynamic growth. These organisations can push for collective interests rather than individual patronage, hence putting pressure on political elites to reduce the costs of doing business and create more enabling environments[100].

Different donors and programmes will have varying levels of risk appetite – which will affect the type of portfolios they build. To aid decision-making, two things can be done. The first is to be aware of the risk of not acting. A good analogy comes from the world of investment. An investor can choose to put their money into equities, which have potential for generating high financial returns - but also carries greater risk that the investment will under-perform and lose money. Alternatively, investors can put money into a fixed term bond that guarantees a steady income, but with a much lower return than the equity fund. Most people focus on the risk of capital loss from equities and tend to assume that the bond is risk-free. However, the bond also carries an *inflation* risk, which is the chance that the cash flows from an investment will not be worth as much *in the future* because of changes in purchasing power due to inflation. In much the same way, donors can build portfolios of programmes for within-sector productivity increases because they want to respond to pressing livelihood needs and do not want to take the risk of wasting money on the development of modern sectors, where the failure rate is high all – all while incurring a risk that, over long time horizons, their 'safe bet' productivity interventions have not led to any demonstrable impact at all as people remain stuck in a poverty trap.

[100]Evans, A., 2018

### Box 7: Economic transformation and agriculture in Africa

Agriculture employs the majority of the continent's labour force, despite only accounting for about 13 percent of GDP (based on 2010 data in Fox, 2014). The sector's role in economic transformation in Sub-Saharan Africa has been described as a 'paradox': Even as the share of agriculture in employment and output shrinks in the long run, the sector plays an especially powerful role in poverty reduction (Brahmbhatt et al., 2016).

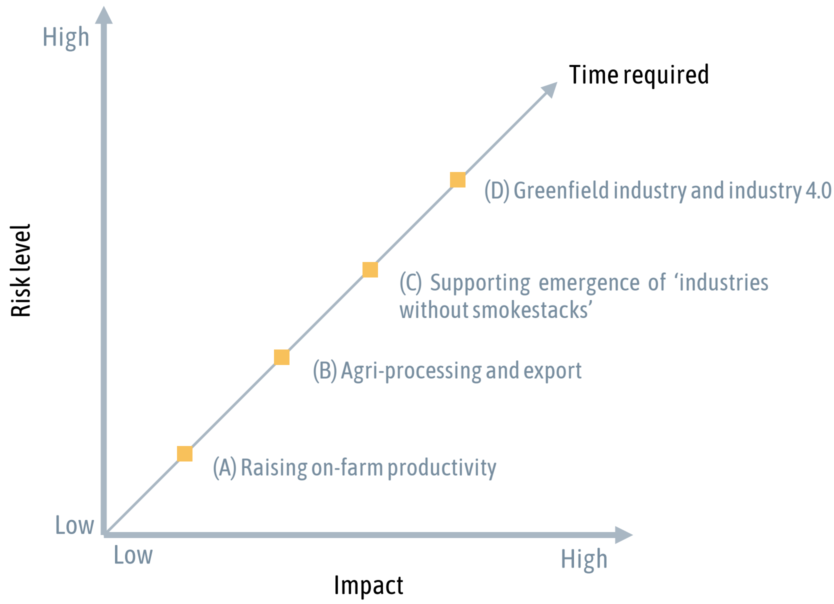
According to Fox (2013), rapid labour force growth and weak formal sector wage employment means that even if sub-Saharan Africa realizes another decade of growth as good or even better than the past one, structural change will likely proceed slowly, so a focus on increasing the productivity of nonwage jobs in agriculture and household enterprises will be critical to absorb new entrants to the labour force. As such, the adoption of modern technologies, value-addition through enhanced processing capabilities and upgrading through higher-value markets continues to be key for agricultural transformation (Breisinger and Diao, 2008).

Lessons from other regions suggest that "switching the sectoral attention away from agriculture before establishing a solid foundation for the transformation of smallholder agriculture will slow down transformation rather than stimulating it". Rapid shifts away from agriculture also risk small farmers being bypassed during the modernization processes, thereby marginalizing a large group of the rural population, entrenching inequality and leading to social tensions. According to one theory, successful agricultural transformation in the medium-term is not only a means of ensuring more inclusive economic growth – it is "a *prerequisite* for transformation, especially in agriculture-based economies such as those in Africa" (Ibid).

The second is to be explicit about the trade-offs that are being made. Figure 5 below visualises the potential trade-offs between short-term and long-term objectives. The higher the potential impact on economic transformation, the higher the level of risk appetite; and the longer the timeframe required[101]. Interventions to raise the productivity of producers to 'keep the lid on the pressure cooker' (Point A) can be reasonably confident of benefitting farmers (therefore less risky), and require less time as people are already engaged in the sector – but the ultimate impact on the transformation of an economy is limited. Supporting Industry 4.0 – economic activities built around automation and data exchange, especially in manufacturing technologies (Point D) – can be a gamer changer, but there is a much higher risk of sectors not succeeding, or of elite capture of gains, and change will take place over much longer time scales.

[101] Impact refers to expectations of both being able to achieve and evidence impact on economic transformation processes. Here, evidence refers to the risk that transformation will not happen (sectors fail), and/or that transformation is successful but fails to lift up people out of poverty (i.e. is not inclusive).

*Figure 5: A risk-return model for building a portfolio of MSD support to economic transformation*




One major benefit of portfolio diversification is that it can help to spread risk across different programmes focused on different sectors, or even within different sectors in the same programme. This appears to be missing from current practice. As one Working Group interviewee noted: "Some agencies have not been mindful enough in designing intervention portfolios… not strategic and deliberate enough. We need to have a robust approach to driving economic transformation".

What is important, ultimately, is to align expectations of the size of economic transformation impact, the level the risk appetite, and the timeframe to realise change. It will never be possible to support all aspects of the complex process of economic transformation; so choices will always need to be made.

## 3.5 Adopt a wider set of facilitation tools for MSD programming

| | |
|---|---|
| **Hypothesis:** | Programmes self-limit by using only a narrow range of 'soft support' facilitation tools, which are insufficient to catalyse the magnitude of change required for economic transformation |
| **What needs to change:** | Use a broader range of facilitation tools, and be prepared to get more hands on in thin markets |
| **Relevant to:** | Structural change objectives |

The range of tools available to market facilitators is incredibly broad[102]. In order to support economic transformation, facilitators will need to make use of the full toolkit.

[102] Off-the-shelf training, tailored training, research, technical advisory, brokering relationships, sharing information, grants, cost-sharing, returnable capital

Structural change in particular may require more hands-on and transactional support to work with market system actors to 'kick start' the development of modern sectors. This may be especially required in thin markets where there is limited private innovation. There may therefore be a period where there is a benefit in MSD programmes become a temporary actor in the market system. Once the desired changes become properly embedded, programmes then gradually transition out. This would mean loosening the maxim in the Operational Guide for facilitators to "remain outside of the market system they are intervening in" (see Box 8).

Alternatively, MSD programmes unwilling to do this could be linked to challenge funds or other grant funding vehicles, or impact investors or DFIs who have 'skin in the game' by investing capital into high potential sectors and enterprises; as is happening for example in DFID Rwanda with the fusion of the IMSAR market systems programme with an AgDevCo investment portfolio[103].

To mitigate the risk that MSD programmes become embedded in the market system, it is important to build incentives in the programme that prevent long-term market distortion. It would also be important for programmes never to compromise on the 'golden rule' of facilitation: make everything you do about building towards market player ownership, such that the system is not reliant continued facilitation.

Opening up the toolkit in this way is controversial, and not all respondents shared this view of deploying more direct tactics. Those that did agree, however, felt strongly about it:

- "*Market systems ideology should be interpreted flexibly, balancing long term systemic change with more hands-on or direct support to prove a business model or market opportunity".*
- *"Market systems development tended to be a bit evangelical in previous years. It's important not to be too religious about it. Sometimes you need to be flexible, you need to come in and have a strong demonstration effect, and judging by the context you're in maybe even become an actor in the market space as long as you have a withdrawal plan. If there are innovative ideas that can be transformational, sharing the risk and providing a grant might be justified and necessary. "*

**Box 8: The role of a market systems facilitator**

*Facilitator*: a development agent/agency seeking to stimulate market system change, tasked with remaining outside of the market system they are intervening in. In developing market systems, facilitators actively avoid distorting those systems and must be conscious not to make market players reliant upon their continued presence

*Facilitation*: the temporary actions of a facilitator to bring about system-level changes and develop market systems for the benefit of the poor.

*Source: Springfield Centre, 2015*

[103] DFID Improving Market Systems for Agriculture in Rwanda project (IMSAR): https://devtracker.fcdo.gov.uk/projects/GB-1-204940/summary

# 4. Synthesis of conclusions and recommendations, focusing on practical implications and guidance for donors

The section summarizes the main conclusions and recommendations of the study. It includes ideas for actions that could be taken by DCED Working Group and its members in order to respond to the findings. We note the limitations of the study in drawing definitive conclusions, and suggest promising areas for further research to deepen an understanding of how MSD might be to support economic transformation.

## 4.1 Conclusions

In theory, there is strong alignment between the principles of MSD as a poverty reduction *approach* and the over-arching objectives of an economic transformation *agenda*. In practice, available evidence shows that MSD programming is currently contributing to some aspects of within-sector transformation, particularly value chain development and agricultural productivity. But this has largely been incidental, not intentional: There are currently few examples of how MSD has been explicitly harnessed to support economic transformation, and particularly for structural change.

In the context of Africa, it is clear that raising agricultural productivity is – and will continue to need to be – an important component of any strategy for *inclusive* economic transformation[104]. As Timmer et al. note, "unless the non-agricultural economy is growing, there is little long-run hope for agriculture [yet] at the same time, the historical record is very clear on the important role that agriculture itself plays in stimulating growth in the non-agricultural economy"[105].

There is, however, an opportunity for MSD to play a number of other roles in supporting different types of transformational change:

**a) Seed.** MSD programmes can support disruptive innovations that seek to kick-start or contribute to the early growth of new, more modern economic activities and sectors. MSD can be used as the analytical lens through which to construct holistic sector-based support strategies, including by creating a more supportive enabling environment for innovation to flourish. The principles of MSD facilitation can also be used to provide to temporary support to market players; but in some cases, particularly where market structures are thin, more direct support may be required. 'Seed strategies', however essentially mean placing bets on high potential sectors; which carries an

[104] Fox, 2016a
[105] Timmer and Akkus, 2008

inherent risk that sectors may fail (including due to factors beyond the control of individual countries, such as shifts in the global economy), and the time required for job-rich growth and to contribute to poverty reduction may be very long.

An example of an MSD programme pursuing this strategy is *FSD Africa* through its support to creating an enabling business environment for mobile money innovation in Kenya (Box 5).

**b) Scale.** MSD can play a play a role in support sectors that are already rapidly emerging, such as the 'industries without smokestacks'. Here, the focus would be on addressing constraints so that opportunities from economic growth are more fairly distributed - helping ensure growth translates into real improvements for poor people[106]. This could mean improving the market infrastructure – such as mechanisms for sound public-private dialogue – to lay the foundations for making economic transformation more inclusive. It could also mean identifying and addressing specific aspects of the political economy, where functions/rule are mismatched, absent or underperforming, in order to "make sure the poor are connected to both the structural transformation and to the policy initiatives designed to ameliorate the distributional consequences of rapid transformation"[107].

An example of an MSD programme pursuing this strategy is *MarketMakers* in Bosnia through its support to creating a vibrant business community capable of actively participating in government policy discussions around making ICT a priority sector for economic growth in the country.

**c) Support.** MSD programmes can continue to support economic livelihoods and to raise on-farm productivity, especially to manage the 'downside risks' of economic transformation. This will be important in the early stages of structural transformation where, as we have seen, urban-rural disparities and inequality can rise. To ensure no one is left behind, MSD programmes can more explicitly support the diversification of rural livelihoods, particularly targeting sectors with high potential for off-farm employment. This could include, for example, sectors such as tourism, micro-distribution and retail where new jobs can be successfully combined with existing farm enterprise activities.

An example of an MSD programmes pursuing this strategy is *Samarth* in Nepal through its historical support to both the agriculture and tourism sectors, where income from household farming is compatible with, for example, an earning an seasonal wages as a trekking porter.

[106] See DFID, 2017
[107] Timmer and Akkus, 2008

In order to realise the opportunity for MSD to play a greater role in supporting economic transformation, we have suggested a number of 'tweaks' to elements of the MSD approach. These include:

- Adapting how sector selection criteria are applied in practice in order to align with structural change objectives
- Engaging more in the 'rules of the game' and addressing political economy constraints to more inclusive economic transformation processes
- Getting clarity and consistency about what systemic change means in the context of transformational economic change
- Introducing a more strategic approach to portfolio management both within and between programmes
- Utilising a broader range of facilitation tools

## 4.2 Recommendations

To support these ambitions, we have further identified three 'clusters' of action that donors and development agencies could take. This is not an exhaustive list, rather it focuses on a set of practical activities and immediate next steps, many of which can be taken under auspices of the DCED Working Group. They also seek to align and build on the recommendations of the parallel Business Environment Reform study.

1. Funders should set clear expectations how they want MSD programmes to 'work politically'. While more in-depth political economic analysis could be built in 'as standard' to all market systems programmes, in terms of implementation, donors can stipulate a strategy of:

- Avoid – Encourage MSD programmes to have minimal collaboration or contact with public institutions. Some formal affiliation with a government partner may be necessary, but this is 'in name only'. Systemic change comes about *despite* government actions[108].
- Align – Ensure programmes are fully aligned with sectorial transformation priorities of the government, and that the focus of MSD interventions is complementary to public policy. Systemic change comes about *in parallel to* government actions.
- About – Rules of the game are an explicit focus of the MSD programme, and the programme works to improve public policy processes and priorities etc. Systemic changes comes about *through* government actions.

[108] Here there is unlikely to be much of an economic transformation focus to the programme

- Absorb – The MSD programme is located close to or within the government, effectively improving the political market system so public actors can play a better facilitation role themselves. Systemic changes comes about *because of* government actions.

These strategies, however, will need to be highly country specific and will depend on domestic political processes – something that, as commentators have noted, donors often understand poorly[109]. A first practical step may therefore be to better understand the experience of MSD programmes that have already attempted to work with and through governments, and identify lessons learned so that funders and programmes go in with their 'eyes open' as to the pros and cons of working politically. An example of an 'absorb' approach is included Box 9.

**Box 9: Working within government in Timor-Leste**

The International Labour Organization (ILO) Timor-Leste's Business Opportunities and Support Services (BOSS) programme was a six-year MSD programme that ran from 2011 to 2016.

The BOSS project was embedded in the Institute for Business Support (IADE), under the remit of the Ministry for Economic Affairs, to address the needs of micro and small enterprises (MSEs) in Timor-Leste's severely under-developed private sector, with the ultimate goal of contributing to employment creation and income generation. On paper, BOSS has sought to develop and strength the Institute's internal capacity for market facilitation, in order to be responsive to the needs of companies in specific sectors such as horticulture, cattle and tourism. In practice, BOSS struggled to remain 'behind the scenes', and IADE became reliant on small pool of international experts from BOSS. IADE was unable to move out of their 'comfort zone' of service delivery. In hindsight, IADE was a new entity, and it inevitably took many years to build up their capacity; they were perhaps the 'wrong' player to perform a facilitation function. A key lesson learned is the importance of being 'absorbed' in the right part of government to maximise prospects of programme success.

2. Funders should ensure the 'enabling conditions' are in place for MSD programmes to support economic transformation. Donor decisions about how to commission, design, structure and evaluate MSD programmes can shape both the incentive and capacity of implementing agencies to pursue economic transformation objectives. While there are no 'ideal' programmes and donors are constrained by the reality of their own political economy, a number of actions can be taken to create the necessary 'conditions' for MSD programmes to support transformational change. This includes:

- Having goals with reasonable impact expectations that are consistent with the timeframe of the programme and the level of risk appetite
- Commissioning longer-term programmes
- More joined up programming across PSD and other disciplines, particularly governance

[109] Timmer and Akkus, 2008

- Introducing mechanisms to explore risk-sharing between donors and implementers – see Box 10.

Finally, it will be difficult to find strategic opportunities for MSD to support economic transformation if donors have no clear over-arching approach to economic transformation. Here, we echo the findings of the Business Environment Reform study in the importance of having a country-specific economic development strategy which is used to frame support for economic transformation.

**Box 10: Sharing the risks and rewards of successful structural change**

In interviews with the Working Group, there was recognition that the risks involved in supporting structural change, and backing new sectors, should not just be passed onto implementers. As one interviewee noted, "*Asking programme teams to identify the big opportunities for long-term transformative change and evaluate which ones are likely to be successful is even more challenging than standard MSD questions of asking what are the constraints and evaluating the options for how these can be tackled and by who*". This implies that strategy-setting and sector selection could become more of a joint activity between funders and implementers, building on recent models such as those being tested in USAID, where some Feed the Future Activities are awarded based on an initial application and oral presentation, with the eventual program 'co-created' by stakeholders (Grants.gov, 2019). Such approaches may help give implementers the 'safe space' they need to experiment and to share risks across donors, implementers and government counterparts.

**3. Conduct in-depth research and commission specific case studies on the impact of market systems development on economic transformation processes.** This paper explored the role that MSD currently plays in promoting transformational change, and how the MSD approach could be adapted or modified to better promote economic transformation in the future. It was limited in the level of depth it could go into specific aspects of transformation. However, there appeared to be considerable interest on the topic amongst Working Group members, especially on unpacking and understanding the potential for transformational change to be more inclusive. More targeted studies could be undertaken, specifically on:

- Country case studies that contextualise systemic change in an economic transformation perspective,
- The political economy of economic transformation, and how it affects the participation and performance of people living in poverty in market systems[110],
- Examples of how MSD programmes facilitated a transition from low-value to high-value added activities within sectors, particularly in agriculture, and on interventions that successfully promoted competition to lead to productivity increases.

[110] According to the World Bank, public and private resource capture can delay economic transformation and weaken market institutions (including regulators and competition authorities that play a key role in support market development).

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# Annex 1. Schedule of deliverables

| Deliverable | Deadline |
| --- | --- |
| Brief inception report (outlining the understanding of TOR, suggestions of possible limitations, etc) | 10th February 2019 |
| Interim report with key issues for discussion of current findings & emerging issues | 28th February 2019 |
| 1st draft report presentation of this to MSDWG | 12th April 2019 |
| Presentation and discussion of draft report at MSD WG Workshop | 25th April 2019 |
| Final report | 31st May 2019 |
| Presentation of final report at DCED annual meeting | 12th June 2019 |

# Annex 2. List of key informant interviews

| Agency | Name |
|---|---|
| *ADA* | Susanne Thiard-Laforet |
| *DCED Secretariat* | Jim Tanburn |
| *DCED-BEAM* | Mike Albu |
| *DFAT* | Julie Delforce |
| *DFID* | Andrew Gartside |
| *FAO* | Siobhan Kelly |
| *FAO* | David Neven |
| *Gatsby Foundation* | Justin Highstead |
| *Gatsby Foundation* | Raji Rajan |
| *Gatsby Foundation* | James Foster |
| *GIZ* | Janna Post |
| *GIZ* | Rainer Engels |
| *ILO* | Merten Sievers |
| *ILO* | Gun Eriksson Skoog |
| *ILO* | Steve Hartrich |
| *ITC* | Anders Aeroe |
| *JICA* | Saki Ito |
| *MasterCard Foundation* | Nafis Muntasir |
| *SDC* | Andrea Inglin |
| *Sida* | Elisabet Montgomery |
| *Sida* | Kåre Johard |
| *Sida* | Elin Carlsson |
| *Sida* | Jenny Krisch |
| *USAID* | Kristin O'Planick |
| *World Bank Group* | Tania Begazo |
| *World Bank Group* | Georgiana Pop |

# Annex 3. Methodology

| Step | |
|---|---|
| *1. Economic transformation literature review* | **What**: Desk-based review of relevant academic literature and policy papers<br>**Purpose**: Set the context and conceptual boundaries for the study - key lessons on processes, drivers and constraints of ET and the role of donors |
| *2. MSD programme mapping* | **What**: Analyse the MSD programmes in the BEAM Programme Index to map how they are contributing to within sector (productivity) and between sector (movement of resources) transformation. Plot the BEAM Evidence Map programme results to ET objectives.<br>**Purpose**: Understand how MSD programming is currently aligned with ET |
| *3. Working Group interviews* | **What**: Semi-structured interviews with engaged MSDWG members<br>**Purpose**: Understand how DCED member agencies have or are using the MSD approach to promote economic transformation |
| **Interim report:** Current evidence and key lessons about the role that donor-funded MSD programmes have been and could play in promoting ET | |
| *4. MSD literature & practice review* | **What**: Desk-based review of relevant guidance materials and grey literature (including case studies)<br>**Purpose**: Understand how MSD can be adapted and can complement / be combined with other PSD approaches |
| *5. Practitioner interviews* | **What**: Semi-structured interviews with a small sample of MSD practitioners<br>**Purpose**: To ‘sense check’ and ensure the feasibility of recommendations, as well as to understand key challenges from an implementer perspective |
| **Draft report**: Recommendations on how MSD practice could be modified or adapted to promote ET | |

# Annex 4. Terms of Reference

*Terms of Reference for a Study on*

## *Promoting Economic Transformation through Market Systems Development*

**Introduction**

The Donor Committee for Enterprise Development (DCED) Working Group on Market Systems Development (MSDWG) is interested to learn how donors can support Economic Transformation (ET) using the market systems development (MSD) approach. This work will be carried out in parallel and coordinated with related work commissioned by the DCED Business Environment Working Group (BEWG) examining how Business Environment reform can support ET.

This draft document has been prepared by a Task-team of the MSDWG, including representatives from DFID, FAO, ILO, GIZ and led by representatives from Sida, Gatsby Africa, ITC, MasterCard Foundation and WB Group.

**Background**

It is generally accepted that a country's sources of economic growth matter for its sustainability and potential to lead to inclusive long-term poverty reduction. Rather than exploitation of natural resources or expansion of production of primary goods, the key is to stimulate strong aggregate productivity growth, which in turn depends on a shift of resources being allocated from low-productivity into higher-productivity activities. The concept of economic transformation is therefore fundamental to long-term development (UNCTAD, 2017).

**Economic transformation** (as defined by ODI, 2017) includes both the *structural* reallocation of resources from low-productivity to high-productivity economic sectors; and more broadly, *intra-sectoral* reallocations towards higher-productivity activities *within* economic sectors, between and within firms. *Structural* economic transformation often attracts more attention, but *intra-sectoral* ET is equally of interest to the MSDWG for the purposes of this study.

In either case, to be judged 'transformative', productivity increases must be sufficiently comprehensive to be reflected in visible and sizeable changes in the major structures of the economy, between sectors, firms etc. In addition, members of the DCED/MSDWG have a particular interest in economic transformation that is inclusive, generating broad-based productive-employment for large numbers and thus leading to sustained poverty reduction.

In recent years, empirical research has increased understanding of the drivers of economic transformation (ET): why and when it occurs and how it can be supported. This includes analysing the political economy of transformation, and considering what the role of development cooperation might be (see e.g. ODI, 2017, Altenburg *et al*, 2016, Pritchett & Werker, eds., 2017, Koh *et al,* 2017 ). Various diagnostic tools and methodologies have also been developed that suggest how Governments and development agencies may select economic sectors most likely to drive transformation in specific national economies (see e.g. Lin and Chang, 2009).

The literature on economic transformation often describes similar concerns and objectives to those identified by donor-supported programmes which use the market systems approach (MSD).
MSD seeks to address constraints that inhibit the productive functioning of a market or industry, and the participation of poor people in it. The approach treats markets as complex multi-function systems with social and political as well as economic dimensions. It looks to identify and address root causes for the failure of specific market systems to perform, provide services or generate employment and income for people living in poverty.

To date there has been no comprehensive examination of how the MSD approach might be useful in strategically promoting economic transformation: that is, in supporting the re-allocation of resources from low-productivity to high-productivity activities. Nor has the role that donors and development agencies might play in using the MSD approach to support economic transformation been examined.

Similar, related questions concerning the role of business environment reform in supporting economic transformation, are on the agenda of DCED's Business Environment working group (BEWG). Like the MSDWG, BEWG members are asking what the role of donors and development agencies could be in promoting economic transformation through business environment reform.
As a result, members of both working groups recently started initiatives (MSDWG in February 2018) and (BEWG in April 2018) to study these issues. Agreement to coordinate the respective studies was reached at the DCED annual meeting in June 2018.

### Purpose of Study

This study should examine how donors and development agencies can practically utilise MSD programming to support economic transformation. It will suggest how the MSD approach can be used, adapted and complemented to promote transformation in developing countries.
The recommendations should be based on a review of existing evidence, both in the literature and among donors and practitioners, and serve as a solid basis for possible future guidance documents for DCED members.

### Geographical Focus

The study shall have a particular focus on economic transformation in Sub-Saharan Africa, where problems of limited economic transformation and poverty reduction are most acute. Relevant and useful experiences elsewhere shall be considered.

### Main Questions

The study should address the following two clusters of questions

1. **What does current evidence show and suggest about the role that donor-funded MSD programming could play in practice, in promoting both structural and intra-sectoral economic transformation?**
   - What particular challenges confront donors in promoting ET in practice?
   - What aspects of the MSD approach lend it the potential to support ET?
   - What are the limitations of the MSD approach in relation to support for ET?
2. **How could MSD practice be modified or adapted, including through combinations with other forms of support for private-sector development, in order to better promote economic transformation?**
   - What are the implications of an economic transformation agenda for MSD programming?
   - Are additional criteria are needed for MSD sector selection? If so, what are they?
   - Where is the greatest potential for coordinating MSD with other forms of support to PSD?

### Methodology and approach

It is proposed that the consultant undertakes the following approach to address the above-mentioned questions. In responding to this ToR, the consultant should suggest specific activities for delivering on this methodology and any suggested amendments.

The MSDWG's Task-team will ensure that the approach used for this study is coordinated with the BEWG team supervising the related study commissioned by the BEWG.

a. Agree the detailed approach and methodology in consultation with the MSDWG Task Team
b. Conduct a desk-based review of existing relevant literature to identify evidence, and key lessons regarding the processes, drivers and constraints of economic transformation, focussing on the historical role for donors.
c. Conduct structured interviews with engaged members of the MSDWG to understand how DCED member agencies have or are using the MSD approach to promote economic transformation.

d. Synthesise insights from the literature review and interviews, and make recommendations regarding the role that MSD programming could practically play in contributing to economic transformation.
e. Address the challenges and other areas for consideration listed in Appendix 1 where possible, without diluting the focus of the main questions above.
f. Describe how the MSD approach might be combined with other approaches to PSD in practice, such as BER, investment promotion, skills development, policy dialogue etc., to create a more strategic donor approach to economic transformation.
g. Formulate conclusions and recommendations for DCED / donors in response to the Main Questions above. These should be included in the report (see below) and presented to and discussed with the DCED community in a physical workshop.

### Outputs

The main output will be a written report, accompanied by a short Power-point presentation, with the following main sections:

1. Executive summary (also published as a Power-point presentation)
2. Presentation of current evidence and key lessons about the role that donor-funded MSD programming could play in promoting economic transformation.
3. Recommendations on how MSD practice could be modified or adapted to better promote economic transformation.
4. Synthesis of conclusions and recommendations, focusing on practical implications and guidance for donors.

The consultant will be expected to submit a draft report first and present this in a DCED workshop as well as the final report and presentation to the MSDWG around the time of the next DCED annual meeting (details below).

### Qualification Requirements

- Solid knowledge and comprehensive understanding of the MSD approach and practical experience of its real-life application
- Good knowledge and overview of different donor perspectives on approaches to support PSD
- Good understanding of SET and overview of the literature as well as ability to quickly provide an overview of relevant SET literature
- Demonstrated ability to provide synthesis and insights, as well as strategic guidance relevant to practical application

- Excellent analytical, writing and communication skills

### Timeframe and deliverables

It is expected that this assignment will be started by 1 September 2018, and completed by 1 July 2019.

The detailed steps are the following:

| Deliverable | Format | By when |
|---|---|---|
| 1. Host kick-off session with DCED task-team to review the proposed methodology and outputs. | Kick-off deck | December 2018 |
| 2. Brief inception report (outlining the understanding of ToR, suggestions of possible limitations, draft outline of the report etc) | Word document | December 2018 |
| 3. Interim report with key issues for discussion of current findings & emerging issues | Word document | January 2019 |
| 4. Presentation of interim report via skype | | January 2019 |
| 5. 1st Draft report | Word document | March 2019 |
| 6. Presentation and discussion of draft report at joint DCED BER and MSD WG Workshop | PowerPoint presentation online/ in person (tbc) | March 2019 |
| 7. Final report | Word document | May 2019 |
| 8. Presentation of final report to the MSD Working Group around the time of the next DCED annual meeting | PowerPoint presentation in person | June 2019 |

### Recipient

The recipient of this work will be the Market Systems Development Working Group (MSDWG) of the Donor Committee for Enterprise Development (DCED).

### Inputs

It is estimated that the consultant will need approximately 30 working days.

### Selection and contracting procedure

The selection of the consultant for both modules will be done through IFC in cooperation with the Task-team consisting of Sida, Gatsby, ITC, WBG, and Mastercard Foundation. The consultant will be managed by MSD-WG Task Team.

*Appendix 1 Challenges and other areas for consideration*

- How does economic transformation contribute to *inclusive* economic growth? What are the potential intended and unintended consequences for those from poorer and marginalised socio-economic groups?
- How might donors move to reconcile short term programme life-cycles with the long-term timelines involved in achieving economic transformation?
- Is it feasible for donors measure some shorter-term results whilst accounting for the likelihood that the significant impacts will be longer-term.
- To what extent can the MSD approach be applied to promote growth of emerging sectors with an economically transformational potential (e.g. fostering new and emerging technologies)?
- What does a focus on emerging sectors imply for how donors manage expectations to achieve economic transformation in sectors where many poor women and men are already employed?
- Does the MSD approach offer any advantages for governments and development agencies seeking to promote economic transformation processes that achieve greater or more rapid inclusion of people living in poverty?
- What additional diagnostics / criteria – beyond those already described in MSD / M4P operational guidance – may be needed in MSD programming for selecting sectors / market systems that are conducive to supporting economic transformation, and resilient in the face of emerging economic trends? (e.g. automation, urbanisation, demographics and the need for food security)
- To what extent does the economic transformation agenda imply a greater focus on constraints or opportunities in the 'rules' part of the market system? How might current MSD intervention practice be supported / adapted to achieve this?
- To what extent is it feasible and desirable for MSD programming to strengthen its focus on outcomes that involve productivity increases, value addition through processing, development of manufacturing capabilities and services within selected market systems?To what extent is it feasible and how can the MSD approach address – or be complemented to address – vested interests and political-economy constraints to inclusive ET?
- To what extent and how can the MSD approach foster a hypothesis-driven and iterative approach to ET beyond the development of specific markets/sectors, to a more comprehensive and strategic portfolio of interventions, allowing for adaptive management, risk taking, experimentation and innovation etc.?

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