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DEVELOPMENT CO-OPERATION FOR PRIVATE SECTOR DEVELOPMENT

Analytical Framework and Measuring Official Development Finance

DAC meeting, 20 May 2016

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EXECUTIVE SUMMARY

The objective of this report is to provide an analytical framework of development co-operation for private sector development (PSD) and a measurement to capture relevant Official Development Finance (ODF). This paper considers PSD as development co-operation that addresses the improvement of policies and institutions, market functioning and enterprise capacity in order to increase the participation of the local private sector—particularly SMEs—in the economy of a developing country.

In general, PSD is considered as an effective means to achieve the overall objective of boosting inclusive and sustainable growth. Here, PSD activities can be broadly categorised into those that address the investment climate or those that address productive capacity. While development partners emphasise the importance of both the investment climate and productive capacity, multilaterals tend to stress the former and bilaterals the latter. Another way of providing an analytical framework is to categorise PSD activities into upstream (public policy and institutions), midstream (market functioning), and downstream (enterprise development) levels.

Within the bilateral development partners, PSD is carried out by one or more ministries, a development agency, a Development Finance Institution, embassies and/or country missions. Multilaterals usually have several specialised departments working on different aspects of PSD, including business environment, trade, and infrastructure. The multi-faceted nature of PSD and implementation by various departments and institutions can be challenging for strategic coherence and internal and cross-agency co-ordination. In addition, most development partners support the private sector directly, including to promote their domestic companies, which could lead to market distortions and compromise development objectives if it is not prioritised over commercial objectives.

Based on the analytical framework provided in this paper, ODF for PSD amounted to USD 96 billion in 2013, which was equivalent to 54% of ODF to all sectors. All development partners extensively supported the investment climate, of which infrastructure took up a significant portion. In fact, half of ODF to PSD went to infrastructure. Disaggregating development partners, multilaterals allocated proportionally more to the investment climate than the bilaterals, while bilaterals supported the productive capacity more than the multilaterals. Furthermore, excluding infrastructure, development partners collectively supported the upstream, midstream, and downstream levels rather evenly.

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ACRONYMS

ADA	Austrian Development Bank
AfDB	African Development Bank
AGID	Advisory Group on Investment and Development
AsDB	Asian Development Bank
BIO	Belgian Investment Company for Developing Countries
BMZ	*Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung** (German Federal Ministry for Economic Cooperation and Development)
CDC	CDC Group
COFIDES	Compañía Española de Financiación del Desarrollo*(Spanish Development Finance Institution)
CRS	Creditor Reporting System
CTF	Climate Technology Funds
DAC	Development Assistance Committee
DANIDA	Danish International Development Agency
DCED	Donor Committee for Enterprise Development
DEG	German Investment & Development Company
DFI	Development Finance Institution
DFID	Department for International Development
DMFA	Dutch Ministry of Foreign Affairs
EU	European Union
EURODAD	European Network on Debt and Development
FMO	Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden* (Netherlands Development Finance Company)
DCD	Development Co-operation Directorate
GEC	Girls Education Challenge Fund
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit* (German Development Agency)
IADB	Inter-American Development Bank
IEG	Independent Evaluation Group
IFC	International Finance Corporation
IMF	International Monetary Found
MDB	Multilateral Development Bank
MSME	Micro Small Medium Enterprises
NORAD	Norwegian Agency for Development Cooperation
Norfund	Norwegian Investment Fund for Developing Countries
ODF	Official Development Finance
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
OPIC	Overseas Private Investment Corporation
POVNET	DAC Network on Poverty Reduction
Proparco	Promotion et Participation pour la Coopération économique* (French Development Finance Institution)
PSD	Private Sector Development
SDC	Swiss Agency for Development Co-operation
SDGs	Sustainable Development Goals
SIDA	Swedish International Development Cooperation Agency
SME	Small Medium Enterprises

SOFID	Sociedade para o Financiamento do Desenvolvimento* (Portuguese Development Finance Institution)
T&C	Trade and Competitiveness Global Practice within the World Bank Group
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
USA	United States of America
USAID	United States Agency for International Development
USD	United States Dollar
WBG	World Bank Group

* acronym in original language

I. INTRODUCTION

1. The private sector plays an essential role in development as one of the main drivers for economic growth, poverty reduction and human development. It accounts for 60% of Gross Domestic Product and provides 90% of all jobs in developing countries, constituting a key source of livelihood, productivity and social cohesion (Evans, 2015; IFC, 2013; WBG, 2012). Furthermore, the private sector produces goods and services --including for the poor-- and generates tax revenues that could be used to provide health and education services. For these reasons, the importance of the private has recently been underlined in the 2030 Agenda, which calls for inclusive and sustainable growth and industrialisation.

2. By recognising its important role, development partners are increasingly promoting private sector development (PSD). While the goal of PSD is to ultimately enhance economic growth and poverty reduction, development partners adopt a variety of approaches, which makes cross-cutting assessments challenging. This is particularly the case from a quantitative perspective as the lack of a common understanding on the scope of PSD makes it difficult to obtain an overarching picture of financial resources allocated to this area. In fact, comprehensive quantitative analyses of Official Development Finance (ODF) to PSD are rare.

3. To fill this gap and shed light on the diversity of PSD approaches, the report provides a qualitative and quantitative assessment on the support by development partners to this area. In particular, it highlights the theoretical underpinnings of PSD and describes the relevant strategic and institutional arrangements of development partners. It also schematises PSD components around an analytical framework that captures the universe of PSD activities which further allows quantification of ODF to PSD. By doing so, the report advances the last major work of the Development Assistance Committee (DAC) on PSD, i.e. the POVNET guidance "*Promoting Pro-Poor Growth: Private Sector Development*" published in 2006.

4. The report represents an initial exercise that can be developed throughout and beyond 2016 in line with the upcoming 2016 OECD Ministerial Council Meeting's priority on productivity and inclusive growth. In particular, the work on development co-operation to PSD could be deepened through surveys, specific quantitative assessments and in-depth analyses at the country, development partner, sector and thematic levels. Research outcomes, findings and policy recommendations can be developed on an iterative basis and consolidated at a later stage.

5. The report is structured as follows: Section two will first outline the different approaches of development partner toward the private sector in general, to clarify the underpinnings of PSD more specifically. Section III will examine strategies and institutional structures of development partners that deal with PSD, identifying common issues and challenges. Section IV will present findings from a quantitative analysis of ODF for PSD by using data from the DAC's Creditor Reporting System. Finally, Section V will provide conclusions, the next steps and pose questions for the DAC.

II. APPROACHES BY DEVELOPMENT PARTNERS

A. Overview

6. The private sector has long played a central part of economic theory, but the perspectives on its role in development co-operation have changed significantly in the last decade. As PSD is mainly concerned with promoting private sector-led economic growth, it can be addressed by both engaging public institutions and also directly supporting the private sector. In recent years, however, the potential on the latter is being pursued, particularly to boost the quantity and quality of resources available for development projects. In other words, bilateral and multilateral development partners are increasingly interacting with them to leverage financial resources and to partner in joint projects (see Box 1). As a result, while the reference to the 'private sector' is becoming prominent in the discussions, the approach towards it may vary according to the particular objective.

Box 1. Direct support to the private sector

Leveraging Private Sector Finance

With USD 218 trillion of global financial assets, the potential for private investment in developing countries is significant (UN 2014:10). Given the unexploited potential of private investment in developing countries, the relatively small scale of concessional and non-concessional development finance (USD 0.2 trillion per year), and the high investment gaps for the developing countries to achieve the SDGs (USD 2.5 trillion per year), development partners use Official Development Finance to leverage private investment thus increasing financial resources for development. For instance, Multilateral Development Banks state that for every USD 1 dollar that they extend directly to the private sector 2-5 dollar of additional private sector investment is mobilised (AfDB et al. 2015:2).

Development partners use several tools to leverage private investment. Primarily, they support international and local firms through advisory services and offer financial resources such as equity, debt, and guarantees for doing business in developing countries, especially via Development Finance Institutions (DFIs). In addition, development partners provide financial assistance to governments and national development banks to on-lend to private companies, which can leverage considerable resources. For example, a study shows that USD 1.4 billion financing from the Clean Technology Fund to the public sector has mobilised about USD 5 billion of private co-finance (CTF 2013). Other approaches include project preparation facilities and project facilitation platforms.

Partnering with the Private Sector

Beyond providing financial resources, development partners recognise that foreign and local companies can also support development co-operation by contributing with skills, knowledge and innovation. Therefore, by collaborating with the private sector, development partners can potentially increase the efficiency and impact of development co-operation. This aspect has been clearly evidenced in the Bilateral Development Partners' Statement in Support of Private Sector Partnerships for Development in 2010, where development partners committed to enter into partnerships with companies of various sizes that would focus not only on profits, but also on social and environmental impact. The importance of partnerships has also been stressed more recently in the SDGs, which call for enhancing "multi-stakeholder partnerships that mobilise and share knowledge, expertise, technology and financial resources to support the achievement of SDGs" (see SDG 17.16).

Specifically, development partners try to help viable businesses expand in developing countries, particularly those with high social and environmental impact, e.g. related to climate-friendly projects or bottom of the pyramid. They engage in social impact investment, responsible business conduct, corporate social responsibility, and public-private policy dialogue. Examples include Grow Africa, which is an initiative of the African Union Commission, the New Partnership for Africa's Development, and World Economic Forum, providing a platform for governments and companies to promote business models that engage smallholder farmers, facilitate value-chain linkages, and improve access to finance, with a special focus on women and the youth.

7. Development partners support PSD as the private sector provides jobs, raises government revenues through taxes and offers products and services, including for the poor. In this context, PSD generally describes activities related to the local private sector, which very often refers to Small and Medium Enterprises (SMEs). Furthermore, echoing trends in the wider development agenda, such as those embodied in the SDGs, the rationale for PSD has gradually evolved beyond economic development and poverty reduction to include: low carbon and climate resilient industrialisation; sustainable production and consumption; food security; decent work; financial access and economic redistribution– with a special focus on women, youth, and the vulnerable[1].

8. Overall, PSD programmes can be diverse as they can try to improve the macro-economic environment, correct market failures, or support specific companies. This paper considers PSD as development co-operation that addresses the improvement of policies and institutions, market functioning and enterprise capacity in order to increase the participation of the local private sector—particularly SMEs—in the economy of a developing country.

B. Analytical Framework: Investment Climate vs. Productive Capacity

9. Overall, all PSD projects ultimately aim to reduce poverty through economic growth. However, differences in political and economic approaches by development partners--notably pro-growth or pro-poor growth--have resulted in significant variation in PSD strategy design and implementation (see Box 2). This multiplicity of approaches is particularly noticeable in PSD programming when development partners select the income group of recipient countries (e.g. low income versus middle income), actors (e.g. local companies versus foreign companies), sectors (e.g. agriculture versus manufacturing), programmes (e.g.

Box 2. Pro-Growth versus Pro-Poor Growth

Understanding the way economic growth contributes to poverty reduction has been a source of debate in the academic community for long-time. The main issue is that, while economic growth is generally considered positive for poverty reduction, the poverty impact of economic growth demonstrates heterogeneity, both historically and geographically (see Dollar et al., 2013; Ravallion, 2004; Ravallion, 2001; Dollar and Kraay, 2001). For this reason, approaches of development partners differ in ensuring that PSD benefits the poorest. To simplify, PSD can be found on a spectrum between pro-growth and pro-poor growth approaches, positioning some development partners more toward one or the other. The focus of pro-growth approaches is mainly on supporting long-term economic growth through improving the investment climate and macro-economic conditions. Pro-poor growth activities involve economic sectors and companies where more poor people work, such as agriculture and SMEs.

Proponents of pro-growth approaches claim that long-term economic growth maximises the impact on poverty reduction. They also argue that poverty reduction interventions--such as support to rural agriculture and informal companies--implies allocating resources inefficiently to sectors, activities and private entities with low productivity and low absorptive capacity (Dornberger, 2005). On the other hand, proponents of pro-poor growth approaches state that, long-term growth could take a long time to trickle down to poor people and occur at different levels of inequality. Therefore, they argue that poverty reduction interventions need to be undertaken in the short-term (Humphrey, 2014).

The debate on pro-growth versus pro-poor growth has regained momentum in the last decade with the emergence of approaches that place the poor at the centre of PSD programming. These approaches include value chain development -- particularly by USAID and the German Development Agency (GIZ) -- and enhancing local economic development, and Making Markets Work for the Poor, an approach adopted by DFID and the Swiss Agency for Development and Co-operation (SDC) (Humphrey, 2014:4). Based on these approaches, development partners provide a range of support such as financial services, infrastructure, skills upgrading and capacity building tailored to the poor (ibid.).

[1] SDG 1.b; SDG 4.4; SDG 5.a; SDG 8; SDG 9; SDG 10.1; SDG 10.b; SDG 12.6; SDG 12.a; SDG 17.1; SDG 17.11; SDG 17.12.

investment climate versus productive capacity), and instruments (e.g. support to governments versus direct support to the private sector).

10. One of the major trade-offs that development partners face while selecting the PSD area to support is whether to focus on the investment climate or the productive capacity. Addressing the investment climate can be associated with the neo-liberal agenda, which considers public action to be necessary in improving the framework conditions for reducing transaction costs, risks and uncertainty for market participants (see Box 3). On the other hand, supporting productive capacity entails enhancing competitiveness in specific economic such as agriculture, manufacturing, services, and so on, as well as private sector entities. Furthermore, while development partner support to the investment climate is generally considered a pro-growth approach, supporting productive capacity can be both pro-growth and pro-poor growth.

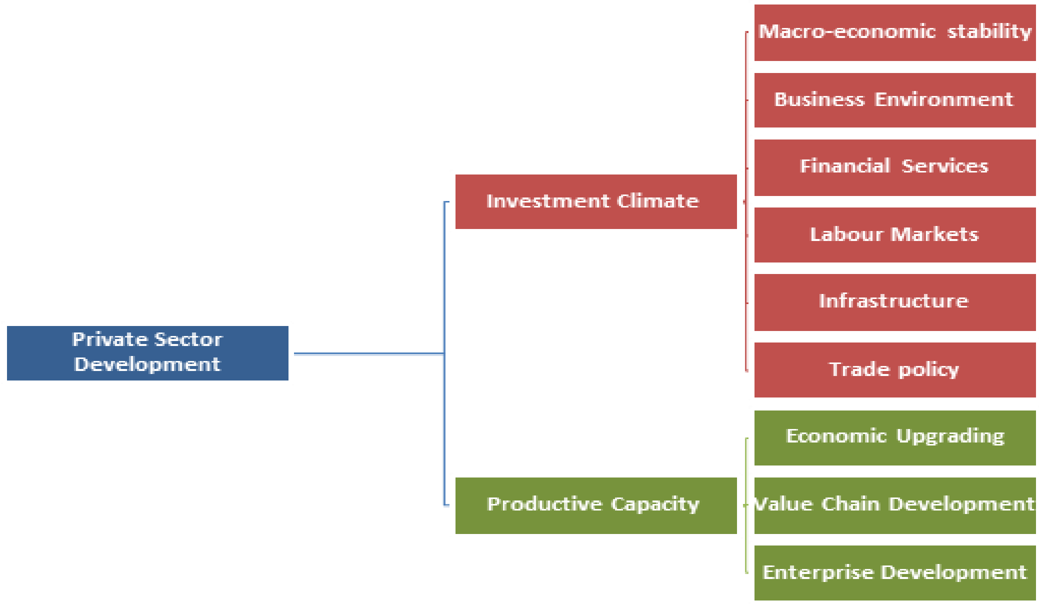
Box 3. Historical background on the role of the public and private sector in economic development

The debate on the role of the private sector in economic development could be traced back to the 1980s when, following a major shift towards the neo-liberal agenda in the advanced economies such as the United States (USA) and the United Kingdom (UK), PSD programmes emerged to create framework conditions for market-based growth (Küblböck and Staritz, 2015; Eustrup, 2009; Stiglitz, 2004). This agenda was spearheaded by the World Bank and the International Monetary Fund, advocating economic approaches that limited state interventions in favour of self-governing markets. Since then, some other development partners, both multilateral and bilateral, started undertaking their development co-operation following this example (Küblböck and Staritz, 2015:8; Gössinger and Raza, 2011:11).

However, the neo-liberal agenda in Africa and Latin America through unsuccessful structural adjustment programmes contrasted with the successful experiences of East Asian countries that did not follow this agenda. This called into question the assumptions of the neo-liberal approach (Stiglitz, 1998; 2004). The main lessons-learned was that the public and private sectors have a complementary role in supporting economic growth, as markets can fail just like governments, if the right incentives are not in place. Probably as a consequence of these events, the development thinking has progressed, with a number of scholars and development practitioners reconsidering the role of the public sector in promoting economic growth and development (e.g. Rodrik, Hausmann, Lin and Chang).

11. Currently, bilateral and multilateral development partners support both the investment climate and productive capacity, although the investment climate is still the dominant approach. In particular, improving the investment climate concerns macroeconomic stability; business environment; infrastructure development; financial services; trade policy; and labour markets, whereas productive capacity is about economic upgrading; value chain development and enterprise development (see Figure 1).

Figure 1. Areas of private sector development



C. Analytical Framework: Upstream, Midstream and Downstream Levels[2]

12. Given the variance in the scope and operational modalities of PSD, understanding development partner support to this area in a comprehensive manner has been challenging. To overcome this issue, an analytical framework is introduced, composing of the upstream, midstream, downstream levels. These levels refer to activities in both improving the investment climate and enhancing productive capacity (see Figure 2). Each level is described as the following:

- **Upstream Level – Public Policy and Institutions** This level focuses on activities related to the appropriate "rules of the game" in promoting a sound and competitive economy that is conducive to private sector-led growth. Here, the recipients of development partner programmes are exclusively within the public sector. Activities covered are mainly technical assistance and capacity building for policy-making or institutional reforms. Support at the upstream level is provided to both improve the investment climate and productive capacity. Regarding the investment climate, development co-operation addresses the policy and institutional framework related to macro-economic stability, business environment, trade policy and labour market regulation. In terms of productive capacity, the focus is on upgrading specific sectors such as agriculture, industry, services, and so on.

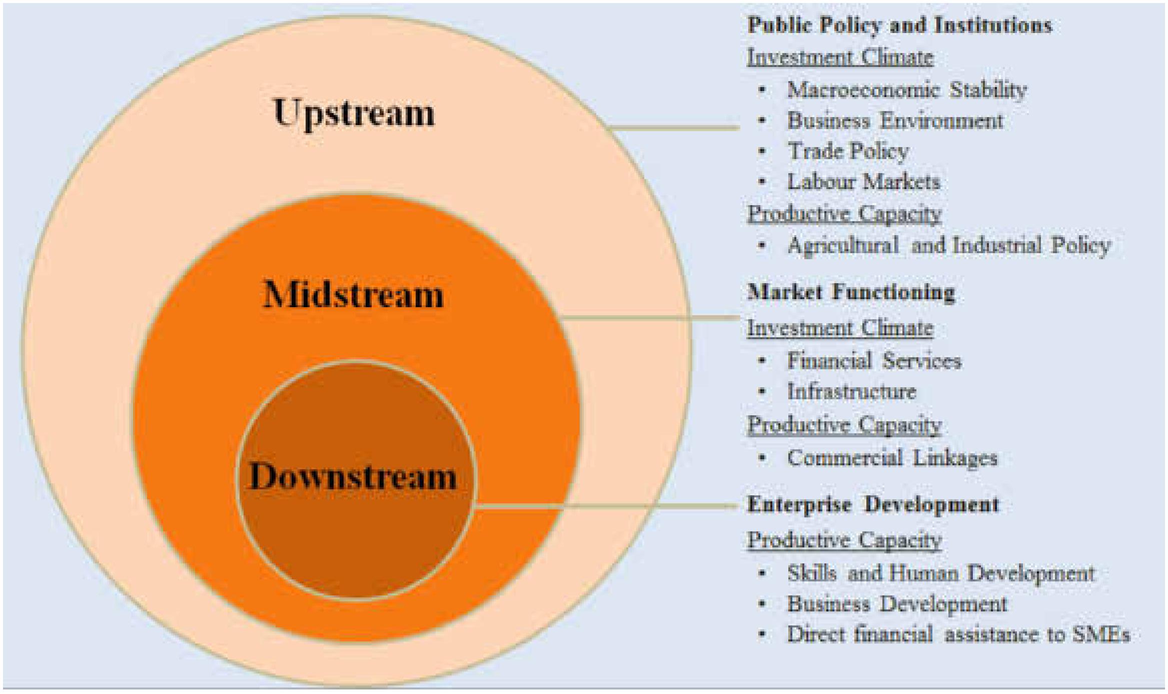
- **Midstream Level – Market Functioning** Development co-operation at this level aims to address market failures that hinder PSD through capacity building, technical assistance, and financial support directed to both the public and private sectors. Similar to the upstream level, support aims

[2] The development of the analytical framework has been undertaken by examining analyses from Gibbon and Schulpen (2002); Gössinger and Raza (2011); DCED (N/A); Kindornay and Reilly-King (2013).

at the investment climate and productive capacity. Activities relevant for the investment climate include expanding access to finance through financial intermediaries and developing appropriate economic infrastructure. To enhance productive capacity, development partners provide financial and technical assistance in order to reinforce commercial linkages with local, regional and global value chains. This includes collaboration with governments, non-governmental actors, chambers of commerce, business associations, trade unions, universities, research institutes, and companies.

- **Downstream Level – Enterprise Development** The support at this level directly targets local companies in developing countries, predominantly SMEs. The objective is to either help increase the competitiveness of these companies or to promote viable and innovative business models for development by reinforcing their productive and managerial capacity. For instance, development partners provide technical and financial assistance to address issues such as formalisation and provision of vocational training to microenterprises. This includes private sector operations by DFIs and aid agencies that support the private sector directly. As projects at the downstream level involve only private sector entities, it does not concern the investment climate.

Figure 2. Analytical framework for development partner support to PSD



III. STRATEGIES AND INSTITUTIONAL ARRANGEMENTS

13. The scope and priority accorded to PSD among development partners vary considerably, which is mirrored in the diversity of strategic and institutional arrangements related to PSD. To shed light on this issue, publicly available information of 12 major bilateral and multilateral development partners has been reviewed[3], combined with analysis from similar research (Kindornay and Reilly-King, 2013; Miyamoto and Biousse, 2014). This section therefore tries to summarise the major patterns and issues in PSD strategies and institutional arrangements of these development partners.

A. Strategies

14. In most cases, PSD is encompassed within the overarching objective of boosting inclusive and sustainable growth, which is considered key for the development partners examined. However, the importance accorded to the private sector as a driver of inclusive and sustainable growth differs. For example, while private sector-led growth is only one element of the objective of economic growth and poverty reduction by Germany and Sweden, it is a 'core operational priority' for African Development Bank (AfDB) (AfDBa, 2013) and a main 'driver of change' for Asian Development Bank (AsDB) (AsDB, 2008).

15. PSD strategies are articulated at different levels, with some serving more as directions for projects, while others having detailed programming, monitoring and evaluation guidelines (Kindornay and Reilly-King 2013). Furthermore, the scope of PSD varies from carrying out activities in specific sectors such as health and education (e.g. USA and UK) to regional integration (e.g. AfDB; AsDB; Japan and Sweden). Furthermore, in some cases, the importance of implementing international agreements, norms and standards is highlighted, for example in trade and climate change (e.g. Norway and the Netherlands). As PSD is undertaken by several departments and institutions within a bilateral country or multilateral institution, the diversity of coverage need to be strategically coherent.

16. Table 1 summarises the elements that are incorporated in the PSD strategies of each development partner in the study. It is important to note that, what is included and excluded in the respective PSD strategy differs by development partners. For instance, while trade policy is part of IADB's PSD strategy, it is not part of the strategy by the EU Institutions. This does not mean, however, that trade policy is not dealt with in the development co-operation programme of the EU Institutions; it only means that trade policy is not considered a part of their PSD strategy.

17. Based on the analysis, the most common areas of PSD strategies are related to the investment climate, particularly for the multilaterals (see Table 1). These generally include business environment reforms[4], infrastructure and provision of financial services. Furthermore, many development partners promote productive capacity, especially value chain development and SME development. Here, the bilaterals tend to have a stronger pro-poor narrative by focusing more on the poor, women and the youth.

18. In many cases, PSD strategies change according to the income level and the specific situation of a country. For instance, the German government's PSD strategy in low-income countries focuses on framework conditions and supporting SMEs to reduce poverty, whereas in middle-income countries, the focus is more on knowledge sharing, innovation and sustainability of the private sector (BMZ 2013).

[3] African Development Bank; Asian Development Bank; Austria; European Union; Germany; Inter-American Development Bank; Japan; Netherlands; Norway; Sweden; United Kingdom; United States; World Bank Group.

[4] Business environment reforms are often loosely defined and sometimes conflated with the investment climate.

Similarly, the PSD strategy of the EU Institutions calls for a differentiated approach based on the local context and situation of fragility.

Table 1. PSD focus areas in areas in development partner strategies

	INVESTMENT CLIMATE						PRODUCTIVE CAPACITY		
	Business Environment	Infrastructure	Labour Markets	Macro-Stability	Financial Services	Trade Policy	Economic Upgrading	Value Chain Development	Enterprise Development
AfDB	•	•		•	•		•	•	
AsDB	•	•		•					
IADB	•	•			•	•	•		•
WBG	•			•	•				
EU	•	•		•	•		•	•	
US	•							•	•
Sweden	•		•		•	•		•	•
Norway	•	•				•		•	•
Germany	•	•	•		•		•	•	•
Netherlands	•	•			•	•		•	•
UK	•	•			•			•	•
Japan	•	•				•	•	•	

19. Finally, although PSD generally relates to the local private sector in developing countries, most bilateral development partners refer to their own domestic companies in PSD strategies. For example, one of the three pillars of the PSD strategy of the Netherlands is to ensure success for Dutch companies abroad (DMFA, 2013:6). Likewise, Sweden and Denmark emphasise that PSD has to be beneficial for the companies and economic growth of both partner countries and their own (see SIDA, 2011:9; DANIDA, 2012:1). While linkages between development co-operation and promotion of companies from bilateral countries could be beneficial for both development partner and developing countries, development objectives should not be prioritised over commercial objectives (see Box 4).

Box 4. Development partner companies in development co-operation for PSD

The new 2015 Norwegian PSD strategy paper mentions that companies from development partner countries can play an important role in improving the environment for business activities (NMFA, 2015:16). In fact, development partner companies, and foreign companies more broadly, can contribute to local PSD in three ways:

- Entrepreneurial clustering through backward and forward linkages;
- Direct, indirect and induced jobs;
- Knowledge and technological spillover effects.

At the same time, focusing too much on benefiting the development partner economy could reduce the developmental impact on the partner country's private sector (Kindornay and Reilly-King, 2013). This can be at odds with the general principles of aid effectiveness agreed in Paris and Busan and the DAC Recommendation on Untying Official Development Assistance to the Least Developed Countries.

Tied aid is a particular issue with regards to aid effectiveness. For instance, a 2014 review of the Dutch PSD programme points out that supporting Dutch companies could lead to a sub-optimal allocation of resources for two reasons: (i) tied aid can be used to promote the purchase of goods and services from Dutch companies that are not necessarily needed by the partner country (IOB, 2014:16); and (ii) economic literature shows that goods and services acquired by partner countries through tied aid are 15-30% more expensive than those selected through international competitive bidding processes (IOB, 2014:7).

B. Institutional Arrangements

20. The multi-faceted nature of PSD is complex, not only because of the diverse scope across development partners, but also because of multiple institutions, agencies and departments working on PSD within development partners. As described above, while most development partners consider PSD as a means to economic growth and poverty reduction, there are differences in whether areas such as supporting health and education or regional integration are included in PSD strategies or are treated outside. This complexity is reflected in the institutional setup of development partners, which relates to issues of coherence and co-ordination.

(i) Overview

21. In general, PSD programmes are implemented through several types of institutional structures without a coherent strategy. Within bilateral development partners, PSD projects are divided among several actors, most commonly one or more ministries, a development agency, DFIs, embassies and/or country missions.

22. Within bilateral development agencies, the structure and degree of centralisation in implementing PSD programmes vary. Some institutional models are particularly centralised, such as the one of DFID, with the Private Sector Department in charge of most PSD work. For other agencies, e.g. Swedish International Development Cooperation Agency (SIDA) and USAID, PSD activities are shared between one or more designated departments tasked with private sector-related operations and other departments such as tourism, regional integration, rural development, and so on, that have PSD activities mainstreamed.

23. Multilateral development partners usually have several specialised departments working on different aspects of PSD, including business environment, innovation and entrepreneurship, trade, and infrastructure. For instance, Inter-American Development Bank (IADB)'s PSD related activities are divided among several departments, such as the Vice Presidency for Private Sector; the Institutional Capacity and Finance Sector, the Integration and Trade Sector, the Infrastructure and Environment Sector, and the Knowledge and Learning Sector. In AfDB, the Private Sector Department has different units that all have some private sector related activities, such as: Infrastructure; Regional Integration & Trade and Energy; and Environment & Climate Change. Within the World Bank Group (WBG), the International Finance Corporation (IFC) is the institution in charge with direct support to the private sector, whereas other PSD activities are shared among the World Bank's Finance and Private Sector Development Network, the Investment Climate Department, and the Trade and Competitiveness Global Practice.

(ii) Direct Support to the Private Sector

24. Aside from traditional assistance to public institutions, both bilateral and multilateral development partners directly support private companies, including for PSD. Direct support to private companies started mostly in the 1990s, presumably as a result of the consolidation of public budgets and state-owned enterprises in the provision of public goods (EURODAD, 2011; Gössinger and Raza, 2011). These private sector operations are generally undertaken through specialised departments or dedicated DFIs, with the aim of bridging the gap between commercial investment and official development finance. Interests toward directly supporting the private sector have increased in recent years, probably due to:

- recognition of private companies as a source of finance and innovative business models;
- reduced lending from commercial banks due to the financial crisis;
- budget constraints in development partner countries; and
- promotion of companies from development partner countries in developing countries.

25. In particular, DFIs directly support local and international companies in order to promote: (i) job creation directly or indirectly by linking with value chains; and (ii) technical change and innovation (Jouanjean et al., 2013). These objectives are achieved by co-financing (e.g. equity and debt), mitigating risk (e.g. guarantees), and providing advisory services (Miyamoto and Chiofalo, 2015:24).

26. Bilateral DFIs have either a single stated mandate to support PSD (e.g. BIO, DEG, CDC, Proparco and Norfund) or have an additional objective to support their domestic companies (e.g. OPIC, SOFID and COFIDES). Furthermore, the governance of bilateral DFIs vary depending on the country-- some are supervised by the Ministry of Foreign Affairs or the aid agency (e.g. BIO, DEG, Norfund); others are a branch within an aid agency (e.g. Proparco, CDC); and the rest are supervised by a Ministry unrelated to development co-operation, usually in charge of trade or finance (e.g. COFIDES, SOFID).

27. Furthermore, the ownership of DFIs differs considerably with some fully owned by state or aid agencies (e.g. Norfund, DFID) and others incorporating commercial banks, trade unions and private sector representatives (e.g. FMO, SOFID). In addition, the composition of board members are also considerably different, which could include representatives from academia, commercial banks, trade unions, local public entities, consulting firms, investment firms, etc. (Miyamoto and Biousse, 2014:13-15).

28. While traditional bilateral development agencies normally undertake operations that involve the public sector of partner countries, some also engage the private sector through the provision of specific instruments, such as guarantees, direct contracts or grants (see Wise, 2012:5; USAID, 2010). These operations by development agencies generally have a more pro-poor approach than the direct support provided by DFIs. An example of this support to the private sector includes DFID's Africa Enterprise Challenge Fund or SIDA's Innovations Against Poverty Programme, which are challenge funds that engage local and foreign companies via competitive selection.

29. Multilateral institutions have non-sovereign operations managed by a specific department or institution, such as the Private Sector Operations Department in the AsDB, and the Private Sector Department in AfDB. Within the multilaterals, the IFC in the WBG and the Inter-American Investment Corporation in the IADB group are the only institutions that are legally and financially independent.

30. Despite the potential benefits of direct support to private companies, issues around project selection, transparency and accountability that could undermine development impact through DFI support have been raised. According to Kindornay and Reilly-King (2013:31):

> Donors tend to paint a picture of the private sector as a key stakeholder with shared interests, rather than recognizing that, in many cases, private sector actors have complicated development challenges. While donors set criteria through their funding windows for who they will engage with, the focus is more on eligibility guidelines (years incorporated, audited financial statements) than corporate track records (in this case, positive social, development, economic, and environmental impacts).

31. In fact, choosing private sector partners to co-operate in PSD programmes could lead to market distortions, questions regarding additionality, or undermining developmental outcomes if project selection and monitoring of operations are not carried out strictly. For instance, the evaluation of Danida's Business Partnership Programme highlighted that direct support is against best practices in PSD, particularly when companies are selected arbitrarily rather than through competitive processes (DANIDA 2014:86). Several other institutions have acknowledged the challenge in direct support to companies, including the AfDB (AfDB 2013b:4), WBG (WBG 2014:20), Sweden (SIDA 2004:6) and the EU (EU 2014:4).

(iii) Co-ordination

32. If there is a lack of strategic coherence and collaboration between designated PSD departments and other related departments within the same agency working on PSD, implementation can be challenging. For instance, an AsDB review showed that, internal co-ordination and synergies between enabling environment support and private sector operations for PSD have been weak (AsDB, 2013:vii-viii).

33. Another important challenge is cross-agency co-operation. This was identified in the cases of Netherlands, Austria, Sweden, Norway, WBG, and the UK, as a result of incoherence among different mandates of several actors and the lack of cross-agency co-ordination. The issue is particularly pronounced between development agencies and DFIs, despite the potential for complementarity. For example, a 2013 review by the Independent Evaluation Group of the WBG on investment climate projects showed that, while they were being implemented by both the World Bank and the IFC, collaboration between the agencies was inadequate (IEG, 2013).The review found that, although projects with joint implementation were more likely to be rated as successful, collaboration was mostly limited to the strategic level (ibid.).

34. Against this background, development partners have been addressing issues related to their institutional structure in the last years. For example, Austria recently established an inter-organisational PSD task force to co-ordinate PSD-related programmes. Similarly, the establishment of DFID's Private Sector Department in 2014 was to build capacity on private sector-related issues across its country offices. Since 2014, all investment climate-related projects in the WBG are being merged into a newly established Trade and Competitiveness Global Practice to centralise PSD programmes. Moreover, synergies have been increased between the World Bank and the direct private sector support of the IFC.

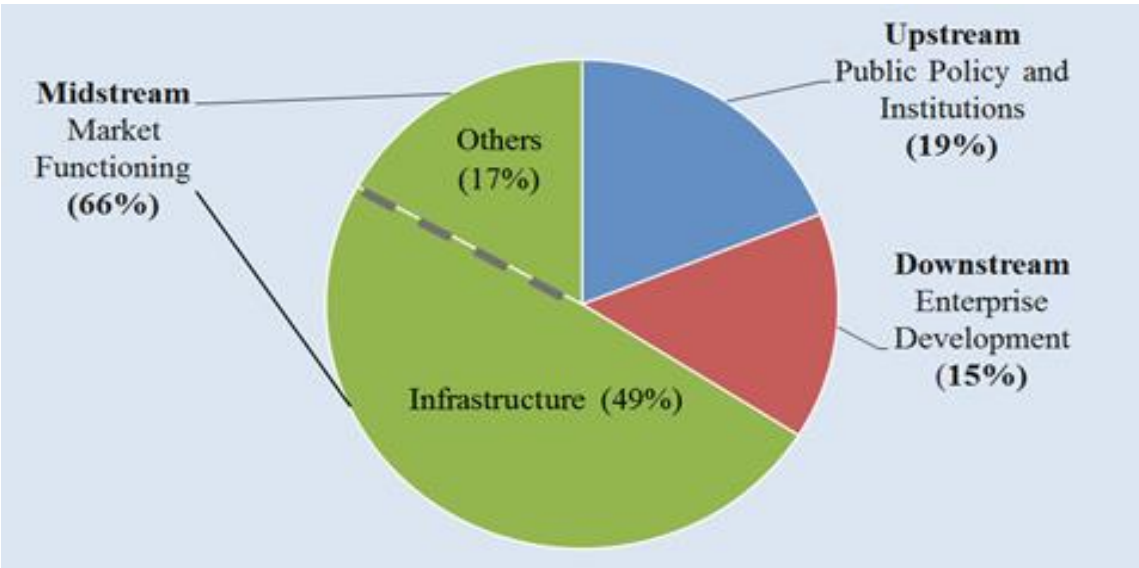
IV. QUANTITATIVE ANALYSIS

35. So far, in the literature of development co-operation for PSD, there is a lack of comprehensive quantitative assessments on ODF to PSD (see Küblböck and Staritz 2015:7; Kindornay and Reilly-King, 2013:19). Even development partners themselves are sometimes not able to measure their own support to PSD. For instance, a review of DFID's spending on PSD notes that it was unable to precisely quantify its support to PSD as it was not a discrete category of expenditure in its budget (ICAI, 2014:4).

36. To fill this knowledge gap, the analytical framework presented above has been used to measure development co-operation for PSD (See Figures 3 and Annex for more details). As a result, concessional and non-concessional ODF disbursed by bilateral and multilateral development partners to areas related to PSD amounted to almost USD 96 billion in 2013[5]. This amount was equivalent to 54% of sector-allocable ODF[6].

37. Disaggregating this amount, the midstream level of market functioning was the level most financed, at two thirds of the total volume (see Figure 3). This high proportion was due to the large amounts provided for infrastructure, which alone accounted for half of total PSD-related ODF. The focus on infrastructure is probably due to its recognised impact on economic growth and poverty reduction (Mwase and Yang, 2012; Agenor and Moreno Ddson, 2006; Straub, 2008), and the capital intensive nature of the related projects. However, this amount does not include non-developmental export credits for infrastructure, which alone accounted for roughly a sixth of ODF for infrastructure. The remaining half of PSD-related ODF was almost equally allocated to the upstream level of policies and governance, the rest of midstream level of market functioning (i.e. without infrastructure) and downstream level of enterprise development. This implies that, excluding infrastructure, ODF to areas related to PSD was spread in similar proportions among the upstream, midstream and downstream levels.

Figure 3. ODF to areas related to PSD (2013)

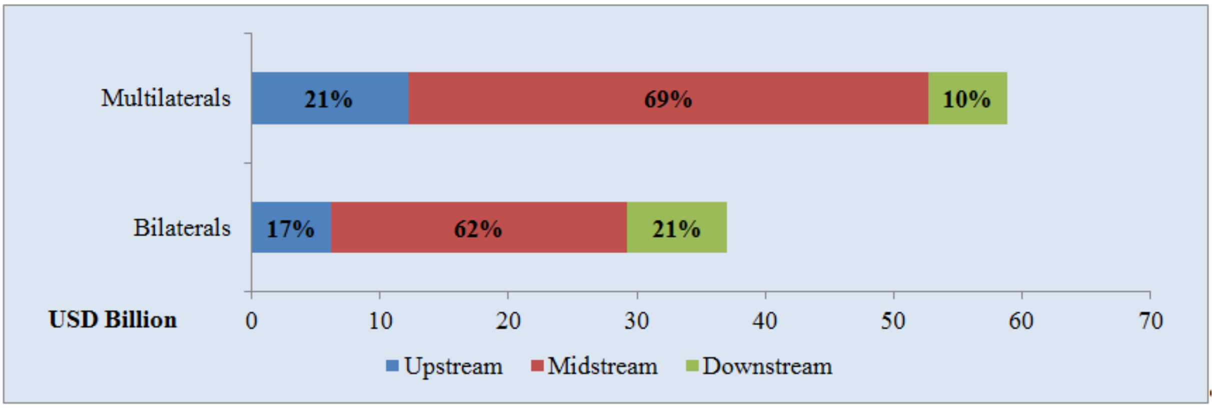


[5] This amount includes development-oriented export credits by development partners that are reported to the DAC.

[6] ODF to all sectors, generally referred to as "sector allocable", includes official support by development partners to specific sectors such as health, education, agriculture, and so on. Therefore, contributions that are not targeted to a specific sector, e.g. balance-of-payment support, debt relief, emergency aid -called "non-sector allocable" – are not considered.

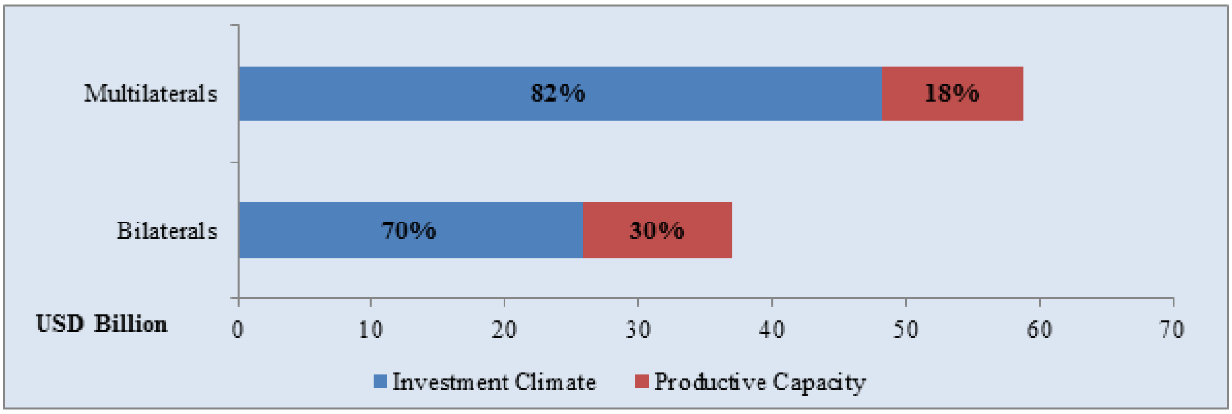
38. Of the total, multilateral institutions provided almost USD 60 billion, while bilaterals disbursed slightly less than USD 40 billion (see Figure 4). In particular, multilaterals proportionally allocated slightly more than bilaterals to public policy and governance (upstream). In contrast, the share of bilateral spending to enterprise development (downstream) was twice (21%) that of multilaterals (10%).

Figure 4. Bilateral vs Multilateral spending to upstream, midstream and downstream levels



39. From another angle, support to the investment climate for all development partners was considerably higher (77%) than that to the productive capacity (23%) (see Figure 5). As mentioned earlier, this is due to the large amount of ODF to infrastructure, which is part of the investment climate. Multilaterals spend proportionally more (82%) than bilaterals (70%) on the investment climate which points to the importance that is given to the area and the comparative advantage that they have in addressing it. Conversely, supporting productive capacity is more important for bilaterals than for multilaterals.

Figure 5. Bilateral vs Multilateral spending to the investment climate and productive capacity



40. These finding are in line with the qualitative assessment provided in Section III on strategies for PSD, which showed that multilaterals strongly emphasise the support to framework conditions and the investment climate. It also reflects the specialisation of multilaterals in designing and implementing policy and institutional reforms and infrastructure development. Furthermore, these findings are also in line with the findings which illustrated that most bilateral development partners examined had a strong narrative on promoting productive capacity, including through directly support their companies to invest in developing countries.

V. CONCLUSIONS AND WAY FORWARD

41. The increasing recognition of the private sector in development theory during the last decades has impacted the way development partners undertake development co-operation. In this context, PSD is being considered as a viable means to reduce poverty by promoting private sector-led growth. Here, the objective of PSD is different from the more recent focus of the objectives by development partners in leveraging and partnering with the private sector, as it largely focuses on building the capacity of the public sector to improve investment climate and enhance productive capacity. From another perspective, development partners do so by providing support at the levels of policies and institutions (upstream), market functioning (midstream) and enterprise development (downstream).

42. The strategies used by development partners to promote PSD vary considerably, which poses challenges in understanding the scope of PSD and measuring efforts toward this area in a holistic manner. Against this background, this paper provided a framework that could be used to analyse development co-operation for PSD qualitatively and quantitatively. The quantitative assessment showed that more than half of ODF to all sectors were allocated to PSD-related areas. Although not all the amounts may be specifically intended to promote PSD *per se*, the framework enables quantitative analysis of the outer bounds of the relevant ODF using a common benchmark.

43. Further analysis showed that development partners allocated 77% of their support to PSD to the investment climate and 23% to productive capacity. However, of the investment climate, two thirds was for infrastructure, with the remaining portion allocated to business environment, financial services, labour markets, and so on. Specifically, the multilaterals provided proportionally more to the investment climate than the bilaterals which provided more to the productive capacity. These findings are in line with a qualitative assessment of the PSD strategies of 12 bilateral and multilateral development partners that were reviewed in this study.

44. The paper illustrated that there was a wide variety of strategies and institutional mechanisms for PSD. This means that inadequate co-ordination across departments within development agencies and between development agencies and DFIs on priorities and division of role can undermine strategic coherence and implementation. To address this issue, however, a number of development partners are currently streamlining their development co-operation for PSD through internal and cross-agency harmonisation and centralisation. At the same time, criticisms have been raised by a number of PSD reviews regarding interventions that target the private sector either directly or indirectly through tied aid. The reviews showed that tied aid can lead to market distortions, if effective project selection and monitoring mechanisms are not in place.

45. This paper provided an initial conceptual framework and analysis, which could be deepened in 2016 and beyond, in line with the upcoming 2016 Ministerial Council Meeting's priority on productivity and inclusive growth. Research can be furthered by undertaking, *inter alia*, surveys, specific quantitative assessments, and in-depth analyses at the country, development partner, sector and thematic levels such as development co-operation for SMEs, responsible business conduct, connecting to Global Value Chains, and so on. Research outcomes, findings and policy recommendations can be developed on an iterative basis and consolidated at a later stage.

Questions for the DAC

- Do delegates agree to the presented analytical framework and findings on development co-operation for PSD?
- What are some topics that can be investigated further which can help DAC understand and collectively better guide development co-operation for PSD?

ANNEX

METHODOLOGY FOR QUANTITATIVE ANALYSIS

46. To measure development partner support to PSD, relevant CRS Purpose Categories[7] have been matched with the policy areas under the analytical framework provided above (see Table 2). This is the first comprehensive quantitative assessment on development partner support to PSD covering both bilateral and multilateral development partners. It has been undertaken by analysing about 75,000 interventions of the development partners that report to the DAC at the activity level. Given the number of projects, the nature of PSD programmes; the quality of reporting and the structure of the CRS systems, two main challenges have been encountered while doing this exercise:

47. Firstly, identifying the exact PSD area of operation of a particular project has been complicated by multipurpose nature of PSD programmes, blending components targeting policies and institutions with others related, for instance, to access to finance or enterprise development. For example, a project about improving economic competitiveness might include support to the regime for infrastructure provision, improve productivity in key industries, and increase access to credit through direct and intermediated financial support. Furthermore, the quality reporting has been questionable several times further complicating the assessment.

48. Secondly, the DAC Creditor Reporting System itself is not structured in a way that allows for straightforward quantitative assessments on PSD. Purpose categories are several times too broad or too narrow to cover specific aspects of PSD. This is particularly the case of business environment reforms, which scattered across several purpose codes. Furthermore, very broad purpose categories such as 25010 ‘Business Support Services and Institutions’, encompassing support for business development services, financial services, and technical assistance for regulatory reforms, or purpose category 15110 ‘Public sector Policy and administrative Management”, further complicates the exercise.

49. For these reasons, projects have been manually redistributed to the relevant components of the analytical framework, where possible. However, as mentioned above, the extensive number of projects did not allow for a systematic redistribution of projects. This implies that although the statistics produced are able to convey main patterns of development partner support to PSD they have to be taken with caution.

Table 2. CRS Categorisation of development partners' support for local PSD

POLICY AREAS	CRS PURPOSE OR SECTOR CODE
Policies and Governance (Upstream)	
<u>Investment Climate</u>	
• **Macroeconomic Stability**	• Monetary Institutions (Purpose Code 24020) • Financial policy and administrative Management (Purpose Code 24010) • Trade-related adjustment (Purpose code 33150)
• **Business Environment**	• Public sector policy and administrative management (Purpose Code 15110) • Public finance management (Purpose Code 15111) • Decentralisation and support to subnational gov. (Purpose Code

[7] The CRS data is classified in Purpose Categories, i.e. categories indicating the main objective of the projects reported within them.

	15112)
• **Trade**	• Legal and Judicial Development (Purpose Code 15130) • Anti-corruption organisations and institutions (Purpose Code 15113)
• **Labour Markets**	• Trade policy and administrative management (Purpose Code 33110) • Regional trade agreements (Purpose Code 33130)
Productive Capacity • **Economic Upgrading**	• Employment policy and administrative management (Purpose Code 16020)
	• Industrial policy and administrative management (Purpose Code 32110) • Agricultural policy and administrative management (Purpose Code 31110) • Agrarian reform (Purpose Code 31164) • Fishing policy and administrative management (Purpose Code 31310)
Market Functioning (Midstream)	
Investment Climate	
• **Financial Services**	• Formal sector financial intermediaries (Purpose Code 24030) • Informal/semi-informal financial intermediaries (Purpose Code 24040)
• **Infrastructure**	• Water sector policy and administrative management (Purpose Code 14010) • Water supply and sanitation - large systems (Purpose Code 14020) • Water supply - large systems (Purpose Code 14021) • River basins' development (Purpose Code 14040) • Waste management / disposal (Purpose Code 14050) • Education and training in water supply and sanitation (Purpose Code 14081) • Transport policy and administrative management (Purpose Code 21010) • Road transport (Purpose Code 21020) • Rail transport (Purpose Code 21030) • Water transport (Purpose Code 21040) • Air transport (Purpose Code 21050) • Storage (Purpose Code 21061) • Education and training in transport and storage (Purpose Code 21081) • Communications policy and administrative management (Purpose Code 22010) • Telecommunications (Purpose Code 22020) • Radio/television/print media (Purpose Code 22030) • Information and communication technology (ICT) (Purpose Code 22040) • Energy policy and administrative management (Purpose Code 23010) • Power generation/non-renewable sources (Purpose Code 23020) • Power generation/renewable sources (Purpose Code 23030) • Electrical transmission/ distribution (Purpose Code 23040) • Gas distribution (Purpose Code 23050) • Oil-fired power plants (Purpose Code 23061) • Gas-fired power plants (Purpose Code 23062) • Coal-fired power plants (Purpose Code 23063) • Nuclear power plants (Purpose Code 23064) • Hydro-electric power plants (Purpose Code 23065) • Geothermal energy (Purpose Code 23066) • Solar energy (Purpose Code 23067)

Productive Capacity • **Value Chain Development**	• Wind power (Purpose Code 23068) • Ocean power (Purpose Code 23069) • Biomass (Purpose Code 23070) • Energy education/training (Purpose Code 23081) • Energy research (Purpose Code 23082) • Business support services and institutions (Purpose Code 25010) • Trade facilitation (Purpose Code 33120) • Agricultural land resources (Purpose Code 31130) • Agricultural water resources (Purpose Code 31140) • Agricultural services (Purpose Code 31191) • Agricultural financial services (Purpose Code 31193) • Livestock/veterinary services (Purpose Code 31195) • Fishery services (Purpose Code 31391)
Enterprise Development (Downstream)	
Productive Capacity	
• **Skills and human development**	• Advanced technical and managerial training (Purpose Code 11430) • Vocational training (Purpose Code 11330) • Technological research and development (32182) • Agricultural education/training (31181) • Fishery education/training (Purpose Code 31381) • Trade education/training (Purpose Code 33181) • Education/training in banking and financial services (Purpose Code 24081) • Agricultural research (Purpose Code 31182) • Fishery research (Purpose Code 31382)
• **Business Development**	• Small and medium-sized enterprises development (Purpose Code 32130)
• **Direct support to economic sectors**	• Agricultural development (Purpose Code 31120) • Agricultural inputs (Purpose Code 31150) • Food crop production (Purpose Code 31161) • Industrial crops/export crops (Purpose Code 31162) • Livestock (Purpose Code 31163) • Agricultural extension (Purpose Code 31166) • Plant and post-harvest protection and pest control (Purpose Code 31192) • Agricultural co-operatives (Purpose Code 31194) • Fishery development (Purpose Code 31320) • Industrial development (Purpose Code 32120) • Cottage industries and handicraft (Purpose Code 32140) • Agro-industries (Purpose Code 32161) • Forest industries (Purpose Code 32161) • Textiles, leather and substitutes (Purpose Code 32163) • Chemicals (Purpose Code 32164) • Fertilizer plants (Purpose Code 32165) • Cement/lime/plaster (Purpose Code 32166) • Energy manufacturing (Purpose Code 32167) • Pharmaceutical production (Purpose Code 32168) • Basic metal industries (Purpose Code 32169) • Non-ferrous metal industries (Purpose Code 32170) • Engineering (Purpose Code 32171) • Transport equipment industry (Purpose Code 32172)

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