INVESTING IN THE BUSINESS OF DEVELOPMENT

BILATERAL DONOR APPROACHES TO ENGAGING THE PRIVATE SECTOR

EXECUTIVE SUMMARY

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Executive Summary

Donors from Organisation for Economic Co-operation and Development (OECD) countries are increasingly looking to the private sector as a key partner for achieving sustainable development results. Private firms and foundations are seen as a source of innovation, expertise and finance to be harnessed in addressing development challenges. At the same time, private sector actors are playing an increasing role in their own right both as funders of development interventions and as important business partners. The private sector is also playing a greater role in international discussions on aid effectiveness and in the establishment of the post-2015 framework that will follow the Millennium Development Goals (MDGs). Donors have put their weight behind statements supporting the private sector at the United Nations (UN) Millennium Summit in 2010 and more recently at the 2011 Fourth High Level Forum on Aid Effectiveness (HLF4) held in Busan, South Korea. These trends signal an important shift where by the private sector is not only being afforded greater space to contribute to international and national policy discussions on development cooperation, but is also expected to serve as an important development partner. While donors have *promoted* private sector development for a number of years, the more recent focus on *partnerships* with the private sector, and its implications for development policy and practice, is an emerging trend.

Over the past few years, members of the OECD’s Development Assistance Committee (OECD-DAC)—the forum through which donor countries coordinate their aid efforts—have renewed their focus on economic growth and the private sector as driving forces behind development. Despite these trends, donor policies for promoting economic growth and the private sector have received very little comparative analysis. This paper seeks to address that gap with an initial mapping and exploratory assessment of bilateral donor strategies on the private sector and economic growth. The paper is based on an examination of publicly available OECD-DAC donor policies reviewed between January and June of 2012, including websites, strategy papers, policy documents, and donor commitments at HLF4 and in other multilateral fora. Taking a framework analysis approach, the objective of the paper is to identify emerging themes in donor policies around growth and the private sector by comparing and contrasting different elements of donors’ strategies. These elements include the visions and assumptions of donors’ strategies, the pillars of their approaches, areas of focus, and budget sizes. The research also examines how, in the context of growth and private sector strategies, donors see the role of the state, private sector actors, and other development actors. Finally, the paper looks at the extent to which donor strategies take into consideration development and financial additionality, international aid and development commitments, cross-cutting issues such as sustainability, gender, and human rights, and principles relating to aid effectiveness. While there has been much work looking at the role of the private sector in development, there has been less of a focus on the private sector in the context of aid effectiveness.

Key findings from the study include:

Scope and logic of donor strategies on growth and the private sector

- The extent to which donors have established, detailed, and publicly articulated their policies on and work with the private sector varies. Donor strategies and policy frameworks have been developed at different levels, with some having broad strategies that serve more as guidelines and provide direction for projects and programs, while others having detailed programming, monitoring, and evaluation guidelines.

- Donors agree that growth is integral to development and that the private sector has a key role to play in this regard. However, donors emphasize different patterns of growth and see various roles for the state and the private sector in achieving growth, development, and poverty reduction. Nevertheless, the entry points for programming and partnership are not very different. In short, while theoretical approaches distinguish various donors, these differences should not be overstated since, in practice, donor responses are not that distinct.

- Although donors recognize that benefits from growth must be shared, most growth and private sector strategies do not engage comprehensively on issues related to the distributional or pro-poor impacts of growth, or the role of the state in ensuring pro-poor development outcomes. Few donors focus on promoting policies that strengthen government capacity to create decent work, effectively collect taxes and deliver social services, and redistribute the benefits of growth to those who are most marginalized by the economic activities that create growth. At best, donors tend to focus on making very narrowly defined markets equitable within and among countries, rather than supporting policies to directly target growing inequalities.

- A goal of donor strategies is improving self-reliance in developing countries through the promotion of economic growth. However, the extent to which donors target domestic resource mobilization and taxation—important areas that, if improved, would decrease developing countries' reliance on aid—is limited.

- In general, donors do not address the political dimensions to growth, the private sector, and development. This reflects technocratic understandings of the state and largely ignores ongoing debates about the role the state plays in development and the political economy in which policies are made. Donor approaches, alongside the impact of decades of neo-liberal policies, continue to diminish the policy space for developing countries to establish socio-economic models specific to their national (and regional) contexts that take into account the views of citizens.

- Donor strategies are based on the assumption that partnerships among development actors represent wins for everyone, recipient governments, the private sector, donors, and civil society organizations (CSOs)—they are win-win-win-win situations. Each actor has a role to play under this assumption. All partners are to engage with and inform national development strategies. Public-private partnerships (PPPs) allow actors to benefit from private sector finance and expertise, while the private sector benefits from financing and the awarding of contracts. Some CSOs (mainly international non-governmental organizations) benefit from additional finance. Yet, this positive framing of win-win-win-win situations is unlikely to survive the *realpolitik* at the country level. Donors' assumptions about broad-based ownership and inclusion are seemingly based on the notion that the interests of all parties are not so different as to hinder agreement. But when policy-making involves a large number of actors—ones with potentially disparate goals, agendas, interests, constituencies, and capacities to engage, as is the case with donors, developing country governments, the private sector, and civil society—disagreements will occur. This does not mean that consensus is impossible; however, it does place increasing emphasis on the importance of the process for securing country ownership and reaching consensus, and the politics of that process.

- It is difficult to assess the scale of donor interventions with and on the private sector. This is largely because many forms of private sector engagement exist, and donors categorize and track their private sector interventions and partnerships differently. In short, without more consistent and accessible data, it is impossible to make any accurate, meaningful, and comparable assessment of the scale and scope of donor financial support either in the area of growth or the private sector.

Engaging the private sector

- Donors engage with the private sector in two key ways: by *promoting* private sector development and *partnering* with the private sector to achieve broader development outcomes. In the case of *promoting* the private sector, the link between growth and poverty in developing countries is seen as a direct one: a thriving private sector contributes to growth, which in turn contributes to poverty reduction. *Partnership* with the private sector will help make effective use of declining aid resources, leverage alternative sources of development financing, and identify innovative private sector-managed solutions to development challenges, including the provision of goods and services to poorer populations (bottom of the pyramid approaches, for example). These approaches are not mutually exclusive. A number of donors are *partnering* with private sector actors to *promote* private sector development. While private sector development remains an important part of donor strategies, joint international statements by donor countries and new funding arrangements being developed at the donor level indicate that there is an increasing emphasis on partnership.

- Donors are focusing their efforts at a number of levels. Macro-level donor policies focus on creating a "*business enabling environment*" — building economic, legal, and regulatory foundations (property rights, financial regulations, governance, and sound public financial management) to ensure that the right conditions exist for the private sector to thrive. Meso-level interventions are those that "*make markets work*" in ways that address market failures and imperfections, enhance competitiveness, and better integrate all actors into markets. These interventions include aid for trade, building value chains, provision of finance, and transfer of technological innovations. Finally, micro-level interventions that "*invest in businesses and people*," entail building support services to enhance longer-term private sector development and growth. Examples include investments in businesses (technical and financial support to the private sector) and people (infrastructure development; health; education; vocational skills training, in particular for women, focused on fostering a thriving workforce; and environmental sustainability).

- At the macro level, donors are promoting international corporate social responsibility (CSR) standards, and to some extent pursuing national dialogue opportunities with the private sector. A key challenge to involving the private sector in national dialogues and planning processes is ensuring that such dialogues take place in a transparent and inclusive manner, and involve the private sector as well as CSOs. Selecting the "right" private sector actors to engage is also a crucial issue. Participants must represent the interests of the broader private sector, rather than their own commercial agenda, and the selection process must be deliberate and inclusive if the end goal is to orient business toward pro-poor policies.

- At the meso level, the new donor modalities highlighted in the paper reflect the emphasis that donors are placing in their international statements on partnering with the private sector. A number of donors are promoting PPPs and making use of challenge and innovation funds as important mechanisms to harness private sector finance and expertise to address development challenges. Donors are providing financing for firms from donor countries to catalyze their investment in developing countries and promoting match-making initiatives that partner national (donor) and domestic (developing country) firms through joint ventures and new trade relationships. Such initiatives also work to promote SMEs through partnerships and better integrate domestic firms into global value chains.

- At the micro level, donors place a lot of emphasis on the individual and integrating each individual into markets as an employee, producer and consumer. In practice, this means building individuals' skills through vocational training programs, giving people access to a range of financial tools, and integrating them into value chains, all of which should ultimately lead to income gains, and in turn, access to basic necessities and new goods and services. Donors' focus on private sector development tends to be more at the macro and meso levels, specifically on creating an enabling environment for business and connecting private sector actors to global markets. However, in a context where many countries, particularly those in Africa, are experiencing periods of sustained growth and investment that are distinguished by stubbornly high unemployment rates, this approach may need to be rethought, or at the very least rebalanced. Focusing more on the micro may have a much larger redistributive impact for poor and marginalized populations.

Implementation considerations

- In general, donors see a role for their own national and foreign firms in their strategies. While many donors are supporting their own private sector, nearly all also include provisions for promoting the private sector in developing countries in their work, often using capacity building and financial services for SMEs as their entry points.

- Donors have some policies in place to ensure financial and developmental additionality in their private sector partnership mechanisms, but it is unclear how donors are ensuring additionality across their programming.

- Financial additionality refers to the extent to which aid funds target sectors and firms that otherwise would not have funds available to them. In practice, the level of financial additionality across donor grant-making programs varies. Of the 12 funding mechanisms examined in this research, half require that applicants demonstrate that either the project could not have happened or would not have happened at the same scale without their support. Half of the initiatives provide match funding to a maximum of 50 per cent. However, none of the grant-making programs include potential criteria to ensure financial additionality, namely to assess financial need, to promote investment in risk-averse markets, to gauge leverage potential, to encourage financial eligibility that favours the domestic private sector, and to assess the opportunity costs of resources used.

- Development additionality refers to the extent to which aid resources directed to, or in support of, the private sector work toward eradicating poverty and achieving other development goals, such as the MDGs or human rights standards. Yet, for grant-making programs, there are variations in terms of the extent to which donors clarify and specify the development impacts that they expect to see from such partnerships. By and large donors have described their development additionality requirements in vague terms (e.g., partnerships must contribute to the goals of the development agency).

- The extent to which donors employ internationally agreed standards and principles, including those on human rights, as guiding frameworks for their work with and on the private sector differs. Twelve donors reference the UN Global Compact, nine reference the OECD Guidelines on Multinational Enterprises, and six refer to the Extractive Industries Transparency Initiative. Eleven donors specifically refer to International Labour Organization (ILO) conventions while ten point to UN conventions and declarations on human rights, such as the Universal Declaration on Human Rights, the Covenant on Economic, Social and Cultural Rights, and the Convention on the Rights of the Child. An additional six donors refer to rights in the general sense in their strategies (i.e., they do not specifically reference UN conventions and standards, but rather point to the respect for human rights as important in their strategies).

- It is difficult to assess the full extent to which donors take into consideration cross-cutting issues—namely gender and sustainability—in the implementation of their growth and private sector strategies. On the one hand, private sector partners may be required to demonstrate expected development impacts across gender, sustainability, and human rights outcomes in order to qualify for donor programs and challenge funds. On the other hand, at the level of donor strategies and policies which provide operational guidance to programming, there is less emphasis placed on cross-cutting issues. It is difficult to tell how much standalone policies on cross-cutting issues influence growth and private sector programming.

- Regarding gender, donors' take an instrumental approach to women's economic empowerment, as the focus is on better integration of women into markets rather than addressing the social and political elements of gender equality and empowerment. Sustainability, including sustained growth and green growth, is referred to in donor policies on growth and the private sector. However, it is unclear whether references to sustainability have translated into in-depth policies or corresponding programs. Despite public commitments to aid effectiveness, donors do not make strong references to their commitments on country ownership, alignment, harmonization, mutual accountability, and results and their further elaboration following High Level Fora on Aid effectiveness. It is unclear how aid effectiveness principles have been incorporated into donor policies on growth and the private sector.

- Most donors' policies include neither an approach to robust and comprehensive results in the context of complex development outcomes nor a commitment to publicly accessible monitoring of results for programming on growth and the private sector. This finding is consistent with other studies looking at donor approaches to private sector development and working with the private sector.

- Transparency and accountability are terms used throughout donors' policies on the private sector. However, these terms are largely understood as the transparency and accountability of developing country governments. Donors may not be fully transparent when it comes to their funding for private sector development, particularly with regard to the private sector contributions to their efforts. Partnerships with private sector actors can also be opaque in terms of the criteria for partner selection and the development results achieved. In addition, it is unclear how accountability functions in new partnerships with the private sector. How are development partners accountable to each other and to supposed beneficiaries for results? From an aid effectiveness perspective, the gap in donor programming on transparency and accountability mechanisms is glaring and concerning, more so given that donors are likely to increase their work in this area in the future.

A number of recommendations arise from this provisional analysis:

- **Enhance tracking, disclosure, and comparability of private sector funding.** Donors need to agree on a common set of sector codes to measure donor contributions to economic growth and private sector development, and make effective use of coding where partnerships with the private sector are a principal objective.

- **Deepen and strengthen implementation of the Paris Declaration, Accra Agenda for Action, and the common principles of the Busan Partnership for Effective Development Co-operation.** Proposals should be assessed against aid and development effectiveness criteria. Donors will need to make a more concerted effort to ensure that their partnerships with the private sector also translate into mechanisms that measure development impacts and outcomes, and generate greater accountability to beneficiaries and citizens, not just developing country governments and/or donors.

- **Support democratic ownership of the growth and private sector agenda**. Donor policies do not promote space for developing countries to establish strong national ownership over the growth and private sector agenda. Donors sometimes favour their own commercial interests to the detriment of developing countries' domestic policies for development. While many donor policies touch upon the need to build self-reliance in partners, country ownership necessitates support for country-led initiatives to build progressive taxation systems with provisions to address capital flight, strengthen social and environmental policies, ensure citizen engagement, and establish safeguards and safety nets for the poor and marginalized. Donors can play a role in encouraging developing countries to initiate truly multi-stakeholder processes that can shape domestic development plans which engage CSOs, business associations, trade unions, and other actors, in addition to private sector stakeholders.

- **Develop common criteria for assessing the private sector with which donors engage**. Donors can play a positive role in building the capacities of domestic firms, even in partnership with national and foreign firms. They can also improve access to finance. In direct support to national and foreign firms or PPPs, donors need to establish a set of funding eligibility criteria for private sector partners that go beyond technical requirements (minimum years incorporated, audited financial statements) to address the track records of these partners in delivering positive development outcomes (in this case, positive social, development, economic, and environmental impacts, particularly for poor and marginalized populations).

- **Establish indicators to ensure financial additionality in private sector development and partnerships**. To achieve this, donors should establish a set of indicators that assess financial need, promote investment in risk-averse markets, gauge the leverage potential of such an investment, encourage financial eligibility that favours the domestic private sector, and assess the opportunity costs of resources used against other development priorities.

- **Regarding development additionality, donors need to ensure that aid resources to, and for, the private sector work toward reducing poverty and achieving other development goals, such as improved livelihoods, the creation of quality employment opportunities, realization of labour rights, and improved social and environmental outcomes.** Donors need to clearly articulate intended development and poverty reduction outcomes for their investments by establishing a monitoring framework with publicly available qualitative and quantitative indicators for measuring gender equality (including measures for the economic, social, and political inclusion and empowerment of women), governance (including the effectiveness and capacities of institutions), and environmental sustainability (particularly climate change).

This paper has provided a broad overview of some of the emerging themes and characteristics of various bilateral donors' strategies and policies, but **questions remain on four key areas:**

- The scope of bilateral donor engagement with the private sector, an accurate measurement of the scale of engagement, historical trends of such private sector support (especially relative to the rest of donors' aid budgets), and an assessment of the range of national-level actors beyond traditional bilateral donors (for example, development finance institutions, export credit agencies, and investment banks) that are substantively engaging in development.

- An assessment of how bilateral donors' policies are being implemented in practice, in particular from a financial and development additionality perspective.

- The impact of these interventions on the ground.

- The growing role and importance of emerging countries in South-South Development Cooperation (SSDC) and triangular cooperation (SSDC supported by donors) on private sector development and economic growth. Where do these countries fit within the findings identified in this research, what can donors and Southern providers of Official Development Assistance (ODA) and other types of assistance learn from these experiences, and what should they avoid? The answers to these questions will provide a broader and more nuanced picture of how development actors are engaging with the private sector overall.

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