BUSAN ISSUE PAPER

August 2011

Aid for Private Sector Development

Introduction

Since the 1980s, multilateral development banks (MDBs), donor agencies, development finance institutions and governments have increasingly promoted private sector growth as the cornerstone of national development strategies. While there is little in depth and up to date analysis on the relationship between ODA and the private sector due to a lack or differences in reporting, the vast majority of bilateral and multilateral donors have considerably increased their focus and engagement with the private sector.

The 2005 World Development Report found that "assistance provided by major bilateral and multilateral development agencies for investment climate improvements averaged USD 21 billion per year between 1998 and 2002 — or about 26% of all development assistance." The OECD estimates that the 22 DAC member countries spent between about USD 8 and USD 10 billion per year between 2001 and 2003, or 15% to 20% of their bilateral ODA for investment promotion -- the bulk of it for infrastructure development2. The International Finance Corporation (IFC) reports that financing for the private sector from MDBs has increased tenfold, from less than $4 billion to more than $40 billion per year by 2007.[3]

[1] Nelson, J. (2010), 'The Private Sector and Aid Effectiveness: Toward New Models of Engagement' in 'Making Development Aid more Effective' The 2010 Brookings Blum Roundtable Policy Briefs

[2] OECD (2005), 'Mobilising Private Investment for Development: Policy Lessons on the Role of ODA', The DAC Journal 2005, VOL. 6 No2

[3] http://www.bidnetwork.org/download.php?id=52034

IBON INTERNATIONAL

The Aspen Institute reports that the 16 European Development Finance Institutions -- which only make investments in private firms or financial institutions -- had an investment portfolio of EUR 16.7 billion in 2008 for a total of 4,221 projects. These financial investments were in the form of equity, loans and guarantees with an average project size of EUR 4 million.[4]

These substantial and increasing volumes of resources being spent for the private sector by institutions with mandates to reduce poverty and promote sustainable development in developing countries certainly deserve closer scrutiny.

Rationale for PSD

Donor agencies claim that promoting private sector development benefits the poor and is therefore consistent with their mandates. The Netherlands Ministry of Foreign Affairs, for instance, notes that "nine out of ten people in the developing world earn their income in the private sector... On average, the private sector in developing countries, both formal and informal, accounts for 65 to 75% of the Gross National Product (GNP)"[5]. Therefore creating a business environment more conducive to the growth and competitiveness of the private sector; assisting poor households and small and medium enterprises to participate in different parts of the value chain; and promoting public-private partnerships in order to reduce investment risks all benefit the poor in terms of job creation and raised incomes, greater availability and choice of improved goods and services at lower prices, and more tax revenues for public services.

This is the basic rationale for the market-led development strategy that has actually been dominant among policy makers since the advent of the Washington consensus in the 1980s. The converse of this is the gradual diminution of the role of the state in steering the economy and in the direct provision and distribution of goods and services through the privatization of state assets and social services, liberalization of trade and investments, and removal or relaxation of regulations on business. Indeed, these structural reforms were often attached as conditions to aid or loans for developing countries.

But in the wake of the worst financial and economic crisis since the great depression, and record levels of hunger, unemployment, and underemployment, widening inequality and mass poverty, it is imperative to question this development strategy as a whole and donor policies for the private sector in particular.

Which private sector?

In the first place, there is a need to ask who is the private sector that donors aim to support. According to the OECD statistical glossary, "the private sector comprises private corporations, households and non-profit institutions serving households" (REF).[6] The 2006 OECD "Promoting pro-poor growth: private sector development" brochure stresses that "the private sector consists of more than formal businesses. Individuals and households, from rich to poor, also operate as private economic actors when they consume goods and services, sell their labour, farm or produce goods and services". The 2003 OECD Poverty and Health publication uses a wide definition, referring to a range of actors who are "all service and funding providers working outside governments", which includes non-governmental organisations, for-profit private sectors, foundations, voluntary contributions and private academia."[7]

With such an all-encompassing definition, no one would dispute that the private sector is absolutely

[4] Barbarasa, E. (2010), 'Catalyzing Support for Small and Growing Businesses in Developing Countries: Mapping the Policies of International Development Donors & Investors'. Aspen Network of Development Entrepreneurs

[5] http://www.bidnetwork.org/download.php?id=52034

[6] http://stats.oecd.org/glossary/detail.asp?ID=2130

[7] http://www.oecd.org/dataoecd/50/31/45677388.pdf

crucial for development. But the needs and interests of for-profit enterprises would certainly differ from that of not-for-profit organizations; as would big conglomerates from SMEs; transnational corporations from local enterprises; formal from informal; and so on. It also follows that these various actors have different contributions and roles in terms of eradicating poverty and promoting equity.

Whose development?

Fostering a favorable environment for business in general, without regard to the differential benefits captured and costs borne by different sections of society (or different "private sectors") is not an effective or equitable use of development resources. Indeed, studies show that local SMEs especially in rural areas have greater positive development impacts compared to transnational corporations yet a Eurodad report revealed that only about 16 percent of total IFC investment in low income countries goes to local firms while the majority is funneled towards Transnational Corporations (TNC) from OECD countries.[8]

Public financing including aid for the for-profit private sector is particularly problematic because of the inherent tension between private interests of business and public or social goals. The profit-maximizing logic and market competition among private enterprises often means reducing wages and undermining collective rights of workers; pricing goods and services beyond the purchasing power of the poor; or simply not shouldering the full social and environmental costs of their operations. Examples are ubiquitous: the poor households who can't access basic services; pollution; climate change, etc. The central duty of governments with respect to the for-profit sector is to ensure that they do no harm and actually contribute positively to development.

This problem is especially acute in dealing with TNCs with billions of dollars in revenues, often larger than the total budget of many low income countries. Such companies have huge advantages in terms of influence and lobbying capacity, access to information, resources and legal and technical expertise -- making it extremely difficult for developing country governments to regulate their operations in order to ensure their adherence to human rights and development goals. Under many trade and investment agreements, large corporations can even sue governments in international tribunals for losses incurred due to, say, changes in regulations or court decisions.[9]

Responding to some of the problems, the OECD has put forward voluntary guidelines and recommendations for the governance and regulation of TNCs, based on major areas of business ethics. Similarly the United Nations Global Compact is an initiative for business to align their work with ten universally accepted principles on human rights, labour, environment and anti-corruption. While positive, these guidelines remain voluntary, lacking any globally enforceable standards within a clearly defined framework. Since their introduction, governments and businesses alike have signed up to the guidelines, but human rights violations and large-scale environmental destruction have continued.

Towards binding codes for private sector development

Government support to the private sector should not undermine the state's legitimate and principal role in providing essential public goods and services to the people, and steering the overall development of the

[8] Eurodad (2010), 'Development diverted: how the International Finance Corporation fails to reach the poor', December 2010

[9] Khor, M. (2008), 'Bilateral and Regional Free Trade Agreements: Some Critical Elements and Development Implications'. Third World Network.

country – as often happens in projects that result in the eventual privatization of public services, facilities and operation. The private sector undisputedly has a role to play in economic growth and development of society, but their operations, especially the for-profit business sector, needs to be regulated while being harnessed towards the promotion of sustainable livelihoods.

Overall, private sector involvement in ODA-funded programs and projects must be in line with the principles of development effectiveness. Involving the private sector in development should be accompanied by commitment to observe democratic ownership, decent work and human rights standards, and to support internationally agreed development goals.

Development finance to be allocated to the private and public sectors needs to be based on local and regional development needs and not on market demand as increasingly practiced by MDBs. These must be set out by country plans established through democratic processes with a redistributive perspective that prioritizes micro-enterprises and SMEs rather than large firms; local rather than foreign.

Public funds, and aid money in particular, should first of all promote sustainable livelihoods and catalyze productive economic development of small-scale enterprises and cooperatives that provide direct and immediate benefits for the poor and marginalized.

Busan and beyond

Similar to the adoption of development effectiveness guidelines of CSOs in the Istanbul Principles (2010), the logical next step for the private sector would be to adopt and adhere fully to aid and development effectiveness principles. This needs to be measurable and enforceable within an international agreed framework for private sector cooperation in development that embraces international conventions and norms on human rights, decent work and gender equality. The Fourth High-Level Forum on Aid Effectiveness in Busan needs to ensure that a reformed global aid architecture includes such an enforceable framework for private sector engagement.

To be eligible for ODA support for global, or country programs, TNCs in particular must adhere to binding guidelines which must include Right-to-know provisions that would require corporations to make regular and timely public disclosure of their operations and financials; mandatory human rights impact assessments; multi-stakeholder oversight mechanisms; and mechanisms for redress.

Overall development finance needs to be incorporated into a reformed overall aid architecture where a democratic multilateral oversight body holds the mandate, ability and power to fully monitor and hold MDBs accountable. The sector needs to adhere to development effectiveness, social justice and human rights – instead of simply promoting economic growth.

Written by
Paul Quintos

IBON International
is a division of IBON Foundation. It engages in capacity development for human rights and democracy around the world.

3/F IBON Center,
114 Timog Avenue, Quezon City,
1103 Philippines
Tel: +632 9277060 to 62
Fax: +632 9276981
Email: international@ibon.org
Web: iboninternational.org