actionaid

In whose interest?

Aid and the private sector

Contents

Acronyms

ADSP	Agricultural Development Support Program
ACET	African Center for Economic Transformation
CDDCU	Choma District Dairy Co-operative Union
CRS	Creditor Reporting System (used by the OECD/DAC to determine what aid is used for)
DAC	Development Assistance Committee
DCF	UN Development Cooperation Forum
DFI	development finance institutions
DFID	Department for International Development (UK)
DG DEVCO	EC Development and Cooperation Directorate-General – EuropeAid
EC	European Commission
EU	European Union
FMO	Dutch Entrepreneurial Development Bank
GDP	gross domestic product
GIZ	German development agency
GNI	gross national income
GPEDC	Global Partnership for Effective Development Co-operation
HIPC	heavilyindebted poor countries
ICAI	Independent Commission for Aid Impact
IDA	International Development Association
IFC	International Finance Corporation
IFU	Danish Investment Fund for developing countries
ITUC	International Trade Union Confederation
IMF	International Monetary Fund
LDC	least developed country
MAL	Zambian Ministry of Agriculture and Livestock
MDGs	Millennium Development Goals
MIIF	Market Improvement and Innovation Facility
NAIP	National Agriculture Investment Programme
NEAT	Nepal Economic Agriculture and Trade
ODA	Official development Assistance
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
PPP	public private partnership
SMART	specific, measurable, attainable, relevant andtime-bound
SME	small and medium enterprise
UKTI	UK government's UK Trade and Investment unit
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNESCO	United Nations Educational, Scientific and Cultural Organization
USAID	United States Aid Agency

Executive summary

This report shines a light on aid to the private sector, an area receiving much current attention as donors flock to the sector to solve their diverse problems. There are important questions to ask about this aid.

What aid to the private sector does – building, leveraging, delivering

Developing countries already have a thriving private sector of their own, for most poor people have to be dynamic entrepreneurs to survive. Supporting, developing, and ultimately transforming this private sector (by moving away from low to high added value economic activities) into one that provides decent jobs and long term tax revenues is important for a country's development. It is therefore not surprising that donors should be looking at ways in which they can help build this private sector, including through the allocation of aid. This can be done directly by supporting businesses, or indirectly by building infrastructure such as roads and energy networks.

However, there is another murkier side to the 'aid and private sector' story. Facing fiscal constraints, donors increasingly seek to involve private sector actors in ways that alleviate pressure on the public purse, whilst still creating the appearance of contributing to development, through 'leveraging'. Leveraging – the use of aid to incentivise private sector investment in a development project – happens through a diverse range of methods ranging from blending facilities, to public private partnerships. Conveniently, it confers some of the benefits of aid onto the private sector of the donor country.

Furthermore, some projects financed by aid are delivered by companies, which are contracted by donors. This is not a new phenomenon, and is often a useful way to implement development strategies. However, it is important to consider here because it makes a difference to the development impact if local developing country companies have an opportunity to tender for this work and a reasonable chance of winning tenders.

These three types of aid to the private sector – building, leveraging and delivering – are often confused in donor policy documents and discussions.

What is happening now?

Due to the marked lack of transparency around aid to and with the private sector, it is currently impossible to estimate aid to the sectors (including education and health). However, using proxy measures we can say the following.

'Building' aid to the private sector appears to be increasing relative to aid to social sectors; in particular, aid to infrastructure is increasing.

Most aid to the private sector goes to middle income, not low income countries. Nearly two thirds of aid to the business and banking sectors, and 85% of aid to equity investment (that can be traced) goes to middle income countries.

Over half of aid delivered with private sector contracts involve companies in the donor country, even where the aid is formally untied.

Questioning aid to the private sector

Aid to and for the private sector is fashionable again. But the kinds of questions that should be asked of all aid should be asked of this aid. Is it appropriate? And is it effective?

Is it appropriate?

The rationale often given for aid to the private sector is that it will support growth. Growth is a vital but insufficient condition for development – it needs to be inclusive, sustainable and transformative. The economies of developing countries need to change rather than retain their current structures. Developmental growth needs to be shaped in these ways. However, donors often portray growth as if any growth at all were a win-win-win situation for companies, developing countries and poor people. This is wrong. It ignores the fact that companies' main motive is to make a profit, not necessarily supporting local development. There is no reason why they should do anything else; development (beyond its economic dimension) is not in their DNA. Moreover, growth is often skewed to the rich or leaves the domestic economy altogether. Aid that supports private sector policy reforms in developing countries also often ignores this reality, seeming to benefit the donors' interests rather than the recipient countries.

Aid is only one form of development finance, and a scarce form at that. It should be primarily reserved to finance activities which cannot be financed in other ways, such as building social infrastructure and services for people who cannot pay. Where development can generate financial returns, other forms of development finance may be more appropriate than aid.

The opportunity cost of supporting the private sector should also be considered. More aid to the private sector, in the current climate, means less aid to other areas. For example, between 2010 and 2011, aid to basic education actually fell by 6%. Cutting aid to social sectors affects women disproportionately, as their unpaid work fills the gap where social services are not available.

Is it effective?

Effective aid generates development results, and provides value for money. A set of international principles (most recently refined in the 2011 Busan conference) reflects global consensus that effective aid is that which affords developing countries autonomy over their own development. Donors can support this, for example by aligning aid with national development strategies, and by putting aid on-budget and using developing country systems and local firms. However, progress in this area in general, let alone in relation to aid to the private sector, has been shockingly glacial in recent years.

To be truly effective, aid to the private sector should support the developing country's domestic private sector rather than companies in the donor countries. Following this principle – widely agreed in the form of the global attempt to eliminate tied aid – would afford countries more autonomy, make the aid more likely to remain in the developing country, and be more cost effective.

Finally, effective aid is transparent and accountable. This principle also seems to be forgotten in relation to aid to the private sector. Much of it is not reported, and even where donors do report, their systems are not comparable. Indeed, the global reporting system does not classify aid to the private sector. Where the global system does report aspects of aid to the private sector – such as aid to equity investment – a depressing amount (43%) cannot even be traced to a developing country.

What should be done?

Donors are currently very interested in aid to the private sector, whether to build it, leverage support, deliver projects or a combination of all three. But is aid to the private sector appropriate and if yes, is it being delivered effectively, reflecting international aid agreements?

The available evidence suggests that this should be an area of some concern. In the excitement of the latest aid trend, it seems that donors may not always be rigorously assessing whether their aid to the private sector is strategically the right and best instrument to support development and increased welfare, given the opportunity cost of using precious aid money in this way. There is a particularly unhelpful lack of clarity around the purpose of donors' private sector aid. There is often more emphasis on leveraging and delivery rather than actually building and promoting local domestic sectors in order to transform and diversify economies. And yet building the domestic private sector through nationally led initiatives, seems to be the most justifiable focus for aid to the private sector.

And donors are not always applying established and agreed development co-operation effectiveness principles to private sector aid; they are not making sure it is 'real aid', aid that puts developing countries in charge of their own development. All too often, it seems, they consider aid to the private sector to be somehow exempt from these important principles.

Recommendations

Is it appropriate?

Donors should ensure:

- aid to the private sector is based on evidence that it supports economic transformation and achieves developmental impact, thus increasing aid's value.
- aid to or through the private sector is not used as a way to critically influence developing countries' policies notably as regards the roles and responsibilities of the private and public spheres.
- that aid is not used where other development finance and other types of policy instrument are available.
- they consider the opportunity cost of allocating aid to the private sector, if it means reducing aid to sectors such as health and education.

Is it effective?

Donors should ensure:

- all aid is provided in line with the partner country national development strategies and priorities.
- aid is on budget, predictable and uses country systems and local procurement.
- aid is untied (formally and informally), prioritising partner country domestic private sector over the international private sector, and preventing tied aid from creeping in through the back door.
- they live up to their commitment to transparency by improving the measurement and impact of aid to the private sector.

Language used in this report

This report refers extensively to the global policy process to improve the quality of aid, the Global Partnership for Effective Development Co-operation (GPEDC). Certain terms have been agreed by participants in this process, and where possible we use this terminology.

Therefore, where once we might have talked about recipient countries (developing countries receiving aid), we now refer more frequently to partner countries. And donors are now sometimes called providers (of aid); these latter terms are used interchangeably in the report.

Where once we might have referred to aid effectiveness, we now talk about development co-operation effectiveness, reflecting the preference of some non-traditional providers.

Introduction

Aid is important. It is public finance specifically targeted at improving human welfare and so it makes a unique contribution to development, different from other forms of development finance. It is long established that spending at least 0.7% of national income on effective aid (the UN target) is one of the contributions rich countries should make to global wellbeing and solidarity. It is also established that aid should be spent according to an internationally agreed set of principles, so that it effectively supports developing countries in their efforts to reduce poverty.

This report shines a light on the role of aid Official Development Assistance – ODA to the private sector. Non-aid development finance is also important in this area (as are other types of policy measures), and is sometimes an appropriate form of financial support. However our analysis focuses specifically and solely on aid. By private sector, we are referring to profit-making companies, not non-profit organisations, to which a different set of considerations apply. Profit-making companies include multinational companies, and all sizes of developing country domestic companies.

There is currently a resurgent interest in the potential role of the private sector in generating economic growth and in turn supporting increased welfare and development. But there is equally growing acceptance that growth needs to be equitable, inclusive and sustainable if it is to support reductions in poverty and inequality. Developing countries already have a thriving private sector of their own, for most poor people have to be dynamic entrepreneurs to survive. Supporting, developing and ultimately transforming this private sector – by moving away from a dependence on low added value economic activities and towards manufacturing and services that provide decent jobs and long term tax revenues – is an important strategy for a country's development. It is therefore not surprising that donors should be looking at ways in which they can help build the private sector, including through the allocation of aid.

However, there is another murkier side to the 'aid and private sector' story. Facing fiscal constraints, donors increasingly seek to involve private sector actors in ways that alleviate pressure on the public purse, whilst still creating the appearance of contributing to development, through 'leveraging'. Leveraging – the use of aid to incentivise private sector investment in a development project – happens through a diverse range of methods, from blending facilities, to public private partnerships, or PPPs. Conveniently, it confers some of the benefits of aid onto the private sector of the donor country.

Furthermore, some projects financed by aid are implemented by private sector companies that have been contracted by donors. This is not a new phenomenon, and is often a useful way to implement development strategies. However it is important to consider here because it makes a difference to the development impact if local developing country companies have an opportunity to tender for this work and a reasonable chance of winning tenders.

As with all aid, providers have a responsibility to ensure that aid to the private sector is given appropriately. In order that it contributes to development, it should only be used where other forms of development finance cannot be, and where the opportunity cost is acceptable. If the aid is appropriate, it must also be provided effectively. It must be what ActionAid calls 'real aid': aid that puts developing countries in the driving seat, supporting the implementation of nationally defined development strategies.[1] At the moment it appears that most providers are not looking at aid to the private sector in a sufficiently clear, targeted and rigorous way. This report looks at how that situation could be changed and sets out recommendations for ensuring aid to the private sector is used strategically and according to agreed international frameworks.

Chapter 1

Aid and the private sector: where are we and how did we get here?

Donors are turning to the private sector for different reasons. The EU recently said that "as public resources for development assistance are scarce, the private sector is increasingly looked at as an important additional source of external finance and domestic resource mobilisation."[2] The UK Secretary of State for International Development has said, "I believe UK businesses more often than not lead the world … as a British minister I make no apology for flying the flag in these frontier markets."[3] One think tank report wryly turns aid jargon onto itself saying that, "private sector is the new donor darling."[4] This chapter introduces aid to the private sector by looking at how we got to where we are.

> Perhaps donor rhetoric is running ahead of the actual aid to the private sector in order to try to create a self-fulfilling prophecy, and one that aligns with the political leanings of key donor countries.

What is happening now?

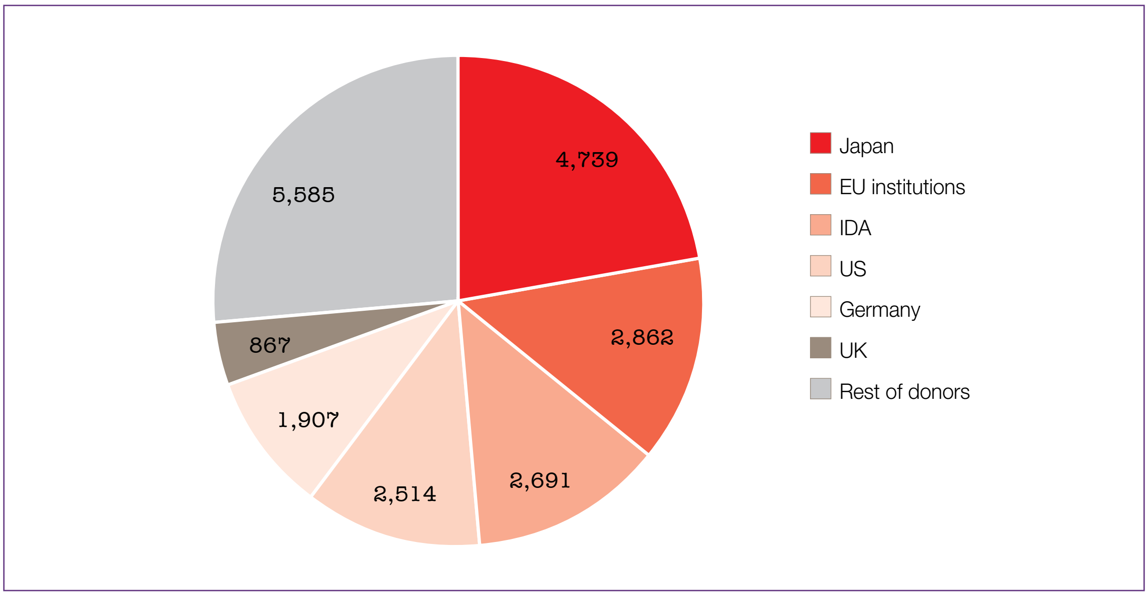
There have been mounting political statements about the intention to increase aid to the private sector. For example, the recent UK statement that aid targeted on economic development would double between 2012 and 2015.[5] It is impossible to tell for sure how much of this is to be allocated to the private sector and exactly for what purpose, nor whether these aspirations are bearing fruit, due to the opacity around aid to the private sector. This kind of aid support goes largely unmeasured. If they report at all, providers use different methods. In some cases it is not clear how to measure leverage, and international aid data procedures fail to capture aid to the private sector. They also certainly do not differentiate between aid to developing country private sector versus aid to multinational companies.[6] Out of the set of aid effectiveness indicators agreed in 2011 at the Busan conference on aid effectiveness, indicator 3 "Engagement and contribution of the private sector to development" is the only one focusing on the private sector, and, as of March 2014, it was still only at the stage of being piloted.

One study found an indication of change in relative sectoral terms.[7] Between 2006 and 2011, aid for the Organisation for Economic Co-operation and Development's (OECD's) category of economic infrastructure and services (which includes business, banking and infrastructure)[8] grew by 72%, compared with just 48% for social sectors.[9] However, the economic infrastructure and services category, while overlapping with the private sector, does not equate with it. Conversely, aid to the social sectors includes some aid that is delivered through the private sector.

Still, the indications appear to point to an increase in aid to the private sector which is so far modest, and strong aspirations to increase it further. Perhaps donor rhetoric is running ahead of the actual aid to the private sector in order to try to create a self-fulfilling prophecy, and one that aligns with the political leanings of key donor countries. Interestingly, the trend in private financial flows (including credit and portfolio flows, as well as investment) to developing countries themselves may be different. After the financial crisis, investors were increasingly attracted to some developing countries, which were seen as safer and more lucrative, but now, as the economic climate in richer countries improves, many investors are moving back. Portfolio flows in particular have always been volatile and remain so.[10]

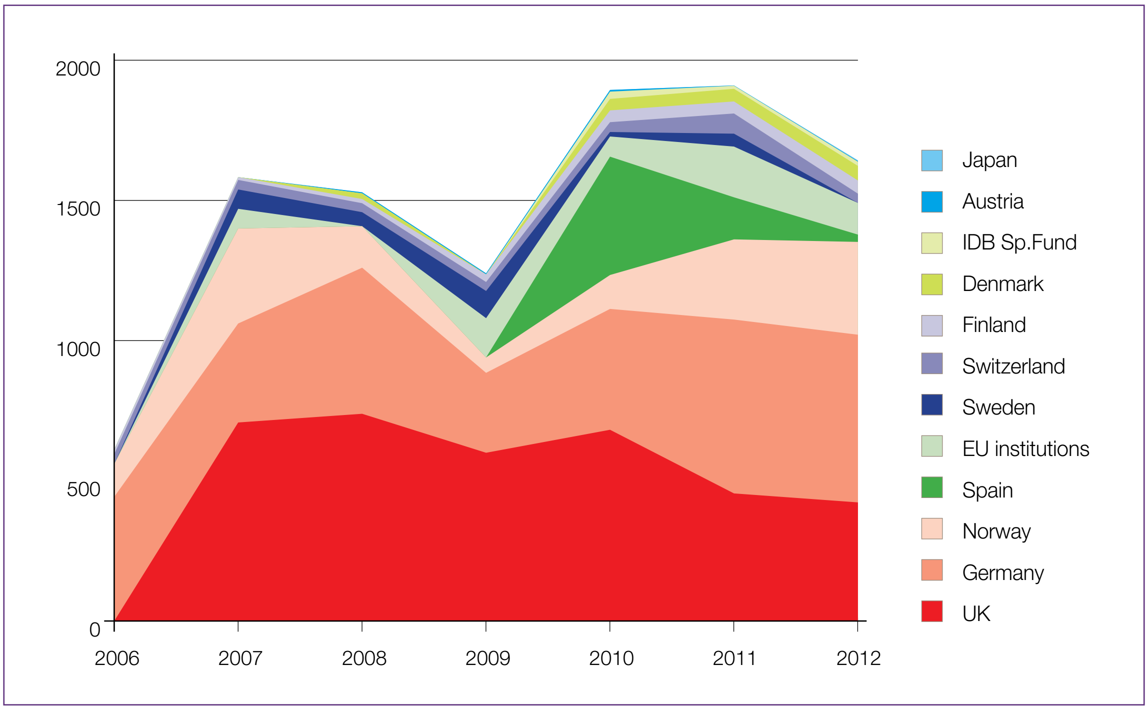
Not all providers are equally engaged in providing aid to the private sector. The biggest OECD Development Assistance Committee (DAC) bilateral providers to support "economic infrastructure and services" are Japan, Germany and the US; the EU institutions also make a large contribution. Among multilateral donors, International Development Association (IDA) and the Asian Development Bank (through its special funds) are the more active in this sector. On average, and for the period from 2006 to 2012, the six biggest donors accounted for almost three quartersof the overall ODA in this sector (see Figure 1). Although increasing in relative importance when compared to total aid figures, just 12 donors (including both bilateral and multilateral) used aid in 2012 to purchase equity in developing country companies (see Figure 2). The biggest providers of aid to purchase equity in developing country companies were the UK, Germany and Norway.[11]

Figure 1. Main donor providers to the economic infrastructure and service sectors. Average over 2006-2012 (in millions of 2011 US$).



Source: OECD DAC CRS database

Figure 2. Donors using aid to buy equity in recipient countries, 2006-2012 (in millions of 2011 US$).



Source: OECD DAC CRS database

A brief history of aid to the private sector

Using aid to support econom development is certainly not new. Development aid was first provided on a large scale during the 1950s and 1960s as countries gained independence from their colonial rulers. It was seen as a complement to domestic savings, necessary to close the financial gap between the quantity of domestic savings and the amount calculated to be needed to generate investment and trigger growth. It was thought that it would only be needed for a relatively short time. The key difference between then and now, however, is that a higher proportion of that investment and growth was expected to be within the public as opposed to the private sector.

That period ended with the economic instability of the 1970s, and the contraction and austerity of 1980s neoliberal ideology and structural adjustment programmes with their emphasis on rolling back the public sector. By the 1990s aid levels had plummeted, while the World Bank push for private sector development grew, although faded somewhat with the controversy surrounding the privatisation of water and other utilities. PPPs are a key remnant of that era, ensuring that donor companies benefit from aid spending, an essential condition for maintaining political support for aid programmes. Meanwhile, growth in many developing countries seemed a distant dream by the late 1990s . The main perceived purpose of aid shifted instead to the social sectors, more directly supporting the poorest people with money for health, education and so on. This swing of the pendulum was clearly expressed with the Millennium Development Goals (MDGs). Now, as 2015 approaches, support for economic development, but this time encapsulated by 'private sector driven growth', is coming strongly into fashion as a development priority and as a purpose of aid, reflecting our economic and ideological times. However it is not a new fashion – it is coming around again, despite its lack of success last time. Arguably the main difference is that the first time the emphasis was on building domestic investment and economic growth and supporting long term transformative economic development . While this time around the narrative emphasises strengthening the role of the private sector per se rather than the public institutions needed to maximise the impact of the private sector on human development and growth.

The international policy environment

There are two current major global processes affecting development co-operation effectiveness: the Global Partnership for Effective Development Co-operation (GPEDC), and the UN post-2015 process to decide the successor program to the MDGs agreed in 2000. All donors participate in and will salute the outcomes of these processes. Some developing countries receiving aid (also known as 'partner countries') participate in GPEDC and in the UN post-2015 process, although unsurprisingly the richer countries tend to hold more power. In this context, it also notable that UN Development Cooperation Forum (DCF) plays a role to mobilise the broad UN constituency, including the providers of South South cooperation, for a better cooperation based on mutual accountability. The DCF meeting in July will address the future of development cooperation in post 2015.

The Global Partnership

The GPEDC is the main global forum on development co-operation effectiveness based on multi-stakeholder governance; it is the outcome of the 2011 Busan conference on aid and development effectiveness, and the successor to the previous OECD-led Rome/Paris/Accra process on development co-operation effectiveness. Like these previous processes, it puts a commitment to developing country leadership and democratic ownership of development at its centre: its founding document says that "partnerships for development can only succeed if they are led by developing countries."[12] However, while the previous process was initially about provider and partner country governments, later bringing in civil society, the GPEDC explicitly also includes a role for the private sector. The GPEDC will have a major stocktake and review at the Mexico City ministerial meeting in April 2014, informed by a report on progress against an agreed set of 10 indicators.

The Busan outcome document states an intention to involve the private sector in development in several ways: by improving the environment to increase private investment and private sector development; by enabling "the participation of the private sector in the design and implementation of development policies and strategies"; by advancing innovative financing mechanisms; by promoting aid for trade, in order to mitigate private sector risk; and by seeking ways to make development and business outcomes mutually reinforcing. This set of policies represents a big jump from the previous aid effectiveness conferences. By contrast, the relevant monitoring indicator, a measure of the quality of public private dialogue, is surprisingly narrow, and its target, "continued progress over time", decidedly un-SMART. (specific, measurable, attainable, relevant and time-bound)[13] Concerningly, the one private sector indicator (which is still being piloted) relates to the "engagement and contribution of the private sector to development." This is often inappropriate, as we show elsewhere in this report.

Post 2015

Donors engaging in the UN development process have recently explicitly invited the participation of the private sector; at the Millennium Summit in 2010/11 bilateral donors issued a statement saying "...[endorsees chose] to recognise the private sector as equal partners around key development issues."[14] This follows a statement from the 2010 UN High-Level Plenary Meeting on the MDGs saying that "sustainably addressing the needs of the developing world represents a huge opportunity for business."[15]

The post-2015 process is the UN-led process creating a successor development framework to the MDGs. It is about sustainable development rather than aid, but it will provide an important piece of guidance for the global direction of aid spending. As with GPEDC it includes a specific place for the private sector. The 2013 report of the UN Secretary General said, "A universal development agenda beyond 2015 will require a robust framework for sustainable development finance including both private and public funding. International efforts are needed to create an environment conducive to business and thus channel capital flows and portfolio investments to the sustainable development agenda."[16]

Redefinition of aid

Official Development Assistance or ODA is tightly defined by the OECD DAC. It must be grants or loans provided at a certain level of "concessionality" and it must be "administered with the promotion of economic development and the welfare of developing countries" as its main objective."[17] Some providers, such as the UK, have gone further than this; the UK International Development Act 2002 states that aid must be "likely to contribute to a reduction in poverty." The OECD DAC definition is important, as it helps to ringfence and protect aid funds. However, it is currently under review, with the intention that other funds that flow from developed to developing countries should generate the kind of political recognition and credit that aid gets. Part of this is about greater recognition of various flows involving the private sector, which would in turn reduce the pressure on countries to meet conventional ODA targets.

The private sector, development and aid

Social and economic development depends on – amongst other factors – equitable, inclusive and environmentally sustainable economic growth in developing countries. This will generate the wealth and jobs needed for all people to have a decent life.[18] A dynamic private sector plays a crucial role in generating this type of growth. In this way, the private sector, inclusive growth and economic development are legitimate topics for development agencies and – alongside other policy instruments – a legitimate focus of development finance. However, where aid is to be used to support the private sector, this must demonstrably contribute to improved welfare and economic development, above and beyond other financing and policies, as well as representing the best use of scarce aid funds.

Where aid is to be used to support the private sector, this must demonstrably contribute to improved welfare and economic development, above and beyond other financing and policies, as well as representing the best use of scarce aid funds.

One important reason for this is that equitable growth which responds to a strategic long term approach to transformative economic development is essential for the eventual end to aid dependence. It is said that in countries receiving a substantial amount of their revenues from aid, governments are less accountable and responsive to citizens, and more likely to be driven by donors' agendas. Done well, and in combination with suitable policies, growth generates some of the wealth that can provide tax revenue, as well as generating decent jobs that lift people out of poverty. This is now happening in many countries; aid dependence affects fewer.[19]

Aid can support the private sector toward this end, but this does not mean that any aid to any private enterprise delivers good development results for poor people, much less that the private sector's contribution in developing countries always does this. Companies' raison d'etre is to maximise shareholder value, not the inclusive development of developing countries – this is not in their DNA, nor what the various incentive frameworks in which they operate tend to prioritise.

Therefore there are a number of critical questions to be asked about any aid support to the private sector to ensure good and transformational results for poor people and cost effective spending. These are similar to questions that should be asked about all aid spending. Is aid to the private sector appropriate in this case – will it be developmental, is aid the right form of finance or the right policy instrument at all, and is the opportunity cost acceptable? And if the answer to all these is yes, then what is the best modality to ensure aid will be provided effectively?

This report investigates the good, the bad and the ugly in this field, and points to the contributions of different donors to effective private sector development that benefits poor people.

Strategic intentions behind aid to the private sector

There are three distinct categories of aid to the private sector.

1. **Building – developing and expanding the private sector (in developing countries)**
2. **Leveraging – tapping the resources and expertise of the private sector for development**
3. **Delivering – turning development projects led by governments into reality**

Chapter 2

Building, leveraging and delivering

Policy discussion on aid to the private sector is mired in confusion as 'aid to the private sector' can mean a multitude of different things, with very different development impacts. This chapter clarifies this quagmire, by looking at the strategic intentions behind different approaches to aid to the private sector.

In the US, 6.8% of people are self-employed; in Bangladesh 85% are.

Strategic intentions of aid to the private sector

Providers have three different (but overlapping) strategic intentions behind the ways in which they talk about and provide aid to the private sector. These are: building, leveraging and delivering.[20]

1. Building – developing and expanding the private sector (in developing countries)

In the 'building' category, the strategic intention of the aid is the development of the private sector in the partner country. **In so far as the aim is transformation, aid may be one of several suitable tools to support 'building'.**

Developing countries tend to have a thriving private sector characterised by drive and entrepreneurialism – for most poor people, these attributes are necessary for survival. They are visibly manifested in the stressful, unpredictable and very hard work of the smallholder farmer (the most common way of making a living globally), the patience of the roadside retailer setting products out on a blanket for minimal profit margins, and the hard physical toil of the cycle rickshaw driver. In the US, 6.8% of people are self-employed; in Bangladesh 85% are.[21]

A strategic medium to long term approach to economic development, however, aims to reach a point where the private sector creates value in a more efficient fashion through a network of slightly larger or much larger domestic businesses. This network should provide secure and decently-paid jobs for women and men, generate revenue and build domestic business know-how, so that ordinary people have the opportunity to live less back-breaking and precarious lives.[22]

Transformational business development is an essential component of economic development in reducing poverty, and goes beyond simply tinkering with the existing system, for example by marginally increasing working conditions in the informal sector. It is at an early stage in some developing countries. Aid is one instrument that may support it through, for example, direct investment in certain strategic sectors and companies, building access to finance, or developing skills (sometimes known as 'making markets work for the poor' or M4P). It may support it indirectly, for example through infrastructure development or through support to policy development. Direct equity investment in developing country companies may sometimes fall under the 'building' category.

Case study

More than milk: What can happen when aid to the private sector supports structural transformation1[23]

Yvonne Chifwala, a 47 year old Zambian smallholder dairy farmer is one of more than 1,000 smallholder dairy farmers who are members of the Choma District Dairy Co-operative Union (CDDCU). She said, "…I am now able to produce at least 60 litres of milk per day, and I am looking forward to a time when I will be able to double my number of milking cows or at least have 10 cows that I am milking at a time." Aid support, aiming to generate structural transformation of the dairy sector and aligned with the Zambian national development strategy, played a critical role for Yvonne helped her improve her standard of living and look to a brighter future.

According to World Bank estimates, the agricultural sector in Zambia represents around 20% of its gross domestic product (GDP). Moreover, the great majority of Zambians make a living out of this sector (in 2005 around 70% of the population, 78% of women). As in many other African countries' tradable sectors, milk production in Zambia is characterised by its informality. It is mainly comprised of micro-enterprises or household production, and largely intended for local consumption. Private investment remains too low to promote structural transformation which would lead to more, better and sustained production, opportunities and jobs.

Acknowledging these difficulties, the government of the Republic of Zambia, through its strategic plans and policies (the Sixth National Development Plan, the National Agricultural Policy and its Poverty Reduction Strategy Paper) identified agriculture as one of the sectors that could contribute to economic diversification and export-driven growth. In May 2013, the Zambian government launched the National Agriculture Investment Programme (NAIP) with four key programme/investment areas to be implemented in the period 2014-2018. One of these is 'Market Access and Services Development', and a major component of it is to 'Promote Value Chain Integration' as a strategy for value addition, improving household income and ultimately reducing high poverty levels, especially in rural areas.

Aligning with this country priority, the World Bank set up the Agricultural Development Support Program (ADSP) directly implemented by the Zambian Ministry of Agriculture and Livestock (MAL). Involving all the different actors along the value chain, ADSP was designed to address the multiple constraints on commercialisation faced by smallholder farmers. One of the components of this US$37.2 million ADSP programme supports the Market Improvement and Innovation Facility (MIIF), with a budget close to US$3.75 million. Under the leadership of the Zambian Ministry of Agriculture, the MIIF provided matching grants (funding 75%, totalling US$58,000) on a demand-driven basis for the development of innovative business linkages between smallholders and other actors in agricultural value chains (like animal feed producers, entrepreneurs providing veterinary drugs and commercial processors).

The CDDCU, unable to properly market the increasing volumes of milk provided by its smallholder farmer members, approached the World Bank ADSP programme, aiming to add value to the raw milk. There was a lot of untapped milk before ADSP/MIIF support, because smallholder dairy farmers were not incentivised by the low prices being offered by the commercial processors. MIIF funds and assistance were used to adopt new technologies to expand the range of dairy products produced (processing raw milk into pasteurised milk for cheese, yogurt and fermented sour milk), to increase storage capacity, and to improve water and power supplies.

The MIIF support quickly started bearing fruit. Since then, CDDCU's average daily milk production has reached 3,000 litres (from 1,000 litres prior to accessing MIIF financing). The price paid per litre of milk to its dairy farmer members is now higher than other dairy cooperatives: Zimbabwean dollar ZMW3.00 (US$0.4886) versus ZMW2.25 (US$0.3664). Being able to open two new sales outlets helped to market all the increasing production and products. CDDCU noticed a tremendous improvement: a steady flow of income to its members, an increase in turnover, improvement in the bargaining power for goods and services, and growth in socioeconomic status at both union and individual member level. Mr Farmer Noole, CDDCU Board Chairman, said, "…we were struggling to establish ourselves when we just began. In my view, the support that we got was the biggest stepping stone. It is possible that we could have developed on our own but the journey could have been painfully slower than it has been with MIIF…"

At the same time the enhanced capacity of CDDCU has resulted in a variety of new services for smallholder farmer members: supplementary feedstock, artificial insemination, veterinary drugs and others services, and other social safety-net services such as school fees, funeral support and credit.

The World Bank's work with a recipient country's institutions, has helped a locally led initiative for the milk sector in Zambia, and led to real results for people like Yvonne Chifwala.

2. Leveraging – tapping the resources and expertise of the private sector for development

In this category, the strategic intention is to expand the resources available for development by involving the private sector. It often translates into engaging companies based in donor countries, although that is not necessarily the case. The suitability of using aid as a lever is questionable, particularly given the tendency for such aid to bypass aid effectiveness principles and benefit foreign companies.

The suitability of using aid as a lever is questionable, particularly given the tendency for such aid to bypass aid effectiveness principles and benefit foreign companies.

Until the financial and subsequent economic crash of the last decade, there was a consensus that aid was primarily a responsibility of governments, to be financed through general taxation, aiming to fulfil the common human responsibility to eradicate the scandal of global poverty in the midst of plenty.

Since the crash, this sense of responsibility has not gone away, either in political or public terms. However, fiscal tightening on a scale not seen in rich countries for many decades has meant that it seems more difficult for providers to prioritise their global responsibilities and find the practical means to make steady progress towards their commitments. This is what has led to the new emphasis on harnessing private sector expertise, resources and efficiencies for development. Increasingly, it seems, the private sector is where the money is, and sometimes it can seem to be the only game in town. For example, in 2012 the G20 said this, "While we recognize that public funds will remain key, they need to be complemented by private funds in order to advance IGG (inclusive green growth). We therefore reiterate broader calls to mobilize private funds, and investments for IGG in developing countries. To this end, sharing of knowledge and best practices on existing innovative mechanisms to mobilize private funds ... is essential and welcomed."[24] Some donor governments may regret this perception of reality; others welcome it as chiming with their own political and ideological leanings.

Owing to the same economic context, another strand of this thinking is about capturing markets and partnerships for donor country companies in the increasingly vital emerging economies, and political relationships with these same countries. This has always been the case, assuring political support for aid policies, but some donors are now making it more explicit. For example, the new European Partnership Instrument (around a billion euros over seven years, some of which may be counted as aid)[25] aims to "support and promote EU interests."[26]

The nature of the 'leveraging' intention is that it is often about involving established multinational companies, as these are the ones with the resources and experience that donors are hoping to make the most of. In practice it may take many forms. These include the nurturing of PPPs (in all sectors from agriculture to industry to education), and blending (leveraging private sector investment through an aid contribution). The challenge fund is another popular mechanism.

The use of PPPs to deliver services including health and education is receiving particular attention from a growing number of donors, ostensibly with the intent of extending the availability of services. However, there is increasing evidence that PPPs in these sectors are actually going into institutions that request payment, despite the well-known negative impact of fees on poor people's access to services.

Box 1: A new alliance for whom – pursuing whose interests?

Launched during the G8 summit held in May 2012, the New Alliance for Food Security and Nutrition provides a good example of the main concerns that surround the global finance mechanisms donors increasingly use behind PPPs.

Presented as a holistic multi-stakeholder approach, the eight most powerful nations in the world, the EU, several African countries and several private sector partners decided to join forces and provide the necessary investment to face agricultural development challenges on the continent. Having pledged over US$3.95 billion in public funds (for the initial six African countries over 2012-2015), the initiative intends to lift 50 million people out of poverty by 2022. So far, 10 African countries have joined; Ghana, Burkina Faso, Tanzania, Mozambique, Ethiopia and Cote d'Ivoire in the vanguard, followed by Nigeria, Malawi, Benin and Senegal with other country candidates likely to take part in the near future.

From the private sector side, a myriad of different companies, but mostly multinationals from donor countries covering the whole range of activities across the agriculture value chain (seeds, chemical inputs, machinery, insurance and finance, processing, transport and trade) have also joined: these include Yara, Unilever, Monsanto, and Syngenta. The corporate financial contribution (between US$3.8 and US$5 billion) and its characteristics are opaque, on the basis of commercial confidentiality.

Through the self-appointed "cooperation frameworks",[27] all stakeholders involved define the conditions under which donors' aid will help in promoting the most needed private investment. These conditions cover a number of changes in laws and regulations around various issues: access to land and water, easing tax regimes and export controls, new measures to promote food security and nutrition, more infrastructure investment, better access to finance, as well as changes in the access to seeds and other inputs such as fertilisers. Overall, behind the multiple arrangements contained in each cooperation framework, the real emphasis lies in promoting better conditions for foreign private investment (for example, securing better access to large portions of land or promoting the use of privately distributed seeds), leaving aside measures to support smallholder farmers to take advantage of the changes. One reason for this may lie in the flawed mechanisms in the decision-making process of this initiative. As has been emphasised by the UN Special Rapporteur on the right to food, Olivier de Schutter, most of these frameworks have barely been subjected to local democratic scrutiny, and participation in performance reviews has been restricted to the G8, the governments and the private sector.

The lack of transparency, accountability and monitoring mechanisms of ODA allocations, to initiatives such as the New Alliance, makes it very difficult to access the degree to which aid disbursements are delivering according to the needs of poor people and to national development strategies. Rather, scarce aid appears to be tied to securing policy changes that support the expansion of foreign companies.

Box 2: Blending – the EU's new best friend?

'Blending' is a mechanism whereby a small contribution of concessional grant funding, often counted as aid, makes the difference between a project being attractive or not attractive to private investors. Thus, the grant funds are 'blended' with loans at commercial or close-to-commercial rates (often via development finance institutions – DFIs), enabling, say blending's proponents, the leverage of much larger amounts of finance than would otherwise be available for development. Blending is most often used for infrastructure projects. So far most EU blended funds have financed public sector projects, but the EU intends to target more private investors in coming years.

Blending is not new – a lot of World Bank finance is run along these lines – but it is currently much debated, because the EU is enthusiastically pursuing this mechanism (sometimes in partnership with its DFI, the European Investment Bank). The EU intends to increase its involvement several-fold in the years to come, in order to leverage private finance (see later section on the EU in Chapter 3). EU ODA channelled through blending facilities increased from euro 15 million in 2007 to euro 490 million in 2012.[28] According to discussions with European officials involved in the programming, the grants used in blending mechanisms could potentially amount to as much as 30% of new development finance allocations, including the aid budget lines, in the next budget period.[29] Other providers are also involved in blending. For example the UK is the biggest contributor to the EU Africa Infrastructure Trust Fund.

Blending may indeed make the difference between, for example, a road being built and not being built in a developing country. However there are many dangers attached to this mechanism. It is very difficult to demonstrate that extra money has actually been leveraged, and there is a risk that aid used for blending may simply subsidise investment that would have happened anyway. This concern is compounded by the opacity of commercially financed projects. This is a major challenge of use of aid from providers strongly committed both to measurement of results and to aid transparency. Finally, the same opacity makes it difficult to be sure that the aid is indeed being used in support of national development strategies rather than in search of profit, and that its use is being driven by developing countries rather than by commercial interests.

3. Delivering – turning development projects led by governments into reality
In this final category, the strategic intention of the aid is to carry out development strategies and projects decided on by governments (either providers or developing countries), involving procurement or broader contracting – out of works. This is an area where aid can be appropriate, in so far as it meets country ownership requirements and is not a source of informal or formal aid tying.

'Delivering' is different from the other categories in that the private sector is implementing rather than co-driving the project. This is not a new phenomenon. It can happen in any area of implementation, from infrastructure to banking to teacher training, and it can be a matter of actually carrying out the work on the ground (for example building a road) or providing technical assistance to support the work. Examples of contracted work include programmes designed directly to give very poor people an income, delivery of health system reforms, applying best practice in police and justice ministries, providing humanitarian response, and monitoring civil society organisation (CSO) programmes, among myriad others.[30]

The companies contracted may either be from the provider or the partner country, or a third country. While the primary purpose in this category is not to develop the private sector in developing countries, aid-financed projects could provide a significant amount of business for developing country companies, building them as well as keeping all jobs, taxes and profits in the developing country. It means aid can carry a 'double dividend' – from the projects themselves and from the building of the local private sector. Joseph Stiglitz has pointed out the importance of public procurement (which accounts for 14.5% of gross national income or GNI in developing countries),[31] "Government procurement policies have important economic and social roles in developing countries… Procurement policies might be used to boost domestic industries or encourage development in specific sectors of national interest. Social objectives could also be advanced by preferences for specific groups or communities, especially those that are under-represented."[32] The OECD's 2006 document *The role of ODA – promoting private investment for development* says that "agencies can help develop the local private sector by procuring as many goods and services as possible in developing countries, subject to value-for-money considerations. This may require some capacity building in the local private sector to enable firms to participate in competitive and transparent processes and so take advantage of these opportunities."[33] The Busan declaration confirms that "in addition to increasing value for money, untying can present opportunities for local procurement, business development, employment and income generation in

Box 3 Aid-funded donor business

The UK government's UK Trade and Investment Unit (UKTI) is part of its Department for Business Innovation and Skills. UKTI's role is to "work with UK-based businesses to ensure their success in international markets, and encourage the best overseas companies to look to the UK as their global partner of choice."[35]

One of its roles is 'aid funded business'. According to its website, "aid funded business offers real opportunities for UK companies. Aid Funded Business is about win-win. British companies win the business, the aid agency funds a sound project and the developing country gains a sustainable asset... But you need to know – and be known by – the right people, in the right places, to break into this market. UK Trade and Investment's Aid Funded Business Team can help you through this process. This is a potentially huge market for British companies and the UK currently gains between 4-17% of multilateral aid-funded business." [36]

The website mainly mentions multilateral aid organisations. However it also says, "the remit of DFID is to concentrate on development. UKTI is responsible for helping British firms win business in the area of aid-funded business."[37] In practice, UK business has already been very successful at winning these contracts. According to recent research, just 8% of 117 major contracts and procurement agreements awarded by Dfid included "non-UK firms among the grantees."[38]The approach being taken by the UK appears difficult to reconcile with its longstanding commitment to untie aid. That commitment has been based on international agreement that tied aid offers less value for money, that helping donor firms is not developmental and that doing so may in fact stand in the way of recipient countries' domestic company growth and so undermine broader efforts for countries to stand on their own two feet.

developing countries."[34] Tied aid provides less value for money, costing developing countries 15-40% more than untied aid to purchase goods and services. Local procurement is equally relevant to aid – funded humanitarian response as it is to other ODA.

Confusion abounds

In their strategies on aid and the private sector, donors constantly mix up these different dimensions of private sector development, as well as the roles of the domestic and multinational private sector, and the intended private sector beneficiaries of aid. This renders many of their statements meaningless or opaque and certainly difficult to evaluate in terms of their suitability for aid funding, or the extent to which they support aid effectiveness principles.

> It is currently impossible to reach a global overall figure of aid to the private sector, or a trend. The global aid reporting system does not measure it, nor do most individual providers.

For example, in its roadmap towards its communication on the private sector and development, the EC[39] says that growth patterns are as important as growth rates, and therefore that support to private sector development must be focused on areas where the impact of growth on poverty reduction is highest. It goes on to say that this includes "support to sustainable agricultural chains, strengthening local agro-processing capacity." This kind of support may sometimes indeed be effective for increasing poverty reduction (see for example, Box 1, a case study from Zambia), in the building category of support. Immediately afterwards, however, the document says that it also includes "private sector engagement in providing poor households with affordable access to basic services." This latter area is a completely different dimension of private sector engagement, not primarily about economic development in the recipient country, let alone building a domestic private sector. Instead, it concerns the promotion of PPPs in delivering essential public services, a model that is highly contested in terms of securing access to services for the poorest and most marginalised.[40]

Can we measure building, leveraging and delivering?

It is currently impossible to reach a global overall figure of aid to the private sector, or a trend. The global aid reporting system does not measure it, nor do most individual providers. Individual providers have different private sector strategies, spanning all three of our overlapping categories; they use language about it in different ways, and have their own reporting systems (or none at all). The much-trumpeted push on aid transparency over the last few years does not seem to have reached the area of aid to the private sector.

However, it is possible to use proxy indicators in our categories to compare the support of different donors in each category. These do not provide a complete picture by any means. It is also important to be clear that there is no judgement of the quality of this aid implied solely by the sectoral categorisation: some of it will be appropriate and effective, and some will not.

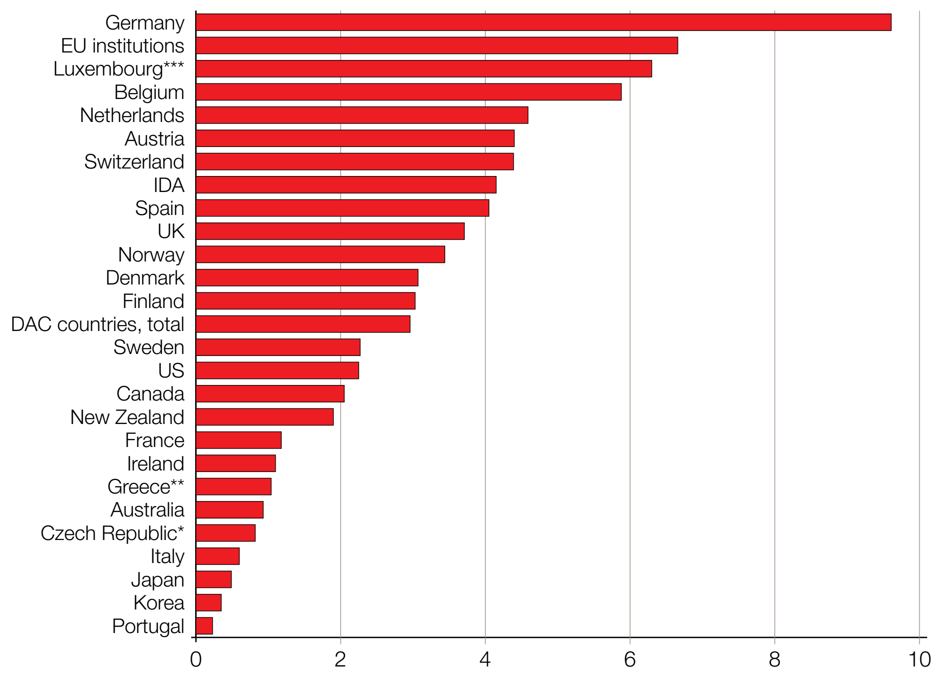
1. Building the domestic private sector – picture unclear

The OECD breaks down all aid by sectoral area, covering for example health, education, infrastructure, governance, agriculture, and a host of others. Any of these may include aid that builds the private sector – but some of the sectoral areas are more likely than others. Attempts at assessment have counted the categories of industry (around 3% of all OECD aid), business and banking (around 3%) and agriculture (around 6%). Others have included infrastructure including transport, energy and communications (14% of all OECD aid).[41]

In this report, we use aid support to business and banking as our proxy indicator for direct aid to the private sector. Around $US3 billion goes from bilateral DAC providers to these areas annually, a figure which has fallen slightly in absolute terms over the last few years (in 2008 it was US$4 billion), Germany and the US standing out as the biggest contributors. The EU institutions in addition contribute US$2 billion, a figure which has increased ten-fold in the last few years. In 2012, these three donors together accounted for two out of every three US dollars given to this sector. Among multilateral donors, IDA and the special funds provided by the Asian Development Bank and the Inter-American Development Bank were the most important (although far behind the three major donors mentioned before). Bilateral DAC providers' aid to business and banking constitutes around 3% of all aid, a figure that has remained fairly constant in recent years. However, as shown in Figure 3, there are important differences among donors in the amount of ODA devoted to this area.

US$6.5 billion, Japan being the largest provider in this area by a long way (around US$3.6 billion), contributing over half of the DAC total. The EU institutions' contribution here has increased very rapidly, from US$1 billion to around US$2.5 billion in just two years. IDA is also an important donor in this sector, allocating US$1.3 billion. The contribution of DAC providers to energy has also increased in the last five years, from around US$4 billion to more than US$5 billion. Again Japan stands out as the largest provider at about US$2 billion. The EU institutions are also large at US$1.7 billion in 2012, and like aid for transport, have increased very rapidly, from under US$400,000 in 2010. IDA provides close to US$1.2 billion and is by far the largest multilateral donor in the energy sector. Considering all DAC aid devoted for indirect building, the communications sector

Figure 3. Proportion of total ODA to business and banking sectors, by provider. Average over 2010-2012.



*: refers to 2011 **: refers to 2009 ***: average concerns years 2010-2011

Source: OECD DAC CRS database

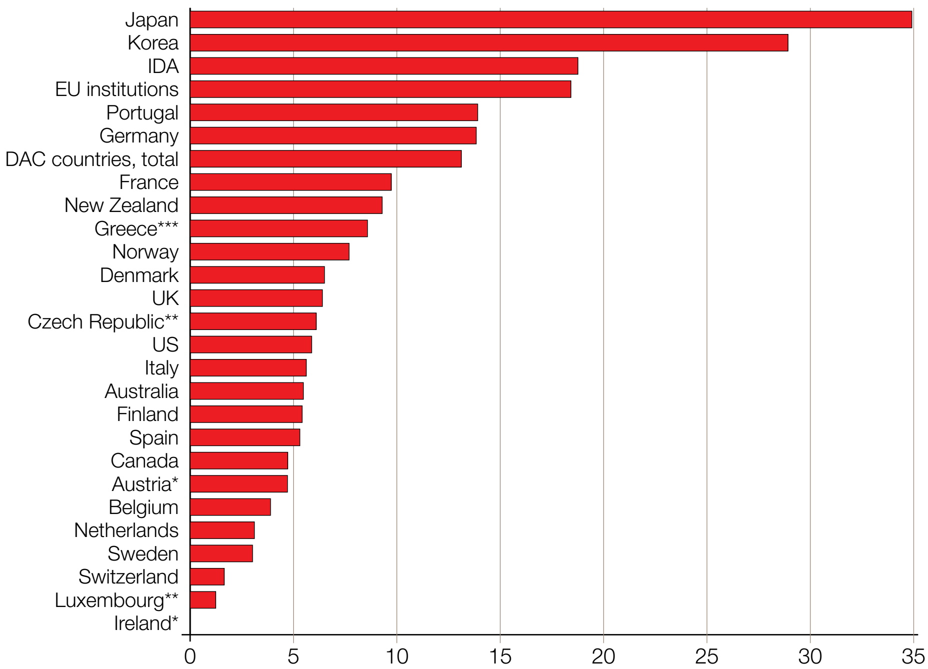
For indirect building aid we use infrastructure (including transport, energy and communications) as our proxy indicator. Aid from DAC providers for transport has increased since 2007 from around US$4 billion to around

represented just over 2%. EU institutions, IDA and Japan were the most active donors in the communications sector (altogether accounting for US$2 of every US$3 within this sector). Bilateral DAC providers' aid to infrastructure in

2012 constituted around 12% of all aid, a figure that has increased by four percentage points in the last seven years. Among different donors (see Figure. 4): Japan, Korea, IDA and the EU institutions are the ones devoting by far the most resources from their aid budgets.

in 2009.[42] At the EU level, ODA levels being channelled through EC blending facilities has risen from euro 15 million in 2007 to euro 490 million in 2012, and the EU hopes to makes greater use of these blending facilities in the near future.[43]

Figure 4. Proportion of total ODA to infrastructure (transport, energy and communications) by provider. Average over 2010-2012.



*: refers to 2011 **: average concerns years 2011-2012 ***: refers to 2010

2. Leveraging – opaque but promising to rise

Measurement of this category is even more elusive than of the building category, as this kind of aid is least often consistently reported. The OECD reports on contributions to PPPs, but these are global PPPs, and don't include the many initiated by bilateral aid providers. Similarly there are figures for blending in the EU, indicating large actual and future increases, but so far this has mostly targeted public rather than private projects.

However, anecdotal reports suggest that 'leveraging' is on the rise. For example, USAID is reported now to programme 40% of its funding through PPPs, up from 8% when the current Administrator, Rajiv Shah, started there

3. Delivering – worrying trends in informal aid tying

There is more information in the delivering category. The largest OECD bilateral contractor is Japan, spending US$6.4 billion, closely followed by the US at US$5 billion. Next came France at US$1.6 billion, and Australia, the UK and Germany also have significant contract levels. However, many providers do not report this information to the OECD: Ireland, Netherlands, New Zealand, Norway, Sweden and Switzerland.[44]

Providers often award contracts to their own companies, so that while the aid may be untied, informally it is still tied, in that the immediate financial benefit remains in the provider country. The share of untied aid that goes back to the provider is increasing, doubling between 2003 and 2010.[45] In 2011 just over half of contracted aid (by value) was spent within the provider country, just over a third to developing countries apart from the poorest, and only 4% to the poorest developing countries.[46] According to OECD, variation between providers is enormous. The bigger Anglophone providers (US, UK, Australia) give over 80% of the value of their aid contracts within donor countries, while France and Belgium manage around 80% to developing countries, and Germany and Japan around half to developing countries.[47]

Figure 5. Geographic distribution of contracts awarded by DAC donors, 2011.

	Total contracts awarded	Within donor countries	Other OECD and non DAC donors	Developing countries (excl. LDCs and non-LDC HIPCs)	LDCs and non LDC HIPCs
	USD million	%	%	%	%
Australia	729.2	85.0	8.6	5.0	1.4
Austria	2.4	87.5	12.5	0.0	4.2
Belgium	13.0	18.5	2.3	0.0	79.2
Canada	18.9	62.4	4.8	16.9	15.9
Denmark	49.1	70.1	28.9	0.4	0.8
Finland	33.9	100.0	0.0	0.0	0.0
France	1,623.2	11.9	7.6	75.5	4.9
Germany	266.4	28.9	22.9	1.8	46.3
Japan	6,430.2	21,1	22,2	56,0	0,7
Korea	21.6	0.0	42.6	57.4	0.0
Luxembourg	32.1	2.5	16.8	27.7	52.6
Portugal	9.1	41.8	0.0	12.1	46.2
United Kingdom	656.8	99.9	0.1	0.0	0.0
United States	4,980.1	90.9	0.2	2.8	6.2

Source: Aid Untying: 2012 report, OECD DAC.

*: least developed countries (LDCs)

**: heavily indebted poor countries (HIPCs)

Chapter 3

Who provides and receives aid to the private sector?

There is a vast range of actors in the complex world of development finance, each involved to a greater or lesser extent in aid to the private sector. Conversely, some types of country appear to receive more than others. This chapter explains who provides, and who receives, aid to the private sector.

Who provides?

OECD bilateral providers

All OECD donors provide some aid to the private sector. Their strategies vary. According to a comprehensive survey of donors' private sector strategy documents, for example, Canada and Japan, are donors who prioritise the 'building' approach to the private sector and aid. Finland and Denmark have specific policy documents describing their approach to engaging in PPPs, the 'leveraging' approach.[48] Some donors, for example, the UK, Sweden, the US and the Netherlands, appear to be engaging in a hybrid of the different approaches, according to their strategy documents. Some donors don't have private sector strategies at all.[49]

EU

The EU is an OECD donor, but large and strategically important enough to merit separate mention. It is moving strongly towards increasing the role of the private sector into its development strategy. Its new 2011 development policy Agenda for Change said, "The EU should support the development of competitive local private sectors" and "The EU should develop new ways of engaging with the private sector, notably with a view to leveraging private sector activity and resources for delivering public goods."[50]

In particular, the EU is rapidly developing blending as a funding instrument. While blending is not always a private sector instrument, the EU clearly perceives it as a way to leverage private sector resources. It includes in its draft private sector and development 'roadmap' the statement that, "facilities for blending grants and loans have the potential to mobilise significant private resources for development," and it has commissioned a study on "engaging the private sector for development and extending the blending activities of the EU."[51] Agenda for Change says in the same section as the private sector quotes above, "The EU will further develop blending mechanisms to boost financial resources for development."[52]

World Bank

Over the last decade the World Bank has played a major role in the promotion of private sector development through a range of aid and non-aid channels, including for example its controversial but influential *Doing Business INDEX*, and Investment Climate Surveys. The International Finance Corporation (IFC) arm of the World Bank is the biggest DFI[53] in the world (see below).

The World Bank also itself provides aid to the private sector. According to the IDA[54] website, "roughly one-quarter of IDA commitments in recent years have focused on strengthening the enabling environment for private investment, including the regulatory framework and institutions, thus helping catalyse private sector investment and growth."[55] IDA has also contributed significantly to infrastructure development.

Providers of south-south development co-operation

South-south development co-operation has grown rapidly in recent years, including assistance from large middle income countries such as Brazil, China, India and South Africa. In part this aims to allow these countries' private sectors to penetrate markets and to ensure the building of infrastructure in the South.[56] Little is published about the detail of this assistance.[57]

However, one report by think tank Overseas Development Institute (ODI) looked at three partner countries (Ethiopia, Zambia and Cambodia) and found that they were receiving a higher share of development assistance from non-traditional sources including non-DAC providers than previously. They were finding that this afforded them both more money and more choice, which they welcomed. They identified their ownership of development policies, donor alignment with these, and speed of delivery as key priorities for them in development assistance, and found that non-DAC providers scored well against these criteria.[58]

Development finance institutions (DFIs)

These public institutions provide finance to developing country companies, often via financial intermediaries. Most bilateral donors have one, for example Belgium's Bio, Denmark's Investment Fund for developing countries (IFU) and the Netherlands' Entrepreneurial Development Bank (FMO). There are also multilateral DFIs, such as the IFC and the European Investment Bank. Parts of the regional development banks, such as the Africa Development Bank, also operate on similar lines.

The development finance provided by DFIs ranges from straightforward equity investments to a range of different types of simple and complex loan structures, to guarantees for investors.

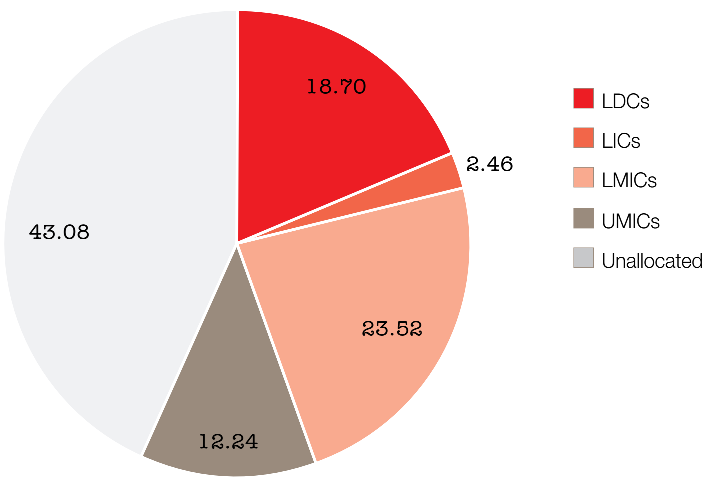
In common with so many other aspects of the topic of this report, figures on DFIs finance are hard to come by. Different DFIs' have different standards of transparency, but there are no overall figures. Donors also differ in the extent to which they use aid to subsidise their DFI's finance – and this is not easy to quantify. On the basis of data disclosed by the Netherlands, Norway and Sweden's DFIs' Eurodad recently estimated that around 2% of these DFIs' direct bilateral assistance was drawn from aid budgets.[59]

OECD figures for equity investments provide a comparison of donors' contributions in this way. The UK, Germany and Finland all give around 5% of their ODA in this way, and Norway over 9%.[60] Many donors, however, do not provide any data to the OECD on it.

Who receives?

Aid to the private sector goes predominantly to middle income countries. Nearly two thirds of the aid to the business and banking sector that can be traced goes to middle income countries. About a third of this is to upper middle income countries.[61]

Figure 6. How ODA to banking and business sectors from DAC donors is distributed (in %).



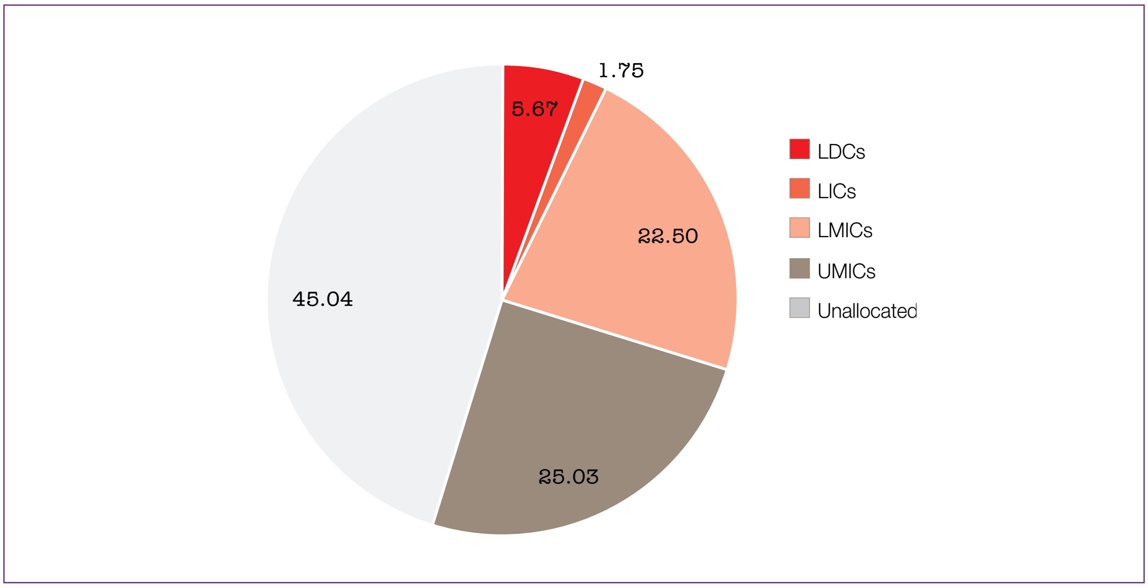
Source: OECD DAC CRS database

Donor private sector strategies tend to assume that partnerships among development actors represent "a win-win-win-win situation" for all stakeholders, including poor people, developing country governments, donors and companies. However, this assumption does not take account of the power differential between actors.

This position is even more marked for equity investment. As much as 85% of the bilateral donors' aid for equity investment that can be traced goes to middle income countries, just over half of this being to upper middle income countries. Only about 13% of aid to equity investment goes to least developed countries or other low income countries.

Nearly half of both these types of bilateral aid cannot be traced to a partner country at all. This demonstrates the lack of transparency of aid that disappears into the private sector through DFIs. If the global aid reporting system does not even know which country aid went to, how is it possible for anyone to demonstrate results, or to ensure country ownership and democratic accountability?

Figure 7. How ODA as equity investment from DAC donors is distributed (in %).



Source: OECD DAC CRS database

Chapter 4

Is it appropriate?

Before providing aid to the private sector, donors need to be clear as to the overall objectives and be sure that aid is the most appropriate instrument, or one of them, to deliver on them. This means asking three questions. Will the aid – be it for building, leveraging or delivery – maximise benefits in terms of improved welfare and economic development? Is aid the right form of finance, and is finance the instrument to promote private sector development? And is the opportunity cost of using aid in this way acceptable?

1. Will it be developmental?

The right kind of growth

Economic growth – the creation of wealth – is a vital but insufficient component of development. For countries with very little wealth, this is self-evident. There is a current proliferation of high profile political statements such as the following, "It is now widely accepted that the primary driver of poverty reduction is economic growth, and the private sector is the engine of that growth."[62] However, in fact this is a complex area replete with conflicting evidence.

> Economic growth – the creation of wealth – is a vital but insufficient component of development.

To succeed in reducing poverty, growth must have certain characteristics: it must be inclusive and sustainable, creating decent jobs for both women and men, harnessing know-how and providing tax revenue. In 2008 the Independent Commission on Growth and Development, comprising 22 leading economists and chaired by Nobel Laureate Michael Spence, examined the policies and strategies of countries that had achieved rapid and sustained growth and poverty reduction over the past 25 years. It found a number of factors at the heart of success: political leadership, industrial policies, managed exchange rates and capital controls; effective institutions and governance structures; a talented public service; strong domestic savings and public investment in infrastructure, health and education; job creation; and social protection.[63]

Transformational development

To generate development, growth also needs to be transformative, genuinely developmental in the true sense of the word. The economies of developing countries need to change rather than retain their current structures. Developing countries need to diversify beyond agriculture and very small informal businesses that directly provide livelihoods for poor people. Or as recently stated by economist Dani Rodrik referring to the African continent: "The underlying problem is the weakness of these economies' structural transformation. East Asian countries grew rapidly by replicating, in a much shorter time frame, what today's advanced countries did following the Industrial Revolution. They turned their farmers into manufacturing workers, diversified their economies, and exported a range of increasingly sophisticated goods".[64] Agriculture and informal sector will be part of the mix for a long time, and support for them remains important. But development means growing by developing higher value industries and activities, so poor people, especially women, are not permanently stuck at the bottom of the value chain. The importance of 'structural transformation' is being increasingly (re)recognised, for example by Ghanaian think tank the African Center for Economic Transformation (ACET) in its Africa Transformation Report, and by the UK's Department for International Development (DFID).[65] Furthermore, this approach may mean a revival of industrial policy – where direct support is given to particular sectors in pursuit of national goals. According to Cambridge economist Ha Joon Chang this "fell out of favour in the 1980s, but today is getting recognition again."[66] Proponents base their arguments on the existence of various kinds of market failure and the need to compensate for these. This is an area that remains controversial, but it has some eminent supporters, not least recent World Bank Chief Economist Justin Lin.[67]

Current discussion focuses on the private sector, but transformative, developmental growth requires a judicious balance between the roles of state and private sector, avoiding unhelpful dichotomies where one is demonised and the other lauded. UNDP recently proposed a new kind of "developmental state."[68]

The Growth Commission found that in every case they looked at, the private sector fuelled growth, but the state was its engine. Prominent and fast growing countries such as Brazil, China, India and South Africa have all included state intervention in their growth policies, in various ways.

The Growth Commission found that in every case they looked at, the private sector fuelled growth, but the state was its engine.

Therefore, some growth contributes to development – but not all growth is developmental. Some involvement of the private sector can contribute to development – but not all, and some can be harmful. The currently prevalent idea that it is all developmental is not based on evidence – systems are not in place to measure the developmental impact of this kind of aid, and this is widely recognised. Furthermore, some providers appear to discount the mounting evidence that excessive inequality stifles growth.[69]

For profit or for development?

In general, donors' private sector strategies tend to assume that partnerships among development actors represent "a win-win-win-win situation" for all stakeholders, including poor people, developing country governments, donors and companies.[70] However, this assumption does not take account of the power differential between actors, where large multinational companies hold much more power than governments of small developing countries. Donors tend to approach aid to the private sector as if the kinds of reforms promoted were not political but technical, and were the 'right thing to do' in all circumstances for all development approaches. In fact, however, they are the implementation of one particular approach to development, which has a highly political basis. They should be treated as such.

Moreover, the interests of stakeholders clearly do not coincide. A company's primary aim is necessarily to maximise returns for its investors; this is not a developmental aim. Some donors (for example Sweden and Germany) do explicitly recognise that private sector actors have incentives beyond development;[71] more donors should follow suit with this realistic acknowledgement. The pre-Busan OECD paper on the private sector and aid effectiveness said, "the profit driven incentives of the private sector often do not converge with development objectives."[72] According to the OECD, the private sector will engage in development based on the motive of securing benefits for the company.[73]

Supporting country leadership?

Rather than supporting developing countries to make their own decisions on the path they want to take on this issue, donors' current approach is generally to support reforms that create 'an enabling environment for business', through the aid they provide (see case study on NEAT in Nepal), or through other methods. The best-known example is probably the IFC-World Bank's *Doing Business Index*, which ranks countries for "ease of doing business" using 10 criteria covering 'red tape' around setting up a business, but also policy and legal areas such as investor protection, contract enforcement and tax payments.[74] In effect, this discourages standards – environmental and social – which are considered to stand in the way of investment. However donors also diverge in their views of the limits of the state's role. For example, Sweden states that it will not support a project contributing to reliance on the private sector for rights such as basic education that, in its view, the state has a responsibility to secure. But the UK explicitly states it will support the involvement of the private sector in the provision of basic services.[75]

Case study:
Promoting an enabling environment for foreign business[76]

Some aid projects, such as the Nepal Economic Agriculture and Trade (NEAT) project, may appear to be about building the private sector, but also have a component which involves interfering in national policy decisions by promoting the national 'enabling environment for business' for decades to come.

There is now less poverty in mountainous, beautiful Nepal, home to 28 million people – it has gone down from 42% in 1996 to 25% in 2011 – but it is still one of the poorest countries in the world. Like most poor countries, Nepal has undergone a process of liberalising economic reform since the early 1990s. This was somewhat interrupted by a 10-year period of civil war and political instability which ended in 2006; however subsequent key political processes such as the negotiation of the constitution are still underway and take much Nepali political space. Nepal does have three-year 'interim' national development strategies. While these include many positive aspirations such as 'inclusive growth', they are said by observers to lack sufficient clarity of strategy for implementation.

Meanwhile, donors continue to come to Nepal to support economic development. The United States Agency for International Development (USAID) launched the comprehensive NEAT activity in December 2010, covering all 30 Nepali districts. It aimed "to promote economic growth, reduce poverty, increase food security and improve lives in Nepal."[77] To do this, it operated on two levels. It was a 'building' the private sector project, supporting small businesses in some rural areas of Nepal, but also providing policy advice to the government of Nepal on the business environment. It ran from January 2011 to August 2013 and several companies partnered in the project.[78]

On the 'building' level, four types of agricultural production were chosen: ginger, off-season vegetables, orthodox tea and lentils. Support was provided to farmers, for example to improve crop collection systems, enable them to get better prices for their products, or to get more value added by going organic. The project also supported microfinance. During the life of the project, NEAT claims to have reached over half a million people, to have increased farmer sales by around US$30 million, and to have facilitated over US$4 million in loans, mainly for women.

On the policy level, the project evaluation document says that NEAT has analysed 40 pieces of policy, nine of which have been passed for implementation. USAID's Country Assistance Strategy for Nepal says that "The US government should actively encourage the government of Nepal to adopt free market reforms as the most effective means to reach the larger goal of poverty reduction."[79] Implementation of this through the NEAT project includes advice, for example, on:

- The Industrial Enterprise Act – to address inadequate legal provisions for investment protection.
- The Investment Policy and Foreign Investment and Technology Transfer Act – to open up foreign equity participation in various service sectors as per the World Trade Organization specific and general commitments and to promote technology transfer and legal provisions for incentive packages to attract foreign direct investment.

- Intellectual property, because “the current IPR... regime fails to attract foreign investment.”
- Contract farming and agriculture – increasing exports which is “only possible if there is land consolidation to increase economies of scale.”
- Reform of laws relating to seeds.

While all these reforms could fall under the general category of ‘enabling environment for business’, a senior Nepali economist said, “NEAT was highly controversial even during the agreement period... There are fears that the way the new Industrial Policy 2010 was approved amidst opposition from various experts and stakeholders was the outcome of pressures exerted from the projects like NEAT ... Who will be benefited, a Nepali or a multinational? The straightforward answer is the big economy with larger business holdings as multinationals.” A senior government official said of the same project, “it is a very notorious game of USAID business to clear the road for multinationals.”

Dr Dhili Khanal, an academic who has long studied economic policy in Nepal, particularly points out that one of the reforms will lift limits on portfolio investment, allowing fluctuations of hot money in and out of Nepal with the accompanying risks, and also about the potential changes to ownership of Nepal’s highly diverse natural heritage. He acknowledges the positive contributions of the ‘building’ aspect of the project, although questions why it is off-budget, and the level of popular participation and democratic ownership. He is also concerned that the project may have influenced Nepal’s policy-making process in “highly sensitive” areas.

The ‘enabling environment for business’ approach is another example of where donors treat something as if it were a matter of technical management where ‘what works’ is self-evident, when in fact it is just one approach out of many possibilities.

2. Is aid the right form of finance for building the domestic private sector?

Aid is a specific and unique form of development finance. It must contribute to the ‘economic development and welfare’ of developing countries in order to be classified as aid; some countries go further than this and stipulate that it must be used for poverty reduction.[80] It is public finance in the form of grants or loans of a certain level of concessionality. The proportion of a country’s national income contributed as aid holds political weight. Aid is limited, and must be reserved for developmental purposes for which other finance is not available – for those development projects which will not provide direct, short to medium term financial returns. As well as the classic social sectors (health and education) this could include, for example, energy or water and sanitation infrastructure reaching people who cannot pay.

There are also many other forms of development finance, as well as private finance. Development finance includes loans at commercial rates, project finance, equity finance, structured finance and guarantees.[81] Non-aid development finance is often channelled through development banks or DFIs (along with some aid finance). It usually supports projects which do provide short to medium term returns. Given the plentiful availability of this kind of finance, care should be taken in allowing scarce aid to creep onto this terrain. Indeed, there is potential for the reverse: for non-aid development finance to contribute more than it does already to development, for example through greater support for national development banks.

However, the boundaries are currently becoming blurred. Aid should not be used where other development finance would be feasible, and it should not be used to subsidise private investment which would have happened anyway without the aid component. This is particularly relevant where aid is used to leverage private financing in a project, through blending mechanisms.[82] There is a risk that the private financing may have been forthcoming with or without the concessional element, in which case scarce aid is being used to subsidise a commercial loan – clearly not a good use of it. It is also relevant where equity financing is counted as ODA. Again, there is a risk that here aid is being used to subsidise commercial investment. This should be a cause for public concern given that it is public money.

Box 4: Dutch Good Growth Fund – good for whom?

This initiative, commencing in 2014, will provide financing for Dutch and developing country businesses. It was announced by a new government at the end of 2012 together with an aid budget cut of one euro billion, taking the Netherlands down far below the 0.7% target which it had previously attained. It has been developed by the Minister for Foreign Trade and Development Cooperation, who is lobbying for this type of financial flow to be counted as ODA. After pressure from parliament, the budget for the fund was reduced to euro 50 million Euros in 2014, which will increase in subsequent years until euro 700 million is reached.

The fund will provide loans to facilitate Dutch investments in developing countries, invest (via financial intermediaries) in small and medium enterprises (SMEs) in developing countries, and provide export credit guarantees for Dutch companies investing in developing countries. The fund stipulates that investments have to be "development relevant" and includes a particular focus on young and female small businesses in fragile states in one of its strands. However mechanisms to ensure implementation of this intention are lacking.

A major concern about the fund is that it represents backtracking on aid tying, because only Dutch companies can benefit from some parts of the fund. "Two of the three tracks are available exclusively to Dutch companies, a unique development in Dutch development policy of the past decades." Another – in common with many of the examples in this report – is the extent to which developing countries' development needs, rather than commercial imperatives (in this case, imperatives of the donor) will drive the allocation of funding. "Exclusive support to Dutch companies which do not have development objectives does not constitute development co-operation."[83]

Box 5: Water and sanitation for poor people?

Germany recently spent euro 40,000 of ODA to leverage euro 300,000 of private sector funding to scale-up water and sanitation programmes. The investment reached 9.5 million people, of whom nearly two million were living in extreme poverty. Thus only 18% of the people reached were very poor. However, aid only had to fund 13% of the cost of the project, therefore it could be argued that more poor people were reached than would have been the case with a project entirely funded by aid and targeted entirely at poor people.[83]

A major weakness of this model of funding is that it is less viable in areas of developing countries where almost everyone is poor and where, as a consequence, it is difficult to secure any returns on investments. Crowding in private investment in water and sanitation in such areas, where it is arguably most needed, is far less likely, certainly if access to water is to be provided at no cost. And if aid is tied up leveraging private investment in areas where fewer than a fifth of people are poor, it will not be available for the areas where everyone is poor and most in need.

3. Is the opportunity cost acceptable?

All developed countries should meet the target of providing 0.7% of their national income in aid, and credit should be given to the few which have done so, including the UK, Sweden and Denmark. However, even were this target to be achieved by all donors, less aid finance would be available than developing countries could use to fight poverty – aid is a scarce resource. In the current fiscal climate, this situation is unlikely to improve. So providers should consider the opportunity cost of any aid spending decisions.

Even where aid is supporting development that benefits poor people, giving more aid to the private sector means less aid for other areas. For example, education is a sector which cannot (or should not) provide short term returns but is crucial for longer term development. And aid to education is currently going down. Between 2010 and 2011, aid to basic education actually fell by 6%, as a result of provider aid cuts; this was the first fall in aid to education since 2002. This fall affected low income countries disproportionately.[85]

Cutting aid to the social sectors may disproportionately affect women. If schools and clinics are not available, the caring, nursing and educating work tends to increase women's unpaid care burden.

As we have seen, aid to the private sector appears more likely to go to middle income countries than aid in general. Given aid's scarcity, this means that an increased provider focus on aid to the private sector may mean a reduction in aid for the poorest countries, which have least ability to finance development through mobilising domestic resources, or through government borrowing on international capital markets. Finally, some forms of aid to the private sector may be more suitable for provision as concessional loans rather than grants. A move towards aid to the private sector could underpin a gradual rebalance away from grants towards loans. This would contribute to reducing debt sustainability and the risk of another debt crisis. According to the IMF, 28 of the world's 70-odd low income countries are currently at moderate risk of debt distress, 13 are at high risk and two are in debt distress.[86]

Overall, it is questionable whether – in looking to allocate aid to the private sector – donors are making strategic choices in the interests of long term development, or merely following a fashion that may mean donors and partners are getting less than optimal development benefits, if not actually undermining long term development.

Chapter 5

Is it effective?

If it is established that an instance of aid to the private sector will be appropriate, there is a second area to explore: will it be delivered effectively? A series of international community meetings – from Rome, Paris and Accra, to Busan – have resulted in a set of carefully worded principles for ensuring aid is delivered in the most effective way. These principles reflect agreement that effective aid is aid that affords the partner country autonomy to deliver its own development priorities. Spending decisions need to be made on proven, effective interventions that follow the agreed principles, and not ideological assumptions that may undermine them.

ActionAid indexes the effectiveness of aid in its *Real Aid* reports.[87] Real aid benefits the partner country rather than the provider (at its most basic, by being spent in the partner country), and puts the partner country in the driving seat of its own development.

While these ideas are by no means new, somehow there seems to be a common conception that aid to the private sector can bypass internationally agreed principles of effectiveness. This chapter explores this situation.

Developing countries in the driving seat – the central principle

As set out in the series of international aid commitments, developing countries must be in the driving seat and own their own development. This is for a number of reasons.[88]

1. Developing countries prioritise it

Developing country governments need control over their own futures, and this means they cannot be determined by providers. This was confirmed, for example, in a major recent study by the ODI[89] which included in-depth case studies of Ethiopia, Cambodia and Zambia. All three countries placed a high priority on ownership. Ethiopia, for example, may reject grants that do not finance priorities in its national plan, those that carry unacceptable conditions or those that are likely to be long delayed.

2. It's value for money

It is reasonable to assume that micro-managing might make results more costly than allowing the implementers to get on with the job; that using existing systems might cost less than setting up new and parallel ones; that a strategic programme will entail fewer transaction costs than a thousand separate projects; and that local partner country contractors will often be cheaper than international ones. Evidence confirms these assumptions. For example, a major EU study on the economic benefits of the development co-operation effectiveness agenda found significant savings from programme work compared with project approaches, as well as savings from untying aid and from reducing volatility.[90] Improving aid predictability increases aid's value by around 15%,[91] while untying (allowing the possibility of using local contractors) increases it by 15-40%.[92]

3. It delivers results

It makes sense that a cohesive national development strategy, led by those most closely concerned with the country's development, will in the long run deliver development results more effectively than un-coordinated projects delivered by those who know the country less well. This is especially true in the medium term and with respect to institutional development. There is much evidence of how country ownership can deliver results. For example, many studies in the health sector – which has been particularly fragmented – have shown the pitfalls of a piecemeal approach and the positive attributes of country ownership of programmes.[93] Another series of studies published in 2011 by Brookings, *Catalysing Development*, took a historical approach and assessed the experience of Korea, Vietnam, Indonesia and Cambodia. The studies found strong country ownership to be key in the development of those countries.[94]

Providers can only influence development to a certain extent. In the main it has to come from within the partner country, and in this sense, it is clear that country ownership of development is absolutely key.

How donors can support developing country-owned development

Aligning with national development strategies

Development can only happen effectively with the guidance of a national development strategy, and this should be democratically owned. While not all countries yet have a functional development strategy, many have developed them in recent years. Wherever a national development strategy exists, support should be provided under its guidance. The successful Asian Tiger economies used clear government-led plans to drive development of the private sector.

Democratic country ownership of development and national development strategies is at the heart of the GPEDC, following on from its central role in the Paris/Accra process, and measured through the first indicator, that development co-operation should be focused on results that meet developing countries' priorities.[95] In the absence of national strategies, there may be suitable sector strategies that can serve a similar function.

The guidance of a national development strategy is particularly important where the aid is to the private sector, as there is a higher chance of donors and companies partnering in isolation from the national strategy than with other aid. Too much of this will undermine ownership, will generate wasteful duplication, and will be less cost effective than if co-operation with the national strategy is ensured. Some donors acknowledge the importance of country ownership in relation to their private sector strategies. For example, Switzerland says it is committed to focusing on country priorities, pro-poor policies and pro-poor growth, and Sweden's business for development policy states that partnerships should strive to align with partner country priorities. However these are "the exceptions rather than the rule."[96]

Meeting development co-operation effectiveness criteria

The global development co-operation effectiveness process has a number of globally agreed indicators for effectiveness, which flow from the central principle of developing country ownership. Those being measured by the GPEDC include:

- aid predictability
- aid on government budget (with parliamentary scrutiny)
- mutual accountability among co-operation actors
- improved quality of and use of country procurement and public financial management systems

These are as important for aid that supports the private sector as any other aid. However in some ways they generate a contradiction, for the model of private sector and market development favoured by many donors is almost by definition outside the remit of government, and this has led to a certain 'myopia' in the application of development co-operation effectiveness principles in this area.[97] A comprehensive 2012 survey of bilateral providers' aid to the private sector found that providers rarely connect their private sector strategies and their development co-operation effectiveness commitments. Most providers also do not measure results of their private sector work robustly (this should be done using partner country reporting systems, which should be published).[98] The aid transparency agenda has left much of the aid to the private sector untouched.

But Paris is burning...

In general, provider progress on aligning aid to national development strategies has been glacial.[99] This situation has gone little noticed by the world because it is so familiar, and yet it is nothing short of scandalous. It makes donor rhetoric about the importance of spending every aid dollar well, ring hollow indeed. It is also economically foolish. Clearly, all concerned could get more bang for their buck from aid that was spent effectively.

The 2011 Paris survey showed that partner countries had made progress. In 2005, the baseline year, 19% of the 32 developing countries that took part in the survey had operational national development strategies. By 2010 this had increased to 52% – significant progress, although still far short of the target which was 75%. However, provider progress was almost non-existent. In 2005, 44% of aid flows were aligned to developing country national priorities. This had increased by an almost inexplicably tiny 2%, to 46% by 2010, despite the target of 85%. Since 2011 the target has shifted, focusing now only on the use of results frameworks, although the relevant indicator 1 is "development cooperation is focused on results that meet developing country priorities". That indicator is still at pilot stage.

The Paris 2011 study showed poor progress on development co-operation effectiveness in general.[100] In the aggregate, providers only managed to meet one of the set of 12 not-very-ambitious Paris targets on development co-operation effectiveness that they had agreed to – the one on co-ordinating technical assistance.[101] More providers used country systems and there were fewer projects set up in parallel to the national strategy, and more frameworks were results-oriented. However, there was no progress or virtually none in many key areas. So, in 2011, aid was not better aligned to developing country priorities. Aid was not more predictable. Almost as much aid remained tied. Hardly any mutual accountability frameworks (between partners and providers) were set up. And providers barely improved co-ordination at all. Developing countries did more on their side of the deal, with far more countries having operational national development strategies, and reliable public financial management systems – although still not enough to meet the aggregate targets.[102]

The latest monitoring report, issued in March 2014, suggests progress continues to be uneven and very slow, with progress against three of the 10 indicators being "too early to assess." Slightly less aid is tied formally (79%, compared to 77% in 2010). More aid is on budget, but nowhere near the target of halving the gap and at least 85% of aid being on budget. There has been no further progress on use of country systems. Overall, none of the Busan targets have been met, something that is clearly disappointing given the amount invested in this global process.[103]

Domestic or international private sector?

Support for the developing country domestic private sector is more likely to be developmental than support to provider country companies for a number of reasons. Firstly, it follows from the principle of national leadership of development and the aim to transform developing country economies sustainably, up the value chain. Developing countries are self-evidently more likely to maintain leadership of their own development dealing with their own private sectors. This is the argument for "localised aid" to the private sector recently promoted by the ODI.[104]

Secondly, financial support to domestic companies is more likely to actually stay in the partner country and the local economy, rather than end up being effectively repatriated as part of eventual profit to the home country of an international company. Finally, aid support to developing country companies is more likely to be cost effective, in the same way that untied aid is more cost effective than tied aid.

A 2011 OECD cross-stakeholder survey on development co-operation effectiveness and the private sector emphasised the need to differentiate between the roles of domestic and non-domestic companies in development. Interviewees from multilateral donors, civil society and companies all said it was desirable for providers to maximise their work with the domestic, as opposed to the international private sector.[105] The OECD further confirms the argument that aid should support the domestic private sector in preference to the international one saying the extent of informal aid tying "raises concerns about the extent to which aid untying contributes to local economic development."[106] However in reality, "Collaboration and policy dialogue between providers and the private sector is certainly increasing, but the evidence to date suggests that engagement with the domestic (developing country) private sector as compared with provider or international private sectors is mixed."[107]

Where aid to the private sector is concerned, transparency is a particular worry, with information hidden to some extent in the name of commercial confidentiality.

There are particular issues in this area in relation to the 'delivering' category of aid. Despite a professed commitment to untying aid from most providers, in practice many factors seem to militate against awarding contracts to domestic developing country companies. Even without suspicion of cronyism, provider country companies may be known quantities with track records of delivery. Sometimes this kind of bias is explicit. For example, EuropeAid requires tenderers to have completed similar projects in recent years. UK DFID has pre-qualified contractors, and has recently cut its total number of contractors and is focusing on larger contractors, making it hard for new entrants to break in.[108] Conversely, domestic developing country companies are often inexperienced at international tendering, and the size of many contracts makes tendering impossible for small and medium companies.[109]

The international consensus against tied aid demonstrates that the proposal to prioritise domestic developing country companies is not in fact controversial. For several years now, there has been international agreement that formal tied aid should be eliminated. A Busan indicator measures progress on aid untying, and the OECD reports annually on it. Progress is happening, very slowly: according to the 2014 monitoring report, overall 11% of DAC providers' bilateral aid remains tied, compared with 13% in 2010. The biggest challenge now, it seems, is to tackle the informal aid tying.

Seeing what's happening – transparency and accountability

All aid needs to be transparent and accountable, and large steps have been taken towards this in recent years, with a welcome political emphasis. UK Prime Minister David Cameron has said in relation to aid, "I want people to see where every penny is going."[110]

Where aid to the private sector is concerned, transparency is a particular worry, with information hidden to some extent in the name of commercial confidentiality. The principles that have risen so fast up the agenda do not seem to be applied in the same way. The 2012 survey of provider policies on private sector aid found that when provider private sector strategies refer to transparency and accountability, this is largely understood as relating to developing country governments. Providers' own transparency on the private sector work is patchy at best.[111] In particular, where aid is blended with commercial loans, or where it passes through DFIs, it is usually impossible to find out how it was spent and what the development impact of the spending was. And of course, this makes it also impossible for parliaments or populations to hold donors, governments or private sector actors to account. According to the proxy indicators we have used (aid to business and banking, and to equity investment) nearly half of DAC donors' aid to the private sector cannot even be traced to a partner country.

In addition, because of the way the OECD categorises aid, it is currently impossible to gain an overall quantitative picture of aid to the private sector.

Case study:

Less than effective? Off budget and tied aid to the private sector [112]

The German-funded INCLUDE project illustrates how a project may have positive impacts but still not support longer term development as it should, according to development co-operation effectiveness principles.

Rama Dangi lives in Tulispur, near the valley of Dang in western Nepal. She is chair of a co-operative group which pools savings and where training and skill sharing "made us equipped to tackle economic hurdles by raising pigs and chickens, bee keeping, unseasonal vegetable farming, ginger farming and so on." However, the role has had impacts for her way beyond business development. "I am proud being a daughter, wife, mother and many other social roles. I am not a university graduate or an official working in an office but I prefer myself to say that I am a woman leader of my excluded society," she said. "The project played a key role in uniting women who were totally neglected and used to be second class citizens within the family... With similarities interwoven between us like the flowers of a garland, we started giving and gaining attention in whatever matters we were going through. The psychological togetherness helped us to surmount all the barricades in front of us, and we won the game. Now, we are citizens, we have our independent identities, we are not called the wife or mother of someone but rather we are spelled by our name. These levels of consciousness among us would have never come if the project had not been implemented here."

The project she describes is project INCLUDE, funded by the German development agency GIZ, and run jointly by GIZ and the Nepali Ministry of Industry.[113] It is a 'building' project which aims to improve business skills and strengthen business institutions, targeting particularly poor, vulnerable and socially excluded people, in the west of Nepal. It has been running for several years, with a new three-year euro 5 million tranche running from 2014 to 2016.

The programme includes work in several agricultural sectors including honey, butternut and vegetables. In the honey sector, for example, the programme aims to improve productivity along the value chain (including processing); develop business management skills and formalise administrative and finance systems; implement a marketing strategy, including a brand for organic honey; improve access to financial services; and improve surrounding policies and regulations. The project also aims to build capacity in relevant parts of Nepali national and local government; support public private dialogue at both local and national level; and support various business associations.

One person who has benefited from the project, Min Raj Ghimire, a member of Ambikeswori Bee Keeping Cooperative Ltd-Ghorahi, Dang, says, "The pattern of living means is changing. Traditional farming is changing to modern farming, rather doing unseasonal cash crops and vegetables. Bee keeping, honey making, cheese, butter, milk products, butternut products and meat products are being supplied to the departmental stores. It has generated few but lucrative jobs. The old ones associated with the projects are now consultants and they go privately to train people as well. Employment generation and economical status uplifting are going in parallel."

However one other commentator, Geeta Dhital, an adviser to the project in Tulsipur Municipality, had a more nuanced view. "Mostly beekeeping is popular in Dang and the hold on knowledge, skill and technology is with the middle class people rather than the marginalized and socially excluded ultra poor – but it does not mean at all that it has not touched them."

Aid provides 26% of Nepal's budget, a high proportion. The largest donor is the World Bank; the largest bilateral providers are the UK, India, Japan, Norway and Germany. While Nepal has a results framework, provider contributions to development co-operation effectiveness were found by the 2011 Paris evaluation process to fall very short of targets in several key areas. Use of programme based approaches is low, co-ordination of technical assistance is poor, and less aid is being channelled through Nepali procurement and financial management systems.

An examination of the INCLUDE project from a development co-operation effectiveness perspective finds that in some ways it is not contributing to improving this situation. The Nepali Ministry of Industry is involved in the INCLUDE project as co-implementer, including chairing the steering committee, but bizarrely the project is off budget – it is not included in Nepal's budget document, the 'red book'. Only 77% of Nepal's aid is on budget. A senior Nepali government official said of this, "at least the red book records the amount that came for the project, but of this type [off budget projects] nothing is there in the government record system, merely the agreement paper signed. A very dangerous trend has started roaring."

GIZ stipulates that the technical manager of the programme must be an international expert. However the official said, "There are more than a hundred experts in Nepal and is not necessary to hire a foreigner to transform a Nepalese village... In the name of technical assistance a huge chunk of ODA project money gets back to the donor country." Referring to aid tying, they continued, "let's suppose a project needed vehicles for transportation and the project could have bought a cheaper and durable one but instead the project buys vehicles from the donor from where the money has come...These are loopholes which to date have not been much debated."

Finally, the project is not using Nepali procurement of monitoring systems, instead requiring participants to use a system that will be set up by GIZ. Therefore the project fails to comply with several key dimensions of development co-operation effectiveness. It appears to be contributing to development, but not to the longer term building of Nepal's national development strategy.

Chapter 6

Conclusions

Donors are currently very interested in aid to the private sector, whether to build it, leverage support, deliver projects or a combination of all three. But is aid to the private sector appropriate, and if yes, is it being delivered effectively, reflecting international aid agreements?

If the overall aim of development is to transform and diversify economies in a way that delivers sustained improvements in human welfare, then the private sector could be a legitimate focus of that aid. In that case, aid to building the domestic private sector appears to be the most appropriate use. Aid to support delivery can also be appropriate, as long as it reinforces local procurement and is not used as a means of informally tying aid. The least appropriate use of aid appears to be as a lever, given the growing concerns around development impact, additional financing that is actually secured and the extent to which leveraging effectively crowds out not only domestic companies but also the public sector.

Poor transparency in this area and particularly around building and leveraging makes it hard to evaluate the amount of money given to the private sector. But such data as is available, the statements made by donors themselves, academic studies, and examples of particular experiences, all suggest that this should be an area of some concern. In the excitement of the latest aid trend, it seems that donors may not always be rigorously assessing whether their aid to the private sector is strategically the right and best instrument to support development and increased welfare, given also the opportunity cost of using precious aid in this way. There is particularly unhelpful lack of clarity around the intention behind donors' private sector aid, with frequent emphasis on leveraging and delivery (often involving donor companies) rather than actually building domestic sectors to transform and diversify economies.

And donors are not always applying established and agreed development co-operation effectiveness principles to private sector aid either; they are not making sure it is real aid. All too often, it seems they consider aid to the private sector to be somehow separate and exempt from these important principles. Ensuring all aid to the private sector follows agreed aid principles would go some way to making it both more appropriate and more effective.

Recommendations for aid to the private sector

Is it appropriate?

Donors should ensure:

- aid to the private sector is based on evidence that it supports economic transformation and achieves developmental impact, thus increasing aid's value
- aid to or through the private sector is not used as a way to critically influence developing countries' policies notably as regards the roles and responsibilities of the private and public spheres.
- that aid is not used where other development finance and other types of policy instrument are available.
- they consider the opportunity cost of allocating aid to the private sector, if it means reducing aid to sectors such as health and education.

Is it effective?

Donors should ensure:

- all aid is provided in line with the partner country national development strategies and priorities.
- aid is on budget, predictable and uses country systems and local procurement.
- aid is untied (formally and informally), prioritising partner country domestic private sector over the international private sector, and preventing tied aid from creeping in through the back door.
- they live up to their commitment to transparency by improving the measurement and impact of aid to the private sector.

Endnotes

1. ActionAid has indexed the effectiveness of aid in its Real Aid reports since 2005.

2. European Commission (2013) Issue Paper for consultations on the proposed Commission Communication "Strengthening the Role of the Private Sector in Achieving Inclusive and Sustainable Growth in Developing Countries", https://webgate.ec.europa.eu/fpfis/mwikis/aidco/images/5/59/PS_Com_issue_paper_Final_EN.pdf

3. Speech by Justine Greening, UK Secretary of State for International Development, 27 February 2014, https://www.gov.uk/government/speeches/smart-aid-why-its-all-about-jobs

4. Kindornay, S. and Reilly King, F. (2013) Investing in the Business of Development – bilateral donor approaches to engaging the private sector, Canada: North South Institute and Canadian Council for International Co-operation, http://www.ccic.ca/_files/en/what_we_do/2013-01-11_The%20Business_of_Development.pdf.

5. Speech by Justine Greening, op cit.

6. Kindornay, S. and Reilly King, F., op cit.

7. The OECD categorises aid into sectors.

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113. All factual information about the project is from project documents seen by ActionAid, including a tender document and an implementation agreement.

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