

## CHAPTER 8

# DEEPENING PRIVATE SECTOR ENGAGEMENT IN AID FOR TRADE

*Contributed by the Organisation for Economic Co-operation  
and Development*

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**Abstract:** *This chapter looks at the engagement of the private sector in aid for trade and in particular the role donor agencies have played in promoting this through supporting an enabling environment for the private sector and addressing market failures in terms of information asymmetries and access to finance. After discussing the various models of public-private co-operation, the chapter concludes that engagement of the private sector in development offers opportunities but also challenges in terms of expectations, costs and benefits and time frames.*

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## INTRODUCTION

The private sector is responsible for approximately 90% of employment in the developing world (both formal and informal jobs). Private entrepreneurs and their profit-making activities – whether large multinationals, medium- and small-scale local enterprises or informal farmers – provide critical goods and services that improve people’s lives, generate domestic tax revenues and are key to stimulating economic growth (see IFC website). In many developing countries the private sector plays a vital role in producing goods and services for export markets, thereby generating foreign exchange (crucial for macroeconomic stability) and enabling firms to expand their production frontiers, achieve economies of scale and enhance their competitiveness. While donor agencies differ in their approaches and priorities to alleviating poverty, they all see economic growth as the requisite factor for meeting sustainable development goals and ending poverty – and they recognise that sustainable development solutions will require a role for the private sector. This is underscored by strong evidence that private investment and private sector-led productivity increases are the transformational force in development (Sida, 2014).

In view of the pivotal role played by business, finding the ways and means of leveraging private sector know-how, productive capacity and financial resources for development is high on the agenda of donor agencies. In order to develop a thriving private sector, donor agencies have played an important role in supporting partner countries to get the pre-conditions for private-sector growth right, including promoting a propitious business climate, investing in infrastructure and facilitating entrepreneurship through development finance and technical assistance. To promote private sector-led, inclusive and sustainable growth, developing countries need to prioritise reducing their trade and investment costs. While developing country governments are responsible for creating an environment conducive to private sector growth, development co-operation can help these governments steer private sector activities to contribute to more inclusive and environmentally sustainable growth.

This chapter reviews the background and current status of the debate on how to enhance the engagement of the private sector in aid for trade. It highlights lessons and challenges faced by donor agencies in deepening private sector engagement in development co-operation through using ODA to leverage private finance and investment. The remainder of this chapter is structured as follows: The first section reviews the changing context for public-private co-operation on development. The second section discusses how OECD countries are promoting private sector investment. The third section focuses on the objective of inclusive and sustainable growth. The fourth section analyses the volume of ODA provided to building productive capacities. The fifth section describes how donors are working with and through the private sector, and the sixth section assesses emerging evidence about the effectiveness of these partnerships. The final section concludes by highlighting the opportunities and benefits implicit in a thriving private sector, and the role of donor agencies in promoting private sector development through development co-operation activities and resources. The chapter is based on academic work, findings from evaluations of donor programmes, responses to the OECD/WTO Survey and case stories submitted by donors, recipients, the private sector and NGOs.

## THE CHANGING CONTEXT OF PUBLIC-PRIVATE CO-OPERATION FOR DEVELOPMENT

The process of globalisation, powered by innovative and widespread improvements in transportation and technology worldwide, has advanced rapidly over the past decade, intensifying the interconnectedness of all countries through communications, trade, financial flows and integrated production systems. OECD countries’ engagement with developing regions, long viewed through the lens of ODA, is poised to increase and deepen through a large and growing network of trade, investment, and development partnerships. Furthermore, the support provided by other providers of development co-operation – including South-South co-operation – through mutually beneficial trade and investment linkages has rapidly accelerated over the past decade. Multinational enterprises (MNEs) are the most public face of globalisation, and there is a reason why. There are 104 000 MNEs in the world, controlling about 790 000 subsidiaries. A full 71% of all MNEs are based in rich countries, and the 500 largest account for 25% of global output and 50% of world trade.

Moreover, MNEs receive 80% of all payments for technology royalties and fees. Despite the predominance of MNEs from advanced economies, a vibrant private sector is blossoming in many emerging economies. Some examples: for Brazil, JBS in food processing, Vale in mining, Braskem in bioplastics, Embraer in aerospace and Cosan in energy; for India, Bharat Forge in metals and Tata Communications in telecoms; and for China, Haier in household appliances, BYD in batteries, Lenovo in personal computers.

The changing nature of international business, in particular the expansion of global and regional value chains, provides new opportunities for developing countries. The liberalisation of trade was a critical factor for the expansion of global production over the past two decades. Trade is increasingly organised in value chains and characterised by fragmented production processes: 85% of global trade is linked to multinational enterprises and 60% is comprised of intermediate goods. International production is nothing new, but its magnitude and the degree of fragmentation in global GVCs is new. To an unprecedented degree, firms are now able to break up their value chains and locate discrete activities according to competitive advantage rather than geographical convenience. In today's globalised landscape for manufacturing and distribution, firms in developing countries can specialise in tasks and specific business services to connect to these value chains. This offers opportunities to both large and also small countries, provided that they find their areas of comparative advantage in terms of costs, productivity, skills and know-how (OECD, 2013).

GVCs provide the private sector in developing countries with unprecedented access to networks, new markets, capital, knowledge and technology, which in turn can offer a path to more diversified and robust economic growth and development. Governments in the developing world, most notably in East Asia, have relied on expanding international trade over the past two decades as the centrepiece of their national strategies for growth and development (OECD/WTO, 2013).

#### BANGLADESH LINKING TO GLOBAL VALUE CHAINS: RESULTS AT A GLANCE

<b>Bangladesh</b>	Netherlands Trust Fund (NTF) allowed Bangladesh to link its competitive IT companies to European markets, unleashing the country's potential. (CS 68)
<b>Bangladesh</b>	Thanks to an NTF matchmaking event, the Bangladeshi software company Nascenia got in contact with Better Collective, starting a successful business partnership. (CS 88)
<b>Bangladesh</b>	Delivering advertising support for the Windows 8 launch allowed Graphic People – a Bangladeshi company – to learn from Microsoft and to gain experience for other future big projects. (CS 87)

Source: OECD/WTO aid-for-trade case story (2015).

The private sector has been responding to these opportunities with significant investment. An example is that of Unilever. By 2020 it expects developing markets to account for 70% of total sales. It is already using a rural sales force of 2 800 of the poorest women in Bangladesh, who now sell the products of seven major companies, including Unilever, and 12 000 more women were expected to be reached as sellers by the end of 2014. In addition to the reputational benefits of companies like Unilever, investing in emerging economies can lead to lower operating and production costs, new market opportunities, wider distribution options and an increased customer base. Beyond the potential of value chains, there are opportunities for private businesses in catering to the needs of those at the bottom of the pyramid (Prahalad, 2004) (in economic literature, the phrase bottom of the pyramid refers to the largest yet poorest segment of society: the three billion people who live on less than USD 2.5 per day).

With billions of people living in poverty, the poor represent enormous potential for companies who learn how to serve this market by providing the poor with what they need. For instance, the Interchange cable network connected Vanuatu to the world, reducing broadband internet costs by at least 70% and enhancing ICT connectivity with foreign suppliers and markets (OECD/WTO, 2015). This creates benefits on all sides: not only do corporations tap into the market, but the poor become empowered customers. Corporations who service this market help create jobs for the poor, ending the vicious cycle of poverty. In short, for broad-based and inclusive growth, the private sector needs to cater to the needs of those at the bottom of the pyramid.

Developing countries have many advantages such as access to raw materials, low absolute labour costs and growing domestic demand. The business environment is generally improving, with many countries registering progress in measures such as the Cost of Doing Business Index and the Logistics Performance Index (AfDB/OECD, 2014). Nevertheless, they are still disadvantaged in other respects, in particular as regards the high costs of doing business due to numerous factors including tariff and non-tariff barriers, logistics and transportation costs and unreliable and costly access to energy. In a world where GVCs are a dominant feature of global trade and investment, the speed and ease of trading goods and services across borders has a direct impact on the attractiveness of particular economies and industries to investors, particularly in the context of regional and global value chains (OECD/WTO, 2013).

### EASING TRADE ACROSS BORDERS: RESULTS AT A GLANCE

<b>Brazil</b>	Brazil's Foreign Trade Mapping Process, implemented jointly by business and government, has reduced time and costs to export and import (e.g. the single window project). (CS 95)
<b>South Africa</b>	Implementation of the new e-customs slashed processing time from four to eight hours to two hours and reduced paper from 16 million to 0.8 million pieces. (CS 96)
<b>India</b>	The integrated check post at the border between India and Pakistan increased the total import value from USD 161 million in 2011-12 to USD 292 million in 2012-13, while exports reached USD 509 million in 2012-13, up from USD 229 million in 2011-12. (CS 100).
<b>Rwanda</b>	After the introduction of the Rwanda Electronic Single Window, the average customs processing time decreased from 34 hours to 23 hours, driving down the cost of doing business and the retail prices. (CS 13)
<b>Gambia</b>	With the creation of the single-window business registration system, a business can be registered within seven days, with reduced costs associated with tax regulations' compliance. (CS 63)

Source: OECD/WTO aid-for-trade case story (2015).

### HOW ARE OECD COUNTRIES PROMOTING PRIVATE SECTOR ENGAGEMENT?

Theoretical arguments and motivations for private-sector support are generally well articulated in the literature. Non-market factors such as the rule of law (i.e. for contract enforcement, intellectual property rights and investor protection), corruption and political instability influence private sector behaviour everywhere, but they loom particularly large in poor countries where market and contracting failures play a much larger role. Market failures such as externalities, asymmetric information, imperfect competition and uncertainty lead to highly imperfect, underdeveloped or missing markets (Pietrobelli, 2007). Co-ordination and system failures represent a further justification for policy intervention. Individual firms' performance crucially depends on the behaviour of other actors, including production and investment decisions in upstream and downstream segments and investment in and provision of related infrastructure and public goods (Reiner and Staritz, 2013).

A sound business climate for investment, competitiveness and entrepreneurship is a pre-requisite for raising living standards and alleviating poverty. The premise for using ODA to promote the private sector is straightforward. The main objective of development co-operation is poverty reduction. Economic growth is a key vector for reducing poverty and promoting development – and it is best achieved through the private sector. Government has a central role to play in making it possible for the private sector to flourish and in ensuring that growth contributes to poverty reduction. In particular, while private sector development is crucial for increasing the pace of growth, the way the private sector develops also has a strong bearing on the pattern of growth, influencing whether growth is broad or narrowly based and whether it is more or less inclusive of the poor (OECD, 2006). The government of Canada is helping developing-country partners create the conditions for strong and sustainable private-sector-led growth through its sustainable economic growth strategy. The strategy's three paths – building economic foundations, growing businesses and investing in people – target the main prerequisites to achieving poverty alleviation through private-sector-led sustainable economic growth.

Donor agencies have traditionally focused their programmes on improving and strengthening the enabling environment for private initiative and business operations in developing countries – and thus achieving development goals by working through private sector growth (Davies, 2011). To help countries improve their business environment, development assistance agencies support interventions using ODA funding to upgrade the legal and regulatory environment, accelerate and rationalise administrative processes, lower the costs of investment, reduce risks, improve competition and develop capacity. The International Finance Corporation has backstopped Rwanda’s policy reforms to accelerate trade-related procedures and reduce their cost: the country now ranks 46 out of 189 in the 2015 Doing Business Report and has been a top reformer in sub-Saharan Africa since 2005 (case story 29). And policy dialogue and targeted support provided by the UK’s Department for International Development (DFID) in Sierra Leone has helped to improve public debt management, which, in turn, has contributed to lower inflation and easier access to affordable finance for the private sector. It has also increased revenue collection and strengthened policies to ensure a sustainable fiscal position.

Donors have different rationales and a variety of policy approaches for supporting the private sector. Aid-for-trade policies and programmes are an important vector in this regard. For example, DFID works with the private sector in much of its aid-for-trade work to improve property rights and the investment climate, supporting private enterprise to increase productivity and the competitiveness of goods and services in domestic and international markets. Grants, loans or equity investments are provided where appropriate to encourage private sector involvement. DFID is co-financing the productive activities of major UK food and clothing retailers through the Trade and Global Value Chains Initiative, which is expected to support the long-term resilience of global supply chains and benefit over 700 000 workers and smallholder farmers working in Kenya, South Africa and Bangladesh. Similarly, the overall objective of Finland’s aid-for-trade efforts is to create decent employment and opportunities for entrepreneurship for all through private sector development. One of Finland’s four development co-operation goals addresses the need for a sound business enabling environment that promotes private sector activity: activities focus on inclusive business, women’s entrepreneurship, the use of information technology for innovative economic activity and youth employment and entrepreneurship.

The multilateral development banks are long-standing supporters of private enterprise and financial markets. Today, many are expanding the range of programmes and instruments they provide in this regard. For example, direct engagement with business and the private sector is increasingly a feature of Asian Development Bank investments and interventions: support is extended through financial assistance, including loans without sovereign guarantees, equity investments, credit enhancement products and loan syndication activities. Private sector development is fully integrated into country and regional programmes: for example, in Indonesia support is being provided to improve smallholder agricultural productivity through value chain development and in the Philippines assistance to attract higher levels of investments in infrastructure is being facilitated through Public Private Partnerships (PPPs). Similarly, the Islamic Corporation for the Development of Private Sector (ICD), the private sector arm of the Islamic Development Bank Group, is providing financial support for the establishment, expansion and modernisation of private enterprises and the development of capital markets. ICD also provides advisory services to governments and private sector groups regarding policies for enhancing the role of the market economy and management practices.

Today, the donor community is increasingly seeking to engage with the private sector in development in order to harness private-sector expertise and leverage additional financing. This entails working with private-sector enterprises to make them direct actors in development and has led to a shift in the paradigm from a largely government-focused approach to a blend of aid, trade and investment activities and initiatives. Successive OECD Development Assistance Committee (DAC) Peer Reviews have borne witness to these trends in development co-operation over many years. A synthesis of peer reviews between 2012 and 2014 noted, “A new or increasing emphasis on private sector engagement and development from reviewed members” (DCR, 2014).

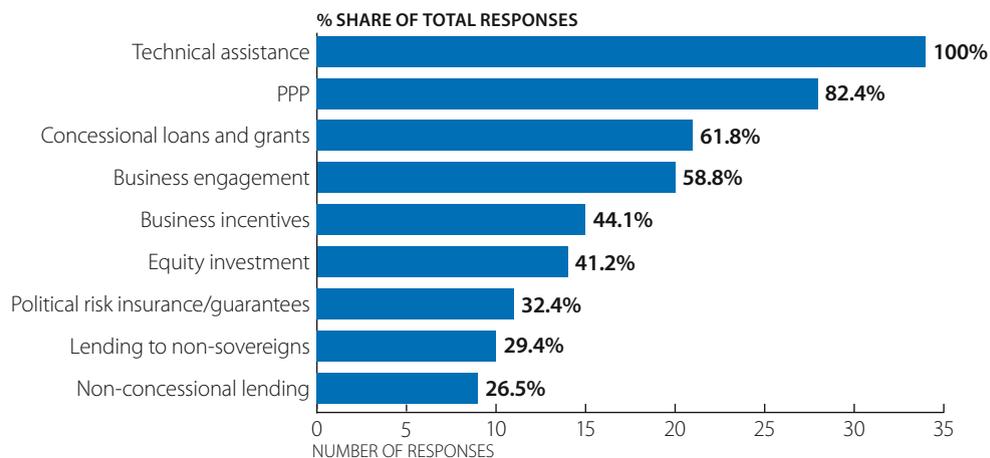
**BOX 8.1 CEO summit of the Americas**

The Inter-American Development Bank has spearheaded an initiative to promote public-private dialogue between governments and the private sector in Latin America through special high-level summits organised in collaboration with host governments, where participants discuss the dynamics and future prospects of trade and investment opportunities within Latin America. The initial CEO Summit of the Americas, organised in collaboration with the Colombian government in Cartagena in 2012, attracted approximately 700 business leaders and 12 heads of state, who exchanged views and ideas with one another in a series of interactive panel discussions. The follow-up 2015 Summit in Panama City reinforced its role as a platform for high-level exchange on regional trade and investment issues, and broadened the scope of the dialogue to also include priorities for the social and economic development of the Americas.

For further information see [www.ceosummitoftheamericas.com/en](http://www.ceosummitoftheamericas.com/en).

Donor responses to the questionnaire regarding the nature of assistance provided to private-sector development indicated unanimous support for technical assistance (see Figure 8.1). This support involves efforts to improve the enabling environment for business through policy development and reform, technology transfer and business development initiatives. Direct support for establishing or expanding businesses – through PPPs and concessional loans and grants – are also a key feature of donor efforts, accounting for more than 80% and 60% of responses, respectively. Many of these activities involve private companies based in donor countries, who receive support for establishing joint ventures or expanding business investment in the developing world: 88% of questionnaire respondents indicated their private sector was engaged in their programmes.

**Figure 8.1 Donor approaches for promoting private sector development (PSD)**



Note: 34 respondents - multiple responses were allowed.

Source: OECD/WTO Aid for trade monitoring exercise 2015

StatLink  <http://dx.doi.org/10.1787/888933241530>

Direct support for private companies in donor countries that invest in business opportunities in the developing world is a key feature of bilateral private-sector activities. Austria's Business Partnership Programme requires companies to carry out long-term investment at their own cost and risk, aiming to generate local value, transfer know-how and technology, create jobs, thus decreasing poverty. In most cases projects focus on setting up and/or strengthening value and supply chains, on improving vocational training and on corporate social responsibility (CSR) activities.

The Austrian Development Agency provides know-how, contacts, business intelligence and up to EUR 200 000 in project finance for eligible companies. Germany has established the develoPPP.de programme to foster the involvement of the private sector at the point where business opportunities and development policy initiatives intersect. Through this programme, the German government provides financial support up to EUR 200 000 for projects e.g. providing vocational training, promoting climate-friendly technologies or improving social standards at production facilities and, if required, technical support to companies that invest in developing and emerging countries.

In the lead-up to the Fourth High-Level Forum in Busan in 2011, there was a growing focus on the role of the private sector and its contribution to the development process (the Paris Declaration [2005] and Accra Agenda for Action [2008] make limited reference to the private sector's role in development, focusing on all development actors working in more inclusive partnerships so that all efforts have greater impact on reducing poverty). The Busan Partnership agreement recognises the central role of the private sector, as well as the benefits of development finance modalities such as PPPs in advancing innovation, creating wealth, income and jobs, mobilising domestic resources, and, in turn, contributing to poverty reduction. The private sector is now an active constituency of the Global Partnership for Effective Development Co-operation. The importance of engaging with the private sector is also a priority for partner countries, where almost 60% considers the private sector as pivotal.

From the perspective of donor agencies, collaboration with the private sector goes far beyond simply securing additional funding. Attracting FDI is important for developing countries because it has the potential to bring a package of benefits, including managerial and technical skills, intra-firm finance, technology spillovers and access to new markets. The private sector also has advantages over the public sector in terms of moving quickly and being adaptable. The benefits of skilled management in organising and training a local labour force, in setting standards for safety and health, in paying taxes to the local government and in raising the technological threshold of local industrial and service sectors contributes far more to the development of the local economy than the direct impact of the investment itself. In particular, the case stories (see the table below) highlight the importance of the private sector in satisfying international standards as a way to join GVCs and consequently spur growth.

#### STANDARDS AS KEYS TO GLOBAL VALUE CHAINS: RESULTS AT A GLANCE

<b>Madagascar</b>	After complying with European regulations on litchi food safety, Madagascar increased export and improved relations between exporters and importers. (CS 45)
<b>Egypt</b>	Once Egyptian food companies obtained the certificates needed to export Halal products to Malaysia, their presence in the Asian country increased by 30%. (CS 61)
<b>Peru</b>	After the US Food and Drug Administration granted Peruvian sacha inchi oil the Generally Recognized as Safe status, sales forecasts increased fivefold (CS 56).
<b>Ethiopia</b>	The expansion and upgrading – according to international standards – of the Addis Ababa airport attracted foreign airlines and associated traffic. (CS35)

Source: OECD/WTO aid-for-trade case story (2015).

Furthermore, for the world's leading corporations, investing in developing countries creates many opportunities to do 'good' while 'doing well' commercially (Warden, 2007). Many of these companies have integrated CSR in their business models, reasoning that their competitive position and the health of the local community are inextricably linked – and mutually dependent. Corporations who have adopted this Creating Shared Value (CSV) business concept have contributed to policy advocacy, using their influence to improve the policy environment for development in the host country or the home country. They have sourced materials, goods and services from developing countries, contributed

to standards compliance and trained and educated workers. They bring skills, ideas and ways of operating in the marketplace. Collaborative private sector ventures and value chain investments (for example, Danone and Walmart) are growing in number and impact, charting an innovative way forward for business involvement in development (OECD, 2011; World Bank, 2011).

In addition to economic development, the everyday operations of private sector firms can contribute to social objectives. For example, existing distribution systems of breweries have been used to deliver fertilisers to farmers and to disseminate condoms and information on HIV/AIDS (Davies, 2011). Coca-Cola is extending its distribution network and transporting medical supplies in Cola Life packing on its trucks (Greening, 2014). Most large corporations also pursue CSR and responsible business conduct, which can positively contribute to development. The UN Global Compact and the OECD Guidelines for Multinational Enterprises are two of the foremost voluntary initiatives that promote corporate responsibility and sustainable business practices. The initiatives complement each other in the goal of creating a more responsible and accountable corporate sector, yet are also distinct and unique. They have complementary engagement and accountability mechanisms. Together they define and enhance the relationship between businesses and international standards, in addition to providing a comprehensive model for responsible business practices today. The UN Global Compact asks companies to embrace, support and enact, within their sphere of influence, a set of core values in the areas of human rights, labour standards, the environment and anti-corruption.

A growing number of companies are engaging in innovative approaches that combine business strategy with objectives that have an impact on society, including sourcing from small producers, payments for environmental services, employing marginalised populations or marketing products adapted to them. For instance, 'FairChain' wants to share the added value in the coffee chain with local economies. Thus, instead of exporting green beans, it supports local roasting thereby ensuring that more of the added value remains in the producing country allowing them coffee to move up from being just a primary growing economy into a secondary roasting economy (CS 117). France is supporting responsible projects of this nature implemented by private companies, sometimes at a significant scale. In 2013 the UK DFID launched the Trade and Global Value Chains Initiative (TGVCI) to create partnerships with businesses to improve working conditions and job opportunities for poor workers and smallholder farmers in the developing world and support the long-term resilience of global supply chains. TGVCI has just approved co-financing projects with major UK food and clothing retailers, which are expected benefit over 700 000 workers and smallholder farmers working in horticulture and garment sectors in Kenya, South Africa and Bangladesh. In 2014, Germany initiated the launch of the Partnership for Sustainable Textiles to foster social and environmental standards along the global textile and garment supply chain. The Textiles Partnership is designed as a multi-stakeholder platform and seeks to build on established sustainability standards and to co-operate with other national and international initiatives at G7, OECD and EU level.

## THE ELUSIVE QUEST FOR INCLUSIVE GROWTH

While overall growth is important, barriers for particularly vulnerable groups must be specifically addressed as part of private sector programmes to ensure all members of society can benefit. High inequality is detrimental to growth because it hampers investment in human capital and undermines the quality of institutions. Rising inequality also erodes the middle class – a foundation of modern democracy and a conduit for advancing social progress. Finally, the persistence of inequality could undermine social cohesion and trigger social and political unrest, thus threatening the sustainability of a country's growth and economic progress. Having said that, the poor are a heterogeneous group, and no aid policy can be successful merely by targeting growth. For example, women's participation in the economy is key to promoting inclusiveness, and this cannot happen without a strong role for the private sector, particularly SMEs, which are a significant source of employment for women in many developing countries. Women face many barriers in terms of access to finance, legal rights and employment discrimination: they will not benefit from programmes that do not support their basic right to participate in the economy with equal opportunity and access to the benefits created (World Bank, 2014).

For many years the World Bank group has been actively supporting the private sector all over the developing world. A distinguishing feature of the Trade and Competitiveness Global Practice in the World Bank Group is its ability to engage firms and entrepreneurs. Targeted start-up and SME support is a major focus of operations: catalytic support to firms and entrepreneurs – in particular, women entrepreneurs – is being scaled up through a more co-ordinated package of sovereign lending and risk management measures, embedded advisory services and direct grant support.

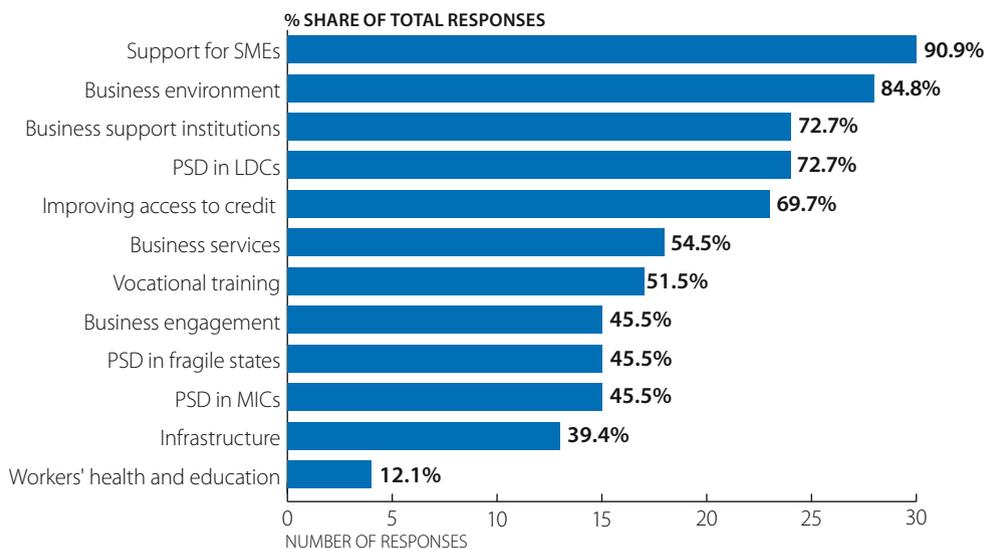
The bulk of aid provided for industrial development, which has totalled over USD 2 billion annually in recent years, is targeted at promoting SMEs, which constitute the bulk of the private sector in developing countries. However, they face serious challenges in expanding their businesses. The most common binding constraints are inefficient regulation, outdated technology and weak technical and entrepreneurial skills. In addition, most firms operate in informal markets, characterised by low productivity and substandard products. La Porta and Schleifer (2014) find that informal firms have low productivity and produce low-quality products: consequently, they do not pose a threat to formal firms. They tend to disappear as countries develop. The formal sector, characterised by firms run by educated entrepreneurs and exhibiting much higher levels of productivity, tend to be an engine of economic growth. Rapid growth of SMEs is a powerful engine for job creation in a wide range of economies, yet more than two-thirds of SMEs in developing countries have no access to finance from the formal financial sector. This market failure is a serious constraint on efforts to promote a strong and sustainable global recovery. The G20 has recently taken up this cause with the SME Finance Challenge in order to identify ways to enhance the effectiveness of governments and public institutions in catalysing private finance for SMEs in developing countries.

#### SME PRODUCTIVE CAPACITY BUILDING: RESULTS AT A GLANCE

<b>Gambia</b>	The New Life for MP Farm – an overall re-engineering of the 100-hectare Gambian MP Farm – reduced irrigation costs, set up a research facility, increased efficiency and workers' wages. (CS 85)
<b>Peru</b>	A project to improve exporter readiness to produce organic mangoes and strengthen Canadian/ Peruvian trade links enabled the export of 12 containers of mangoes, with improved incomes for more than 200 families. (CS 101)
<b>Ethiopia</b>	Ethiopian trainees had the opportunity to take a 14 day-course at Czech Vítkovice Machinery Group, receiving practical training in machining and welding. (CS 83)

Source: OECD/WTO aid-for-trade case story (2015).

Without effective technical, managerial, and marketing skills, SMEs are not likely to raise productivity, diversify products and expand their businesses. Some donors support the framework conditions for SMEs growth and employment. Others provide aid to enhance the competitiveness of SMEs (Japan, for instance, has promoted energy saving in SMEs in India). Other aid projects are targeted to specific sectors (OECD/WTO, 2013). The EU, for example, is aiding Jordan in its efforts to attract sustainable businesses that add value, thereby enhancing the services sector so it can become more productive and globally connected. Canada is helping to rebuild the private sector in Haiti by facilitating export growth and diversification. The main goal is to develop and promote artisans' craftwork in order to increase Haitian exports in the home decor and gift sectors. In addition to this, management development centres and business advisory services can help SMEs raise their productivity and extend their marketing reach. Local business advisory networks are helping SMEs with specific problems. The Italian government's support for SMEs in Iraq, including programmes for strengthening trade and investment policy capacity, has generated 60 partnership agreements, created more than 1 300 jobs and mobilised investment totalling USD 42 million (case story 22).

**Figure 8.2 Key focus areas of donor support for PSD**

Note: 33 respondents – multiple responses were allowed.

Source: OECD/WTO Aid for trade monitoring exercise 2015.

StatLink <http://dx.doi.org/10.1787/888933241547>

SME development is a core focus of donor support: more than 90% of survey respondents noted that their private sector development programme was focused on supporting the development of the SME sector (see Figure 8.2). Furthermore, SMEs are often beneficiaries of other activities receiving widespread donor support – such as strengthening the capacity of business or trade institutions, improving market information and business services and enhancing access to credit.

Efforts to address the gaps and maximise the employment opportunities of people living at the bottom of the pyramid are expanding quickly. Several donors are focusing on the high win-win potential of promoting poor producers, entrepreneurs and consumers in supporting private sector development, and they have developed specialised institutional expertise in this type of initiative. UNDP's private sector strategy includes specific actions to promote bottom-of-the-pyramid business development, including advocacy to encourage the private sector to develop inclusive business models for poor markets, providing innovative finance and grants to stimulate sustainable private investments in pro-poor enterprise development, facilitating the integration of poor producers/other market actors in key value chains and economic sectors and improving the policy and institutional infrastructure for inclusive market development. UNDP's approach directly includes the poor on the demand side as clients and customers and on the supply side as employees, producers and business owners at various points along value chains.

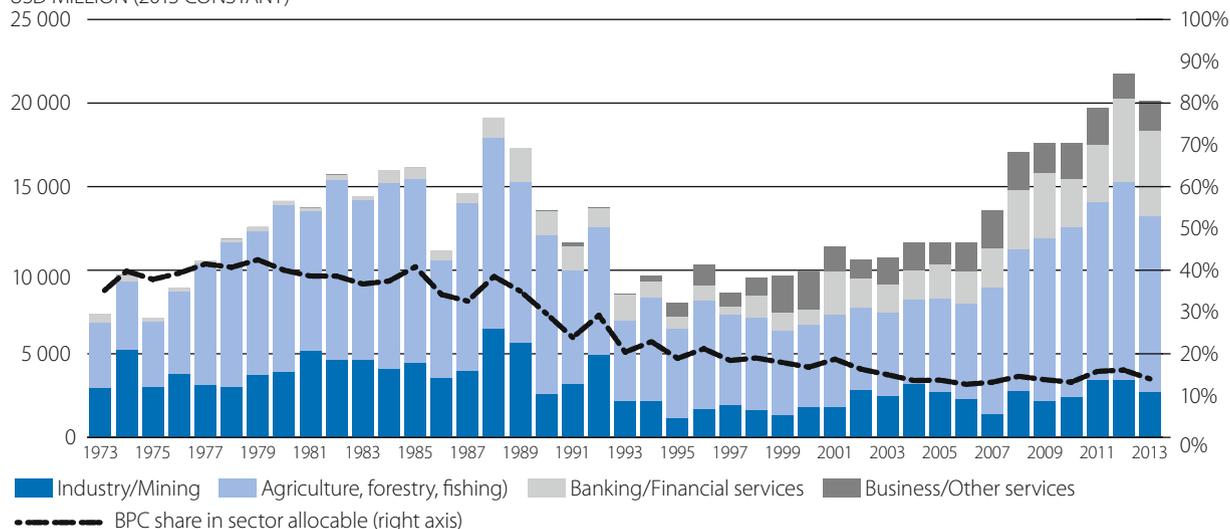
## AID FOR BUILDING PRODUCTIVE CAPACITIES

Reflecting the increasing priority that donors attach to private sector development, aid dedicated to building productive capacity (BPC) – resources targeted at agriculture, industry, the financial sector and business services – more than doubled over the period 2003-12 from USD 10.7 billion to USD 21.5 billion (see Figure 8.3). While the BPC share of sector-allocable ODA has increased to approximately 14%, this is small relative to the priority attached to the private sector in the 1970s and the 80s, when routinely 30-40% of ODA was committed to private sector activities. The recent resurgence in support for the private sector has been driven by aid targeting agriculture, fisheries and forestry, which received almost 60% of total ODA targeted at building productive capacity. Many donors are keen to support small farmers – possibly the largest segment of the private sector in the developing world – who play a key role in rural economies by providing jobs, income and food security. For example, with financial support from Australia, the Indonesian

government's Agriculture, Forestry and Community Development Program has reached more than 21 000 households, enlarged cultivated areas, increased agricultural yields, raised the value of production and increased the profitability of farming enterprises (case story 51). And as a result of the Canadian government's Enhancing Arab Capacity for Trade (EnACT) programme, the number of halal-certified companies has more than doubled from 21 to 52, and the presence of the Egyptian food-processing sector in the Malaysian market has increased by 30% (case story 61).

**Figure 8.3 ODA Committed to Building Productive Capacity (BPC)**

USD MILLION (2013 CONSTANT)



Source: OECD DAC Creditor Reporting System.

StatLink  <http://dx.doi.org/10.1787/888933241557>

The share of sector-allocable ODA for agriculture fell from about 25% in the 1970s to a low of 5.8% in 2004. In light of the food crisis in 2007-08, however, donors have responded by increasing their support for the agricultural sector (OECD, 2010): in 2012 the corresponding figure for support to agriculture had risen to close to 9%. A recurring feature of aid projects in agriculture is an emphasis on rural poverty and food security. For example, in one of the largest projects reported recently, the World Bank committed USD 1 billion in loans to India for agricultural development through a national rural livelihoods project. The United States government provided support to Afghanistan for improvements in technology and management practices to increase organisational and market efficiency to promote resilience in production and livelihood systems. The EU is addressing food security with USD 139 million for the poor and vulnerable in fragile circumstances in countries such as Afghanistan, the Democratic Republic of the Congo, Haiti, Liberia, Madagascar, the Democratic People's Republic of Korea, Pakistan and Sudan. Following implementation of the Gambian government's programme to improve mango production, productivity and sales in rural zones increased, and 250 farmers exported 352 tonnes of mangoes, generating total revenue of USD 77 million (case story 62).

For the private sector to grow, access to finance is essential. Aid supporting banking and financial services has progressively increased its share of total BPC since emerging in the mid-1980s, and since 2000 has grown exponentially from USD 896 million to USD 5 billion in 2013 – effectively quintupling over the period. Today, banking and financial services account for fully 25% of total BPC. These resources are channelled to central banks, formal sector financial intermediaries, credit lines, and microcredit and credit co-operatives.

**BANKING AND ACCESS TO CREDIT FOR GROWTH: RESULTS AT A GLANCE**

<b>Africa and Mekong countries</b>	The ITC/OIF project facilitated the establishment of direct interbank co-operation between 14 African nations and three Mekong countries, contributing to a sharp rise in trade. (CS 57)
<b>Gambia</b>	The ITFC extended USD 14 million in favour of the Gambia Groundnut Corporation in order to finance the groundnut commodity, benefitting thousands of local farmers. (CS 69)
<b>Papua New Guinea</b>	By expanding rural access to banking through 15 000 ATMs, EFTPOS (Electronic Funds Transfer at Point of Sale) machines, agents and mobile phone payments services, more than 500 000 people can now carry out rapid and secure financial transactions. (CS 52)
<b>Pacific Island countries</b>	The Pacific Financial Inclusion Programme allowed more than 150 000 people to access new savings accounts and more than 450 000 people to use mobile telecommunications to store and transfer money. (CS 53)

Source: OECD/WTO aid-for-trade case story (2015).

In Papua New Guinea, an ambitious micro-banking programme has significantly expanded rural access to banking through 15 000 ATMs, EFTPOS machines, agents and mobile phone payments services: more than 500 000 people can now carry out rapid and secure financial transactions for both personal and professional purposes (case story 52). In addition to credit, a healthy business and investment environment requires trade and business associations, legal and regulatory reform, private sector institutional capacity-building and advice, trade information and public-private sector networking at trade fairs. These business services received funding averaging approximately USD 1.9 billion per annum over 2010–13, roughly in line with trends over the past decade (for example, the United States provides grants to improve the capacity of businesses to integrate into domestic and international markets through increases in productivity, improvements in corporate governance, and the development and application of modern technology and marketing practices). Business capacity development programmes include activities that help firms and associations to respond to international market opportunities.

**WORKING WITH AND THROUGH THE PRIVATE SECTOR**

As discussed above, donor agencies are seeking new ways of using development resources and tools to strategically leverage the private sector role in contributing to positive development outcomes. Recent trends suggest growing ODA volumes supporting private sector investments and new types of partnerships to engage business as a core partner in development. Costs might be shared in order to reduce risks for private investors to acceptable levels or compensate a private investor for the provision of public benefits. Competitive challenge funds are a popular format, channelling resources to the private sector to bring about investments and activities that advance development. It is generally expected that such donor support triggers private activities that would otherwise not happen, or that it enhances their development impact by improving their viability or pro-poor focus, or that it helps make them happen significantly sooner. In other words, donor support should be both catalytic and additional.

Te Velde et al. (2008) highlights the different approaches of development agencies. Bilateral donor agencies such as the DFID are more closely aligned with the view that support for the enabling environment is the most effective approach for promoting private sector development, while others such as GIZ and DANIDA are more engaged at the business services and financing and/or investment levels. These two approaches have characterised donor support for decades and are today commonly referred to as the donor-led model. The UN Industrial Development Organization (UNIDO) believes that more directive policies (e.g. industrial policy) may also be appropriate.

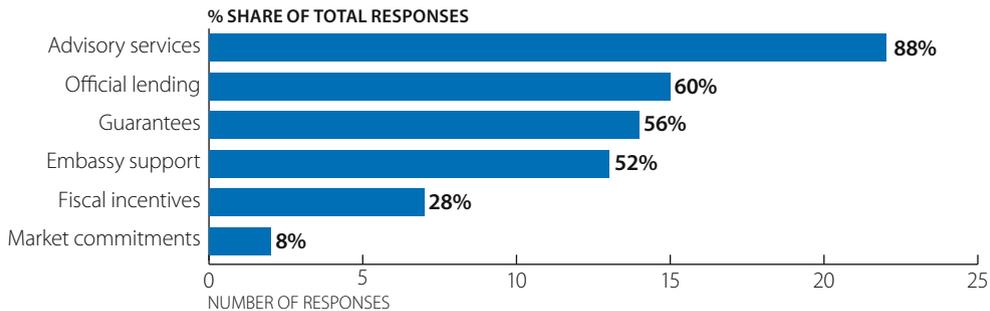
A partnership that is industry-led and targets transformations across global supply chains – what the Donor Committee for Enterprise Development (DCED) defines as the coalition model, reaching a broad number of beneficiaries and engaging with key economic actors within the supply chain – is considered to be ideally suited for mainstreaming market transformation. However, a key challenge to this approach is ensuring that the coalition initiatives involve a sufficient number of key players within the value chain willing to change their core business practices in ways that result in transformational change. Donor-funded global initiatives of this nature face challenges when transformation is required in developed countries. Both the donor-led and the coalition models have clear funding strategies that are based on harnessing private sector funding and innovations. In most donor-led projects, private sector operators are providing up to 50% of the funding. Some coalition models use fees and match-making schemes to secure private sector contributions.

In practice, aid for the private sector encompasses many types of activities. The most common area of work among bilateral and multilateral donors is in creating propitious business-enabling environments, including providing infrastructure, improving the skill-set and well-being of workers and enhancing economic reform and governance (details of the private sector development strategies of donor agencies can be found here: <http://www.enterprise-development.org/page/psdstrategies>). SME development is a cornerstone of private sector promotion for the majority of donor agencies. In addition to project support, DAC members such as the UK and Sweden offer advisory support. They also contribute expertise and promote knowledge-sharing. Business engagement – where the private sector is involved in direct dialogue with government and plays a constructive role in national policy-making – is an emerging area of work for many DAC members. The Global Partnership for Effective Development Co-operation is engaging the private sector to foster more effective development co-operation. To that end, OECD and UNDP are developing an indicator that measures the private sector contribution to development via public-private dialogue).

For many OECD members, a primary area of engagement with the private sector is through development finance institutions (DFIs). DFIs commonly organise their investment facilities and lending operations as blended mechanisms, bringing together ODA grants, concessional loans and investment guarantees with private resources from the corporate and financial sector, benefiting from the fundraising capacity of the latter (Miyamoto and Biousse, 2014). Overall, guarantees have proven a valuable instrument that makes it possible to undertake desirable investments in high-risk countries and sectors. If poorly managed, however, they generate low financial and economic additionality and may become an instrument of political control and patronage. DFI operations have been increasing dramatically, with estimates of around USD 40 billion in DFI investments in 2010. They are projected to reach USD 100 billion by this year (Reality of Aid, 2012). In the EU, DFIs have established a forum for discussion on development policy among member governments through the Association of European Development Finance Institutions (EDFI), in addition to traditional ones such as the DAC.

DFIs are a key vehicle for donors who wish to encourage the direct involvement of their own private sector in programmes and projects promoting business development in partner countries: almost three-quarters of survey respondents provide support of this nature. Advisory services and match-making initiatives – often managed and delivered in-country by development co-operation and embassy staff – are provided by almost 90% of the donors responding to the questionnaire (see Figure 8.4). Direct financial support, including loans and guarantees, are a common feature of programmes promoting direct investment operations: donor DFIs are important actors in delivering these resources.

**Figure 8.4 Types of support provided by donors to encourage donor company investment**



Note: 25 respondents – multiple responses were allowed.

Source: OECD/WTO Aid for trade monitoring exercise 2015

StatLink <http://dx.doi.org/10.1787/888933241565>

Many of the European donors have established DFIs. As an example, the Finnish Fund for Industrial Co-operation Ltd. (Finnfund) is a Finnish DFI that provides long-term risk capital for private projects in developing countries. Apart from co-investing with Finnish companies, Finnfund can finance ventures that use Finnish technology, co-operate with Finnish partners on a long-term basis or generate major environmental or social benefits. The Dutch Good Growth Fund supports small- and medium-sized Dutch businesses and entrepreneurs in emerging markets and developing countries by facilitating financing for development-based local investments and exports.

Among the various approaches to private sector engagement, there is an interest in leveraging ODA to facilitate PPPs that can encourage investment, not least in the infrastructure sector. PPPs are increasingly considered to be an attractive development finance option as they are generally perceived to be an efficient tool for financial resource mobilisation, with higher initial costs but lower risk levels. Responding to the OECD/WTO survey, 44 partner countries noted that they were involved in PPPs at the national level and 30 at the regional level.

PPPs can allow the public sector to harness the expertise and efficiencies that the private sector can bring to the delivery of public services and can also be a good way to provide sub-contracting opportunities for local firms. The Australian government's support for the Philippine Public Private Partnerships Centre has supported six infrastructure projects worth USD 1 billion since 2011, increasing private sector participation in PPPs and improving procurement co-ordination (case story 50). Another example of a successful PPP arrangement is Dubai Ports World in Senegal, which has resulted in a significant upgrading and expansion of the container terminal (from 300 000 to 600 000 units), creation of more than 200 jobs, and specialised training in line with global standards for all terminal employees (case story 94).

Japan provides a variety of schemes to support the private sector in investing in developing countries. Results from preparatory surveys conducted through Japan International Co-operation Agency (JICA) schemes based on private sector proposals encourage private entities to resolve the development issues of developing countries. Investment in infrastructure projects, such as the construction, operation and maintenance of power plants, railways, airports, industrial parks, water and sanitation and hospitals, are considered based on the results of the above feasibility studies. If feasible, JICA may support the proposals of the PPP infrastructure projects through the Private Sector Investment Fund (via equity and/or concessional and non-concessional loans).

While PPPs hold promise as a means of bringing together public and private – as well as local and international – resources and expertise, much is required from all involved to realise their potential (OECD, 2005). As EURODAD (2013) and others have argued, the efficacy and effectiveness of PPPs should not be assumed. Moreover, there are still few diagnostic tools available to determine when and how PPPs represent a preferred financing arrangement, and evidence regarding the effectiveness and efficiency of PPPs is scarce. PPPs can, for example, benefit private firms that already have sufficient access to finance at the expense of domestic micro, small- and medium-sized enterprises

## EMERGING APPROACHES ENGAGING THE PRIVATE SECTOR: RESULTS AT A GLANCE

<b>Uruguay</b>	Creation of a national trade intelligence platform to support SMEs in their international expansion. (CS 103)
<b>Viet Nam</b>	An online portal has been established allowing exporters to submit electronic invoices to their buyers, accelerating payments and increasing transparency. (CS 32)
<b>Asia</b>	ASEAN TMview provides companies with a reliable, efficient and cost-saving database of 2.2 million trademark filings to facilitate national and international trademark protection. (CS 59)
<b>Global</b>	ITC's suite of market intelligence – particularly important for LDCs that lack sources of trade intelligence – contributed to USD 126 million in exports in 2014. (CS 54)
<b>Pacific ACP countries</b>	The Pacific Islands Microenterprise e-Marketing Support is providing local companies with training to access the Internet for online sales and bookings. (CS 76)

Source: OECD/WTO aid-for-trade case story (2015)

## ASSESSING DONOR SUPPORT FOR PROMOTING THE PRIVATE SECTOR

Pressures are rising to demonstrate that partnerships with business are a good use of public resources, not least as media attention focuses on donors' funding decisions. There is a need for more effective measurement of the private sector's contribution to development and in turn the impact that providers of development co-operation have in leveraging and mobilising this contribution. Agencies struggle to make a credible and convincing arguments for the additionality of their support, for example, by empirically demonstrating that aid is channelled to the companies and sectors that have least access to private capital markets and provide the best development outcomes for poor people.

A growing number of evaluations of private sector approaches and programmes suggest mixed results. For example, an independent evaluation from the Swedish International Development Cooperation Agency (Sida) found good evidence that policies to improve the investment climate and human capital boost growth. However, identifying priorities and the correct sequencing of reforms remains a challenge, calling for more contextual research that takes account not only of the binding constraints but also the feasibility and timescale of implementation. For example, while Sida's interventions monitored outputs effectively, few of them had evaluated the outcomes and impacts that had resulted. It also found that evidence substantiating results as a consequence of industrial policies is weak, especially as regards addressing regional income disparities and job creation (SIDA, 2014).

Providing non-financial business development services results in modest gains that are strengthened if they are combined with access to financial services and targeted at transformative enterprises. More systematic approaches to business development services, such as supply-side stimulation and embedded services, achieve both stronger impacts and are more sustainable. Market-based approaches – such as the Making Markets Work for the Poor (M4P), which has been adopted by several DAC members (e.g. DFID, Sida, SDC and ADA) – have the potential to address many of the weaknesses of traditional private sector development programmes by addressing the underlying causes rather than symptoms of market failures and delivering system-wide sustainable impacts. In conflict-affected environments, a combination of restoring macroeconomic stability, building infrastructure to create employment and addressing binding constraints to growth, promoting entrepreneurship and improving the functioning of value chains that matter for the poor has proven to be effective.

Evaluations tend to be critical of direct support to individual private enterprises, including support through business-to-business partnership models, which have not proved to have strong development spillover effects. There is a danger that new instruments will lead to an increase in tied aid and be mainly supply-driven. This in turn risks a skewing of activity from low to middle income countries and from sectors and local partners which are strategic for recipient countries to those that are strategic for donor countries. Schulpen and Gibbon (2002) critically reviewed private sector development

policies, for example, arguing that they were shaped mostly by the nature and interests of the private sector in donor countries themselves, incorporated a high proportion of tied aid and failed basic tests of coherence. Moss (2010) claims that donor attempts to address the investment constraints that hinder private sector growth, while constructive and positive, have been inefficient and sometimes haphazardly deployed. The lack of selectivity, prioritisation or strategic focus has hampered the effectiveness of aid. There is also the latent danger of supporting enterprises that are not competitive and/or repeating the industrial policy failures that were widespread in many countries in previous decades.

ODA used to leverage private finance is often channelled through financial intermediaries, which are bound by commercial confidentiality and limitations to public disclosure of information. This has highlighted the importance of private sector accountability but more broadly of strong institutional co-ordination and coherence between agencies and authorities (e.g. DFIs) when public money is being used to leverage private finance. While DFIs have played a role in channelling funds from multilateral and bilateral lenders to selected enterprises and industrial sectors, their performance has often been questioned (Kwakkenbos, 2012; Spratt and Collins, 2011). They are ultimately investment banks as well and need to remain attractive to investors from the private sector as well earn income from the risk-taking activities they engage in (e.g. equity, loans and guarantees). This will tend to lead to DFI support for companies that are already somewhat established and ready to export rather than small local enterprises or businesses in the informal sector – from which the poor might derive more benefit. Risks associated with supporting a company where capital was not otherwise available must be balanced with likely returns for the private investors and for the continued financial viability of DFIs.

In recent years, some DFIs have reformed their systems and begun according a higher priority to development impact in their operations, as illustrated by the increasing amount of data they are collecting. DFIs such as CDC and Norfund now have extensive reporting systems for tracking social and environmental aspects of their operations (Norwegian Church Aid, 2011). However, there are problems remaining in terms of what the data tells us about development impact, particularly how much change can be attributed to the contribution of the DFIs. In current DFI statistical systems the numbers are complex, their significance is opaque and the influence that the results have on actual investment decision-making is unclear.

Reporting on the development impact from public-private partnerships tends to focus on factors such as improvements in productivity, capacity development, project reach (e.g. number of participants) and environmental impact. Information on the rate of return for private sector partners has not been readily available. From a development perspective, there is need for longer-term assessments of what these partnerships mean for employment across the income spectrum in developing countries.

Although many multinational enterprises demonstrate a respect for high standards of business conduct, some may neglect the appropriate principles and standards of conduct in an attempt to gain undue competitive advantage. This may be particularly true in environments where regulatory, legal, and institutional frameworks are underdeveloped or fragile (OECD, 2013). Against this backdrop, responsible business conduct (RBC) has become a priority in the global economic agenda. The Dutch government, for example, has made adherence to the OECD Guidelines for Multinational Enterprises mandatory for every company receiving ODA funding.

## CONCLUSIONS

The private sector plays a pivotal role in economic development, generating jobs, growth, technology diffusion and incomes. It is the motor for expanding trade opportunities, which augment the production frontiers of national businesses, generate foreign exchange reserves, and facilitate entry in GVCs. The donor community has been a strong advocate of private sector development, working to improve the enabling environment for business through policy development and reform, technology transfer and business information and development initiatives. Donors have also provided direct support for establishing or enlarging businesses – through twinning arrangements, joint ventures, PPPs and concessional loans and grants. And they have played a supportive role in developing financial markets, supporting productive activities of those living at the bottom of the pyramid and encouraging responsible business conduct by multilateral enterprises.

Challenges remain: connections between trade and enterprise development could be deepened, more empirical information is needed assessing what works and what doesn't work, systemic approaches that identify and address root causes of private sector development blockages are needed and a stronger focus on results and impacts could be more broadly mainstreamed throughout private sector support efforts. The development assistance community has learned much over the past 50 years about how to best support private enterprise in the developing world, and there is strong momentum for deepening this knowledge going forward and sharing it more broadly with other development actors across the world.

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