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"PUBLIC AID AS A DRIVER FOR PRIVATE INVESTMENT"

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List of acronyms

AECID	Spanish Cooperation Agency
AMC	Advanced Market Commitments
BCtA	Business Call to Action
BNDES	Brazilian Development Bank
CAF	Corporación Andina de Fomento
CRS	Creditor Reporting System
CSOs	Civil society organisations
DAC	OECD Development Assistance Committee
DFID	Department for International Development
DIAS	IIC monitoring system
DNP	Colombian National Development Plan
ETG	Export Trading Group
ETG	Export Trading Group
FDI	Foreign direct investment
FRICH	Food Retail Industry Challenge Fund
GDF	Growth Diagnosis Framework
GDP	Gross domestic product
IDB	Inter-American Development Bank
IDP	Investment Development Path
IFC	International Finance Corporation
IIC	American Investment Corporation
LDCs	Least developed countries
M4P	Making Markets Work for the Poor
MIF	Multilateral Investment Fund
NSGOs	Private - –through non-sovereign-guaranteed operations
ODA	Official Development Assistance
OMJ	Opportunities for the Majority
PEPE	Private Enterprise Programme Ethiopia
PPP	Public-Private Partnership
PSD	Private sector development
PSDS	Private Sector Development Strategy
PSO	Private Sector Operations
R&D	Research and development
RbF	Results - based Fund
SCF	Structure Corporate Facility
SCR	Corporate social responsibility
SGOs	Public sector –sovereign-guaranteed operations
SME	Small and medium enterprise
TFFP	Trade Finance Facilitation Program

TNC	Compel a transnational company
TNCs	Transnational companies
UNCTAD	United Nations Conference on Trade and Development
UNDESA	United Nations Department of Economic and Social Affairs
UNDP	United Nations Development Programme
WID	Women in Development

Executive Summary

Public Aid as a Driver for Private Investment

Iliana Olivié and Aitor Pérez

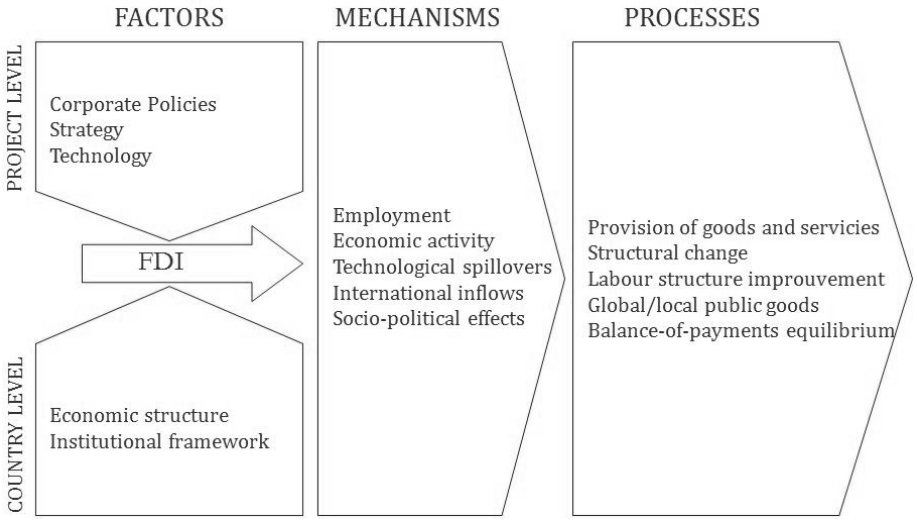
From Monterrey to Busan: rethinking aid as a catalyst for private investment

The Monterrey Consensus stated in 2002 that there is a need to intensify efforts to "promote the use of Official Development Assistance (ODA) to leverage additional financing for development, such as foreign investment, trade and domestic resources". Since then, several international fora have addressed this question and revalidated the idea of aid as a catalyst for private flows. In general terms, there would seem to be a consensus on the complementarities of public aid and private investment to foster development. However, in order to move from general statements to effective aid planning, we still lack relevant knowledge on how aid can trigger the sorts of investments that would have the greatest impact on development. Such knowledge entails going beyond business-environment policies, to a more targeted approach to private sector development.

How does investment impact on development?

Dozens of analyses approach the empirical link between FDI and development by focusing on specific investment projects in specific countries, sectors, and time periods. These studies may answer the question of whether certain FDI flows are good. However, they are far from being conclusive and they do not tell us how the effects of FDI spill over into development, which is equally relevant in order for policy makers to draw conclusions. There is also a more explanatory body of literature that assumes the complexity of development processes, as well as the role of country and project factors in the overall causal chain. However, this literature is strongly focused on the technological aspects of investment as the main development driver, ignoring the impact of FDI on other variables linked to development, such as employment or tax payments.

Figure I. The investment-and-development framework



So, due in part to the complexity of the FDI-development nexus, we do not have a *general* narrative on *how* FDI intervenes in development. However, based on previous field research by the Elcano Royal Institute, a case-by-case approach to an investment project (with a particular set of defining variables) in a specific country (with its own particular economic structure and institutional framework) might be very relevant. These case studies have provided an assessment of the impact of several private investments in Dominican Republic, Bolivia, Brazil, and Colombia, and a better understanding of the role played by different development actors in every case (national authorities, civil society organisations, international cooperation agencies and private companies).

The link between investment and development is complex but can be systematised across three main steps: factors, mechanisms and processes. A particular combination of factors—the features of the investment project and those of the host country—triggers specific mechanisms of different economic characteristics (technological, social or political). Ultimately, these characteristics will have a positive and/or negative impact on what we can call development processes—variables that can give a partial definition of development. For example, labour-intensity of tourism activities along with greenfield investments by international hotel groups in Dominican Republic (factors), positively impacted on employment (process) by means of direct job creation (mechanism). However, low levels of demand of intermediary goods and the weakness of the local supply (factors), explain the fact that indirect job creation was very limited (mechanism).

This same analytical framework has been used to understand the role of Colombia private equity funds in business development aligned to national government strategies, the impact of Brazilian local content policies in productive linkages and technology transfers, or how legislative action and civil society contestation can increase the contribution to development of a gas field in Bolivia.

Private sector development and international cooperation. Where do we stand?

Although reporting standards on aid do not specify whether or not a donor commitment is addressed to support or collaborate with private actors, for the purpose of this study, we have considered public aid for private investment all ODA flows classified as equity investments or any other flows channelled via PPP, or addressed to certain economic infrastructures (banking and business services) and productive sectors (agriculture, industry, fishing, tourism, mining, construction). This leads us to conclude that donors have dedicated 10% of their aid to supporting private investment during the period 2007-11, which amounts to a yearly average of USD 16 billion distributed as follows:

Figure II. Public aid for private investment

2007-11 average

Category	Amount[1]	%
EquityInvestment	1,537	10%
Public-PrivatePartnership	619	4%
EconomicInfrastructure	4,029	25%
ProductiveSectors	9,841	61%
Agriculture	7,360	
Other sectors	2,481	
Total	**16,026[2]**	**100%**

[1] 2007-11 Average ODA commitments, USD million

[2]10% of overall ODA (USD 153 billion)

Source: OECD.Stats

In order to overcome statistical limitations and also to understand the logic behind every aid modality, the previous quantitative analysis has been completed with a case study of two donors considered to be relevant supporters of private sector activities: The Department for International Development (DFID) and the Inter-American Development Bank (IDB).

The *Department for International Development (DFID)* is the ministerial department leading the United Kingdom's official development cooperation and managing most of its aid. DFID's support to private sector initiatives either attempt to create economic opportunities for the poor -mainly by delivering jobs- or to address their most basic needs, DFID being an important sponsor of the Markets for the Poor paradigm.

Wealth creation programs by country offices are a good example of DFID aid oriented to job creation. Every country operational plan contains wealth creation objectives that usually manifest in the creation of jobs and the increase of household incomes. The way to achieve this objective can be, for instance, by supporting self-employment by granting local micro-finance institutions. When addressing certain global issues (like health) where markets are failing the needs of poor people, some of DFID's programs consist of collaborating with the private sector to "make markets work for the poor". This is the case with the Advanced Market Commitments program, which tries to improve the availability of vaccines and makes them affordable by committing public aid to R&D activities on a performance basis.

The *Inter-American Development Bank*'s priorities are reducing poverty and inequality by fostering development through the private sector. Direct funds for private companies are spread through four different IDB institutions, one for each company size (big companies, SME, micro-businesses and the base of the pyramid). Indirect PSD operations promote development through the private sector but working primarily with governments. This includes legal and regulatory frameworks, infrastructure projects, and promoting innovation.

Therefore, IDB supports private investment in a comprehensive way. The Bank is aiming to hinder the institutional framework for improving the provision of goods and services –more specifically financial markets and services–, employment –for instance, upgrading skills for workers– and structural change –e.g. fostering firm and cluster productivity–. It also has the goal of addressing weaknesses in the economic structure by improving infrastructure; something that may impact on the contribution to public goods (by bettering the energy supply and water and sanitation), on the provision of goods and services (through better transportation infrastructure and water supply) and on structural change (by means of a more productive and competitive supply function).

How donors obtain a catalytic effect from aid

Based on these donors' experience, several criteria must be taken into account in order to ensure a catalytic effect from aid. First, as a precondition for any catalytic effect, donors must intervene in those regions and sectors unattended by private initiative (additionality). Secondly, when investing directly in private equity, they must leverage other investors' resources. However, in sector- or country-based interventions, focused on institutional and economic factors, public aid's catalytic effect would consist in removing constraints to businesses and triggering private investment. Thirdly, donors must favour profitable businesses, so that these and their development outcomes will persist when aid stops. Finally, they can seek a demonstration effect, so that successful pioneer investments can show the path for new investors and multiply development outcomes.

Recommendations for donor and recipient countries using public aid as a catalyst for private investment

Development goals and aid focus (company, economic structure or institutional framework) determine different modalities of public aid for private investment, as shown in the previous figure. Regarding development goals, it must be said that several works describe private sector development as a catch-all without a clear proposal for achieving development results, but some donors show that a more strategic approach to private sector development is possible. Both donors analysed in this paper demonstrate that aid addressed to private sector is a means to an end when facing unemployment and income poverty (i.e. microfinance programs); when contributing to public goods (i.e. performance grants for the low-carbon energy industry); when providing certain goods and services (i.e. R&D incentives in the vaccine industry); or when accelerating structural change (i.e. funding capital-intense activities by SMEs).

Figure III. Public aid for private investment: modalities

		Development goals				
		Employment	Goods and services provision	Global and local public goods	Structural change	Balance of payments
Aid Focus	Company					
	Economic structure		Aid modalities			
	Institutional framework					

Knowing that (in a post 2015 era) both recipient and donor governments are expected to put into practice the Busan consensus on private sector involvement in development cooperation, the following are some elements to take into account when rethinking public aid as a catalyst for development-oriented investment:

- *Clear development goals:* Donors must engage with the private sector only with a view to achieving identified outcomes. *Knowledge-based interventions:* Although we cannot draw general lessons from the economic literature on FDI and development, analysis of typical investment projects in a specific region or sector may provide information on development that can positively influence the design of development strategies on a larger scale.

- *Alignment to national strategies:* Following aid effectiveness principles, donors must align their PSD programs to national development strategies, and national authorities must adopt strategies containing clear guidelines for international donors.

- *Additionality:* When private sector contribution to development is possible with the private sector's own resources, there is no need to detract public aid from other purposes.

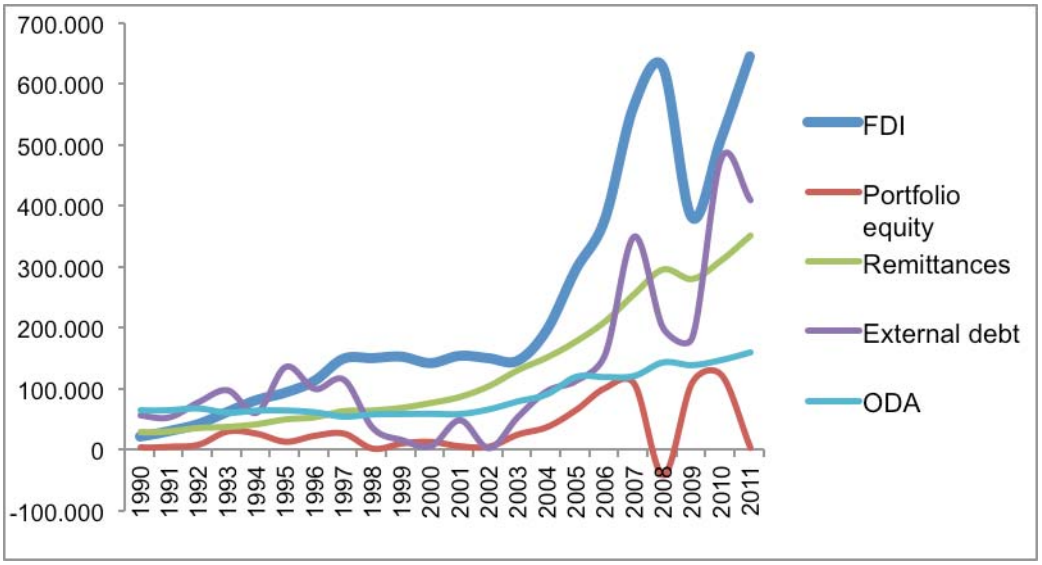
- *Leveraging other resources when possible:* A catalytic effect is not always possible for business involving the poorest communities and therefore having a greater development impact. Leveraging other resources can be a second-level objective, and must not reduce the pro-poor orientation of aid.

- *Favouring other catalytic effects.* Leveraging other investor's resources when investing pubic aid on private companies is not the only possible catalytic effect. Removing certain constraints to business development or obtaining a demonstration effect from a specific investment may also mobilize additional private resources.

ODA+ accounting system: To keep track of PSD at a global scale, the official reporting system run by the OECD needs to be adapted in order to specify whether or not a commitment is addressed to PSD, and to record other public flows not accounted as ODA, including development banks resources and DFI funding.

In 2002, the Monterrey Consensus stated that there is a need to intensify efforts to "promote the use of Official Development Assistance (ODA) to leverage additional financing for development, such as foreign investment, trade and domestic resources" (United Nations, 2002). It recognised that "ODA can be critical for improving the environment for private sector activity and can thus pave the way for robust growth". Since then, the idea of public aid as a catalyst for private investment has been addressed in several international fora. Taking into account the volume and oscillation of both types of flows, this seems to be an idea worth exploring.

Figure 0.1. External financing to developing countries
(net inflows in millions of current US$ to low- and middle-income countries)



Source: World Bank, World Development Indicators, online data base; Organization for Economic Co-operation and Development (OECD), OECD.Stat, online data base.
Note: ODA figures reflect net flows of ODA channeled to developing countries, according to OECD aid recipients list.

While the Paris and Accra Fora focused on aid effectiveness (OECD 2005, 2008), the Busan Forum (OECD, 2011) recognised that aid is only part of the solution to development. It included a proposal of a new paradigm of "cooperation for effective development", framing under cooperation strategies, all types of financial flows likely to contribute to development — whether public or private, domestic or international. Based on the idea that development is driven by structural, sustainable and inclusive growth, recipient and donor governments also agreed to rethink how aid should be spent in order to catalyse private investment. Furthermore, they recognised the central role of the private sector in creating wealth, income and jobs, and, in turn, contributing to poverty reduction. The governments suggested some specific measures for further involvement of the private sector in development

policies. For example, these included enabling the participation of business representatives in the design and implementation of development strategies, and developing innovative financial mechanisms to mobilise private finance for shared development goals.

The more specific idea of using ODA as a catalyst for foreign direct investment (FDI) was introduced by the OECD (2006) as part of the Initiative on Investment for Development launched in 2003. Both OECD's Development Assistance Committee and the Investment Committee issued a policy guidance for development agencies aiming to mobilise more productive investment in developing countries and to increase the impact of growth on poverty reduction.

In reality, international organisations like the United Nations Conference on Trade and Development (UNCTAD), the World Bank and regional development banks have always been active in monitoring and supporting developing countries' investment policies. Different ODA-funded programs have provided least developed countries (LDCs) with technical assistance to improve business climate and attract foreign investments. The challenge now would be to drive FDI towards country-specific development goals and strategies and needs. UNCTAD itself suggests moving toward a "new generation of investment policies" based on its integration into development strategies. From this approach, its latest World Investment Report (UNCTAD, 2012) focuses not only on mobilising investment, but also on ensuring that such investment contributes to sustainable development. The report contains an investment policy framework consisting of 11 principles to be integrated in national investment policies and international investment agreements. Its 11th principle is addressed to international cooperation actors and advocates supplementing support to investments in LDCs; conditioning investment guarantees from donor countries on social and environmental impacts; and promoting responsible investment in sensitive sectors, such as farming.

While traditional investment policies focus on factors conditioning private financial inflows —for example, regulation of profit repatriation— so-called new generation investment policies and, particularly, ODA-granted activities must be based on a better knowledge of factors conditioning FDI impact on development, like social and environmental corporate policies. That is the scope of this document. Based on previous research by Elcano Royal Institute, the first two sections provide a literature review on the effects of FDI on development, a specific framework to assess investments from a development approach, and a sample of specific investments in developing countries. The third section offers an overall picture of the involvement in private sector development (PSD) by the donor community, whereas the fourth section takes a close look at two reference donors in PSD – the United Kingdom and the Inter-American Development Bank (IDB). The fifth and last section concludes and offers policy recommendations.

This document is a request of the United Nations Department of Economic and

Social Affairs (UNDESA). Its aim is to provide an input for the UN Secretary-General's report to the Development Cooperation Forum, to be held in 2014.

1. How does investment impact development?

1.1 The lack of a definite answer from academic literature

Exploring the investment-development nexus

Investment is considered a key element for economic growth, according to economic classic literature, from Smith to Marx: investment and, more specifically, reinvested earnings, lead to capital accumulation and, therefore, to growth and economic and social well-being. In fact, investment (gross fixed capital formation) is one of the pillars of the economy – more specifically, one of the elements of the gross domestic product (GDP). Investment has a leading role in aggregate demand, according to Keynes' (1936) investment theory; and in long-term growth –through technological upgrading– for neo-classical theorists (Solow, 1956; Massell, 1962; Romer, 1986; Lucas, 1988). Pioneers of development, such as Rosenstein-Rodan (1943), consider investment as one of the three pillars of a 'big push' – along with public guidance and domestic market protection. The structuralist school of thought gives investment even greater importance, as it is the basis of industrialisation conducted through import substitution (Lewis, 1955).

In spite of this, contemporary literature on the investment-development nexus is scarce. To date, economic literature has hardly explored how different types of investment –for instance, by productive sectors[1]– may have different effects on growth or development. During the 1990s, analysis of the investment-development nexus was captured by the debate around the sources of growth for the most dynamic economies in East Asia (Krugman, 1994; Felipe, 2006). More recently, apart from a few disperse insights on the conditions for the long-term effects of investment on growth (Li, 2002), a larger debate remains absent.

On the other hand, from the moment that development economics appeared as a specific field of research, the effects of a foreign direct investment (FDI) in developing countries became subject to analysis. According to the pioneers of development studies, external financing has several benefits, such as coverage of the local savings gap needed for launching the big push (see for instance Rosenstein-Rodan, 1943, and Lewis, 1950). To the contrary, meanwhile, according to Structuralists, foreign capital may play a role in the deterioration of terms of trade of peripheral economies (Singer, 1950). Latin American Dependentists go even further, arguing that foreign capital may lead to economic, technological, political and even intellectual dependency (see for instance Sunkel, 1972).

But it was not until the advent of international industrial relocation in the 1970s that economists began to focus on the more specific determinants —both push and pull factors— of this relocation process (see, for instance, Hausmann and Fernández-Arias, 2000) and on the effects of FDI inflows on developing countries (Reuber *et al.*,

[1] With the exception of De Long and Summers (1991) and Pritchett (2003).

1973; Lall and Streeten, 1977)[2]. There may be a link between these two issues: the reasons that compel a transnational company (TNC) to settle in a particular developing country strongly influence the development outcomes in the host economy.

Studies of the specific impacts of FDI on development are mainly empirical. They tend to test the effects of foreign investment via one or two macro variables in a given sector, in a certain country and over a specific time period. The effects most frequently explored by this type of literature include growth[3], innovation and technological spillovers[4], and productivity[5]. Other research explores the link between FDI and local investment[6], productive linkages and structural change[7], trade[8], labour[9], institutional quality[10]; also poverty, inequality or human development in more general terms[11]. Although there are a number of studies on FDI in developing countries, the variety of evidence and outcomes in the existing literature makes it difficult to determine whether FDI is good or bad, in general terms, for development in host countries.

So, does this body of literature offer an answer on the effects of FDI? Not really. Despite the fact that there are a good number of studies on the specific consequences

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[2] For a comprehensive survey on both types of literature, see García (2006). On the effects of foreign investment on development, see also Ramírez Cendrero (2006) and Zilinske (2010). On effects on both home and host economies, see Lipsey (2002).

[3] Dutt (1997); Blomström *et al.* (1998); Borensztein *et al.* (1998); Saggi (2000); Obwona (2001); Zhang (2001); Hermes and Lensink (2003); Akinlo (2004); Alfaro *et al.* (2004 and 2010); Nunnenkamp (2004); Carkovic and Levine (2005); Chudnovsky and López (2007); Batten and Vo (2009); Wang and Wong (2009); Azman-Saini *et al.* (2010); Choong *et al.* (2010); Shen *et al.* (2010); Zhao and Zheng (2010); Ahmed *et al.* (2011); Nicet-Chenaf and Rougier (2011); Cipollina *et al.* (2012); Choong (2012); Herzer (2012); Izuchukwu *et al.* (2012); Li and Xu (2012); Ouyang and Fu (2012); Driffield and Jones (2013); Yalta (2013).

[4] Blomström and Persson (1983); Haddad and Harrison (1993); Dunning (1994); Borensztein *et al.* (1998); Aitken and Harrison (1999); Blömstrom and Sjöholm (1999); De Mello (1999); Kugler (2000 and 2006); Javorcik (2004); Blalock and Gertler (2005); Jordaan (2005); Takii (2005); Chudnovsky and López (2007); Girma *et al.* (2008); Girma and Gong (2008); Padilla (2008); Paus and Gallagher (2008); Fu and Diez (2010); Marin and Sasidharan (2010); Ren and Hao (2010); Zhang *et al.* (2010); Huang *et al.* (2012); Rosell-Martínez and Sánchez-Sellero (2012); Wang and Wong (2012); García *et al.* (2013); Mastromarco *et al.* (2013). See also a survey by Görg and Greenaway (2002).

[5] Sadik and Bolbol (2001); Chudnovsky and López (2007); Chakraborty and Nunnenkamp (2008); Ang (2009); Wang and Wong (2009); Menghinello *et al.* (2012); Wang (2010); Balsvik (2011); Fillat and Woerz (2011); Guo and Chen (2011); Hagemejer and Kolasa (2011); Hong and Sun (2011); Lin *et al.* (2011); Suvanto *et al.* (2012); Bodman and Le (2013).

[6] Ndikumana and Verick (2008); Wang (2010); Kim *et al.* (2013).

[7] Fu (2011); Liu (2011); Andergassen and Candela (2013).

[8] Blomström and Kokko (1997); Chudnovsky and López (2007).

[9] Dragin *et al.* (2010).

[10] Ali *et al.* (2011).

[11] Nunnenkamp (2004); Tsai (2005); Choi (2006); Reiter and Steensma (2010); Gohou and Soumare (2012); Lessman (2013).

of FDI for developing countries, the existing literature is far from conclusive (Moran, 2011).

Why is this so? Firstly, apart from the accounting problems related to FDI flows at the macro level (Hausmann and Fernández-Arias, 2000) and to the output variables, there are methodological differences in these statistical models that might explain the very diverse results. In addition, the studies summarised here lack a theoretical base. Besides the general Smithian or pioneers' assumption that capital mobility might foster development, or the Marxist or Dependentist notions according to which international investment can create an obstacle to development, there is no theoretical proposal that comprehensively examines each of the elements and steps that form the causal chain linking FDI and development. Moreover, and most importantly, the methodological features of the empirical, quantitative econometric literature on the conditions that determine the sign and intensity of the impact of FDI on development still fail to completely explain *why* –because it does not tell us *how*– FDI impacts on development. In other words, we are faced with a 'black box' on the impact of foreign investment on development (Bell and Marin, 2004; Ramírez Cendrero, 2006; Narula and Dunning, 2010; Zhan and Mirza, 2012). "[W]e would go so far as saying that while a relationship exists between FDI and development, this relationship 'hides' a very large 'black box' of intervening mechanisms and processes" (Narula and Dunning, 2010: 265).

Would it be feasible to build a theory on the FDI-development nexus?

In the early 1980s, Dunning proposed a first step towards a theoretical framework for exploring the *way* in which FDI (first inward, later outward) might have an impact on development –that is, *how* the result would appear– based on three assumptions: that the impact might be indirect, that it might be of a changing nature, and, lastly, that development is complex and multifaceted.

Approaching this issue from a somewhat Rostowian view, this IDP (Investment Development Path) literature developed by Dunning (1981 and 1988) and Narula and Dunning (2000 and 2010) represents an important contribution to the understanding of the economic dynamics triggered by FDI, as it analyses the phenomenon holistically, and with a temporal dimension. According to the IDP, countries can progress towards economic development by going through five stages, each of them characterized by distinctive features of FDI, such as (1) the net flow, (2) the characteristics of inflows and outflows, (3) the O advantages – features of the firm, (4) the L advantages – features of the host country, and (5) the economic structure of the host economy. According to the IDP, *different combinations of these features* (for instance, how O advantages interact with L advantages) will end in *different impacts on development,* and these combinations will vary over time.

The explanatory capacity of this literature is extraordinary, especially compared with the more abundant empirical-quantitative literature on this issue. It assumes the

complexity of development processes; the time-varying nature of FDI and development, and their interaction; and the role of 'country' and 'investment project' factors on the overall causal chain. However, the strong focus on the technological aspects of investment as the main drivers to development might be ignoring the impact of FDI on other variables linked to development, such as employment, balance-of-payments, the role of civil society organisations, or the provision of basic goods (Narula and Dunning, 2010; Morrissey, 2012; Narula and Driffield, 2012). In this sense, the economic literature lacks a theoretical proposal that totally opens the black box of FDI and development.

The need for a new approach: interdisciplinary case-by-case analysis of FDI

So we perceive that, firstly, no theory on FDI and development exists (or even appears feasible) due in part to the complexity of the FDI-development nexus. Secondly, as a consequence of the quantitative empirical research techniques being used, most results presented by academic literature are limited to showing a particular and partial impact under very precise and particular circumstances and conditions – *what* impact under *what* condition(s). Thirdly, and consequently, we shall not attempt to (and probably cannot) build a *general* narrative on *how* FDI intervenes in development.

Given this, the appropriate methodological approach to the study of the effects of FDI on development would be a case-by-case approach, focusing on a given investment project (with a particular set of defining variables) in a specific country (with its own particular economic structure and institutional framework).

It should be noted that the need for this type of micro approach was first detected 40 years ago. After reviewing the research on FDI and development conducted in the 1950s and 1960s, Granell (1973) concluded that "(…) the adequate methodological approach to calibre the effects of foreign investment and multinational companies must not be macroeconomic. The global results of such an international phenomenon for the economy and society in different countries and, particularly, in developing countries, combine different partial effects that are impossible to evaluate homogeneously: economic, political or social advantages and costs (…). The alternative (…) is the interdisciplinary case-by-case analysis of particular investment projects. This should be framed and approached on the basis of the adequacy of the investment project to the economic, political and social goals defined by the country where the investment project is hosted[12]" (Granell, 1973, p. 10). A similar view was expressed by Vernon (1980), who advocated for the case-by-case approach to this issue, and by the IDP tradition (Narula and Dunning, 2000 and 2010), as mentioned previously.

12 Author's translation.

1.2. A comprehensive framework to analyse investment's impact on development

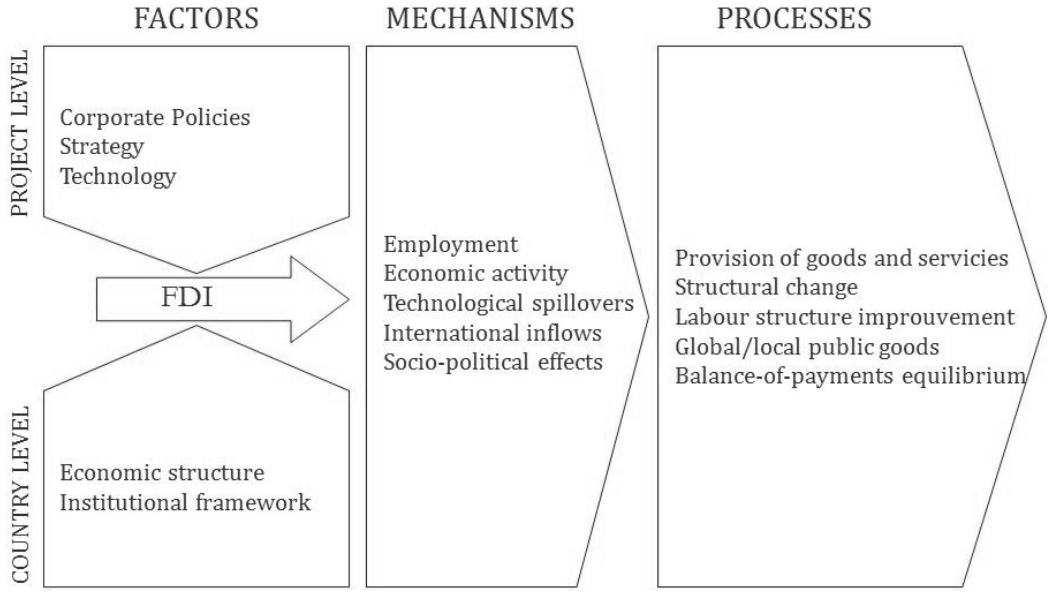
Although we cannot draw general lessons from the economic literature on FDI and development, following Granell's proposal for a new methodological approach to this issue, we believe that a case-by-case analysis of particular investment projects would be very useful, not least for policy-makers. For instance, developing countries and their donor partners could approach companies with a clear proposal for private-public partnerships. Furthermore, they could analyse typical investment projects in a specific region or sector and design development strategies on a larger scale.

Moreover, as this methodology would focus on specific investment projects, it would be suitable for analysing any type of project, regardless of whether it is internationally or domestically financed. In other words, with these specific features, the analytical framework could also be a research tool[13].

Therefore, the following proposal is addressed to development actors and analysts and contains an analytical framework for assessing private investment (both foreign and domestic) from a development angle.

The causality chain: factors, mechanisms, processes

The link between investment and development is indirect and therefore could be s



[13] Actually, despite the fact that this line of research at the Elcano Royal Institute has concentrated on analysing FDI (see section 2), the framework revealed in this section has served as the basis for analysis of locally financed investment projects in Colombia (Olivié *et al.*, 2012).

Factors are the defining elements of a given investment project: essential features of the investment, including characteristics of both the investing company[14] and the host country; the latter can be divided into factors of the institutional framework and factors of the economic structure. For instance, labour intensity would be classified as a factor of the TNC, while an abundant qualified working force would be a factor related to the host country's economic structure (figure 1.1).

It should be noted that a host country's education, industrial, trade, fiscal, financial and exchange rate policies (to name a few) are not included (as such) as variables in our framework. We neither ignore them nor consider them incapable of impacting on development. On the contrary, these economic and social policies are the key to the configuration of what we have called the host country factors. For instance, the sign and magnitude of such policies as these have been the most important pieces of the industrialisation process in several East Asian economies for the last five decades, according to Amsden (1989), Wade (1990), and Chang (1994 and 2004). As one of our goals is to provide inputs for policy making in both host countries and donor investor countries, the conclusions of this line of research should identify critical institutional and economic structure factors for attracting and sending 'development-friendly' FDI. These conclusions would ultimately inform the design of policies in a wide range of issues, from education and innovation to monetary and fiscal matters.

Figure 1.2. Inputs for the black box of investment and development: the factors
2a. Host country factors

Economic structure	Institutional framework
Market competition	Governance and transparency
Local competitiveness	Labour and environmental legislation
Local provisioning (a)	Fiscal pressure and progressivity
Internal market size	Civil society organisation (c)
Trade openness	Productive sector support [incl. Nationality requirements (d)]
Human capital qualification Labour demand (b) Physical infrastructures	Norms on universal coverage

(a) Refers to the capacity of the economy to provide inputs needed by the TNC.
(b) Refers to the volume of similarly qualified labour force demanded by the local economy, inside or outside that same production sector.

[14] Somehow, the unit of analysis is the TNC, and not the FDI flow. See more on this dilemma in Narula and Dunning (2010).

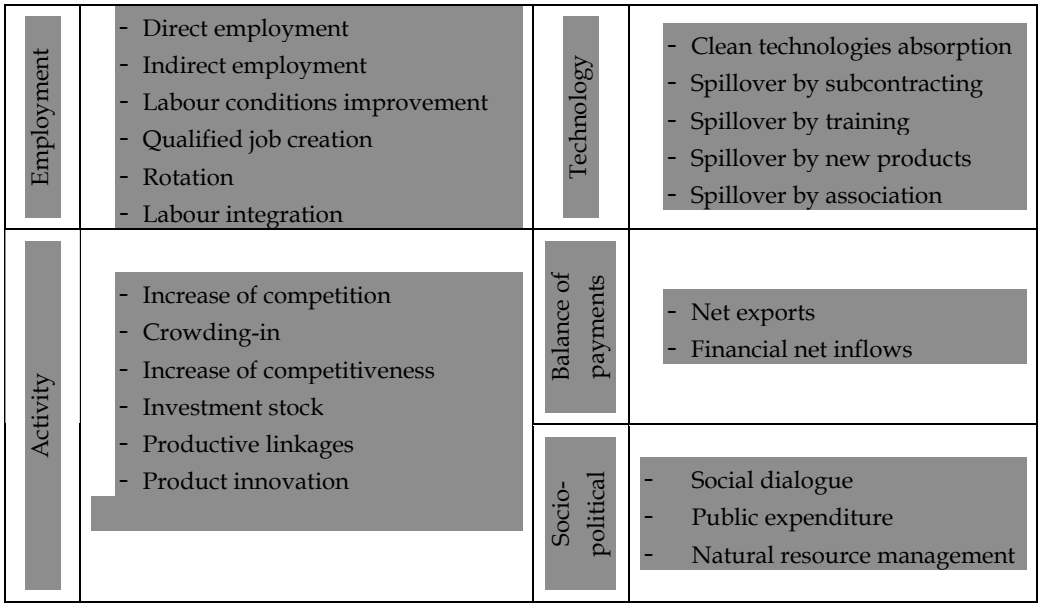
(c) Refers to the capacity of the local society to organise its demands and lobby activities.
(d) Refers to the norms requiring national ownership of some parts of the production chain (i.e. requirements on joint-ventures).

2b. Investment project factors

Policies	**Strategy**	**Technology**
Training policy	Greenfield / M&A	Labour / capital / natural resources intensity
Wage policy	Basic / strategic production	Dependency on intermediary goods
Policy of relations with local communities	Dependency on local assets	Technological gap
Environmental policy	Inward / outward orientation	Clean technologies

Mechanisms are typified sequences of events that can be triggered in diverse scenarios, appearing as the consequence of the confluence of different factors. A mechanism could be, for instance, the increase in wages that might result from the two factors mentioned above –qualified working force and labour intensity- or through corporate policy.

Figure 1.3. Mechanisms that link factors and processes in the investment-development chain



Lastly, *processes* are the ways by which FDI impacts development in the host economy. These are the result of the triggering of one or more development-friendly

mechanisms. An increase in wages, for example, can lead to improvement in the labour structure and, therefore, in development. All socio-economic contributions expected from a private investor can be framed under the five processes listed below:

- Structural change, which is defined as a process of economic growth based on an overall increase in productivity. The process implies a modification of the host economy's productive pattern through the incorporation of new technologies into the productive structure, or through better assignment of resources within the economy. Growth is included in the variable.

- Balance-of-payments equilibrium is conceived as a trend, not as a level (as we consider development processes to be). Thus, we can consider a positive impact by FDI on development even in the event of extraordinary disequilibrium caused by the investment project under analysis.

- Provision of goods and services by a company also contributes to development, as these are made available to the whole population.

- Labour structure improvement refers not only to the volume of employment, but also to dimensions such as job quality (for example, the possibility of giving access to vulnerable groups).

- Private companies also contribute to local and global private goods by paying taxes and by reinforcing public sector capacities to deliver goods and services. They can also contribute to sustainable management of global public goods, such as water.

So, the impact of FDI on development is indirect and complex. It can involve over 50 variables and, consequently, its impact can be diverse. Indeed, a single investment project might be found to have a positive impact on a particular process (such as structural change) while at the same time exerting a negative impact on another process (public goods, for instance). The FDI-development framework is therefore an analytical tool for approaching such a complex phenomenon and drawing lessons on a case-by-case basis.

Box 1.1. Main features of the FDI-D analytical framework

Linked to the Structuralist tradition

The framework is based on the assumption that economic growth per se might not trigger an economic development process if it implies an stagnant assignment of production factors in an uncompetitive, low-technology way.

Based on a comprehensive definition of development

Development is defined as being sustainable both economically and environmentally (see the mechanism of natural resources management), as well as politically and socially (see the mechanism on social dialogue). Growth led by a structural change process can be inclusive or exclusive; this aspect is taken into account by including mechanisms such as labour integration.

Assuming the complexity of development processes

The framework does not assume homogeneous behaviour by all TNCs in a given economic structure. Neither does it assume similar behaviour by all TNCs across all developing countries, as cross-country approaches do. Moreover, statistical problems related to the recording of FDI flows at the macro level, such as those highlighted by Hausmann and Fernández-Arias (2000), are here avoided. Following the so-called Growth Diagnosis Framework (GDF) developed at Harvard University (see, for instance, Hausmann *et al.*, 2008), this framework assumes that development processes are not simple, direct, and automatic relations between macroeconomic variables (and, therefore, not simple, direct, and automatic recipes for development).

Built from a micro/meso approach

The framework's independent variable, FDI, is the investment project — something that situates this framework at the micro level. However, macro and meso variables are also taken into account (as they determine the economic structure of the host economy, and define its institutional framework).

Useful for identifying bottlenecks

One of the main uses of this analytical proposal is to identify bottlenecks to development, as with the approach taken by the above-mentioned GDF.

Box 1.2. Types of variables of the investment-and-development analytical framework

Factors: traits or characteristics of an investment as a whole, including features both of the investment company and of the socio-economic structure in which it is inserted. Examples of factors are the intensity of labour required by the business, or the availability of sufficiently trained human capital in a recipient country.

Mechanisms: sequences of events present in many different cases. These are triggered as a result of a combination of certain factors. A mechanism would be, for example, an improvement in working conditions, which could be explained by a combination of factors such as those in the above paragraph.

Processes: the ways in which investment generates positive effects on the development of the recipient country. These are the result of one or several mechanisms. For example, an improvement in working conditions may contribute to an improvement of the country's employment structure.

2. Investment's impact on development: evidence from the field

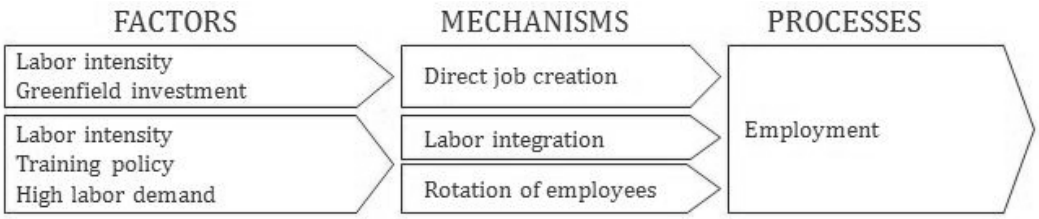
This section presents key findings of the effects of different investments, mostly foreign, on development of host countries. The lessons are drawn from prior case studies in Latin America (Dominican Republic, Bolivia, Brazil, and Colombia) and North Africa (Morocco and Algeria). These are examples of the investment-and-development analytical framework at work. The role played by national authorities, civil society organisations, and private companies in driving development impact will be underlined in each case.

Hotel resorts in Dominican Republic[15]

In 1971, and with support from the World Bank, the Dominican Republic began to foster private investment in tourism by means of fiscal and financial incentives. Over ten years, this strategy mobilised only national investors and raised hotel capacities up to 6,000 rooms; but from 1981 onward, foreign investors added to the country's stock by 2,000 new rooms per year over three decades. According to UNCTAD, the tourism sector as a whole accounts for roughly 10.2% of gross fixed capital formation in the country. The lion's share belongs to foreign investors (approximately 80%). Even some infrastructure projects in hotel areas, such as a highway and an international airport, are financed and operated by foreign investors.

Obviously, such investments, along with those in real estate and industrial free zones, have contributed to structural change. The country has made a shift to a more diversified economy and almost doubled its GDP in the last decade. Because Dominican hotel resorts are oriented toward foreign visitors, the impact in the current account has also been positive. However, the most significant direct contribution from foreign hotel investors to development in the Dominican Republic has probably been job creation (figure 2.1).

Figure 2.1. How hotel resort investments impact on employment

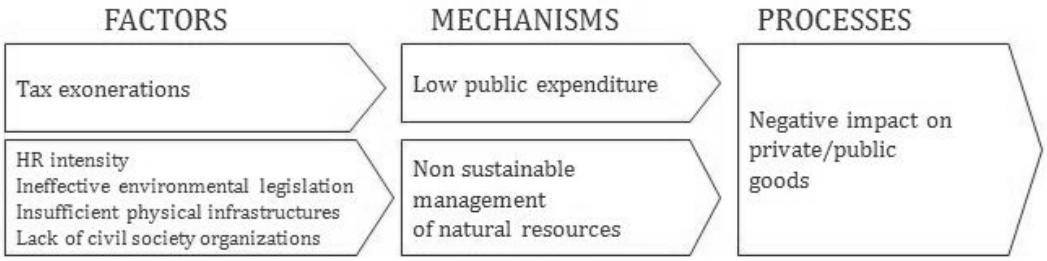


[15] See full case study in Pérez (2011).

Greenfield investments in labour-intense activities have a big impact on direct employment. In 2005, hotel, restaurant and bar activities employed more than 200,000 people, accounting for more than 5% of total employment in the country and an increase of 46% over 10 years. (OMLAD, 2009).

From a qualitative standpoint, tourism activities have had limited impact on qualified job creation or the improvement of labour conditions, as most employment remains unskilled. The average salary in hotel resorts is lower than in the rest of the formal economy. However, the overall remuneration in hotel and restaurant activities makes living conditions for their employees better than for unskilled workers in other sectors, according to the UN Development Programme (UNDP, 2005). UNDP has also remarked on the large number of women working in hotel resorts and the positive consequences of this on poverty alleviation. Such a high demand for unskilled workers has contributed to the integration of populations excluded from the formal market into international companies. Corporate training policies have also reinforced labour integration and even favoured certain dissemination of skills, as they have benefited hundreds of thousands of unskilled people over the last three decades. Several works point out how foreign hotel operators have positively influenced labour practices in the whole country (Intermon Oxfam, 2007; Fanelli and Guzmán, 2008).

Figure 2.2. How hotel resort investments impact on global/local public goods



Development outcomes from hotel investments are not always positively received in the surrounding communities. Tourism makes intense use of land and water. This negatively impacts not only the conservation of natural resources, but also access to basic goods such as housing and water by local populations (figure 2.2).

The weakness of the State has limited more effective environmental legislation, as well as public infrastructure, like sanitation and water supply networks. Tax exemptions for international investors have also limited the government's financial capacities for proper urban planning. Private investors have themselves financed and operated certain transport infrastructures linked to tourism, including the Punta Cana Airport, but they have not made similar efforts to build an environmental infrastructure for waste disposal or irrigation. According to Oxfam (2005), the lack of control over sewers and garbage is having a strong impact on aquifers and on the

ocean itself. This puts in danger the coral ecosystem, due to proliferation of algae. Uncontrolled wells and mangrove drainage also diminish the natural contributions of high-quality fresh water into the ocean, which is the basis for coral growth. Paradoxically, in the end this will have a big impact on the quality of the beaches where the hotels are situated.

International development actors like Oxfam and UNDP advocate for greater social responsibility from hotel companies. Thus far, however, no local civil society organisation has addressed any relevant demand in this respect.

Providing financial services to the base of the pyramid in Colombia[16]

Kandeo is a private equity fund based in Mexico whose investment strategy is focused exclusively on companies that offer financial services to the base of the pyramid. Recently, it has set up a fund in Colombia —Kandeo 1 Colombia— leveraging USD 126 million from institutional investors, mainly Colombian pension funds and insurance companies. The company not only administers the fund, but also takes an active role in the operational execution of its investments by assigning a fully dedicated manager to the acquired company. This ensures interaction and support between the investing company and the acquired company.

Figure 2.3. Development effects from an online factoring company in Colombia

One of Kandeo's investments in Colombia is a factoring company providing cash flow for small and medium enterprise (SME) operations by means of electronic factoring. This is a market niche not covered by the biggest banks in the country. The financial success of the factoring company is based on its own risk assessment methods for client companies' portfolios, supported by specific IT solutions. This makes it possible to serve many small invoice-discounting operations of small businesses which lack access to credit.

This investment, as well as other businesses supported by this fund (like microfinance companies), contributes mainly to better provision of goods and services through product innovation (figure 2.3). In this case, innovation is not based on the discovery of a new product, but rather its adaptation to a specific market. Because the product is strategic for broader business development, and given that its

[16] Full case study in Olivié *et al.* (2012).

target population is excluded from traditional bank facilities, the contribution is especially relevant in terms of development.

In fact, this approach is perfectly aligned with the main objectives of the Colombian National Development Plan (DNP, 2011), which considers access to financial services and development of capital markets, the keys to increasing competitiveness and productivity. This, together with innovation and support to growth, define the strategy for sustainable growth and competitiveness. In fact, several multilateral and bilateral donor agencies operating in Colombia have made financial investments in private equity funds.[17]

Productive linkages in the car industry in Sao Paolo, Brazil[18]

Industrial policies in Brazil aim to promote structural change by developing specific sectors of greater technological content and higher productivity. The car industry is one of those sectors and, undoubtedly, the most important instrument of this policy is the Brazilian Development Bank (BNDES, after its name in Portuguese). BNDES is a public entity that has become the main instrument for the long-term financing of the Brazilian economy. With greater assets than the IDB, and in a context of scarce long-term financing, its eligibility criteria shape Brazil's economic structure in accordance with the federal government's guidelines.

In the state of São Paolo, the main hub of the car industry, the most visible foreign investments arrived in the 1950s and 1960s, when companies like General Motors and Ford set up their plants. However, investments in the car subsidiary industry arrived during the 1990s, when global sourcing became a threat for local companies due to their lower competitiveness. The local industry was reorganised with financial and technological support from foreign investors. In general terms, foreign investors have supported Brazilian structural change by concentrating on secondary and tertiary sectors, unlike in many developing countries. In the manufacturing sector, FDI is primarily directed at chemicals and motor vehicles. Within the latter, the number and turnover of component manufacturers by foreign investors almost doubled in the 1990s (Laplane and Sarti, 2008).

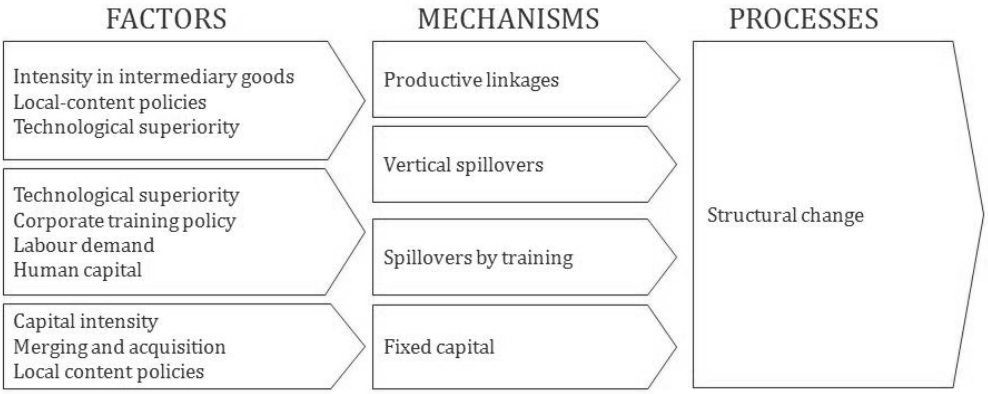
During the 1990s, and often prompted by their own multinational clients, European and North American investors established themselves in Brazil to more efficiently supply the interior market. It should be highlighted that the entry of foreign

[17] Some of these investors with a development mandate are the International Finance Corporation (IFC), the Inter-American Development Bank (IDB), the Corporación Andina de Fomento (CAF), Spanish Cooperation Agency (AECID).

[18] See full case study in Pérez (2012).

companies through acquisitions does not ensure gross physical capital formation (as greenfield investments do). However, new investors —often supported by the BNDES— soon enlarged their capacities, and the machine tool sector has grown, thanks to the boost provided by automotive suppliers. These are third-generation linkages that also include business-to-business service companies including areas such as marketing, finance and law (figure 2.4).

Figure 2.4. Contribution to structural change from the car industry in Sao Paolo, Brazil



The BNDES capital goods programme has financed in favourable conditions the acquisition of capital goods used to enlarge the car industry capacities. Furthermore, the vehicles themselves –the end product of the supply chain– are purchased by Brazilian companies with funding from the FINAME programme. This includes cars, trucks and buses. These credit facilities are only available if the manufacturers can guarantee a local content of over 60%. Of course, when the BNDES funds are requested for new investors' business plans, they must commit to acquiring local inputs in line with the bank's estimation of the local economy's capacities.

Such productive linkages have contributed to structural change by doubling the turnover of the subsidiary car industry and increasing its share of GDP from 2% in the mid-1990s to 3% in 2005. FDI may have also favoured technological spillovers in two ways. The first is by reducing the technological gap between the subsidiaries of multinational groups and Brazilian branches by replicating best practices at an international level through training programs. The second is by disseminating knowledge and techniques through employee rotation and by raising standards to suppliers.

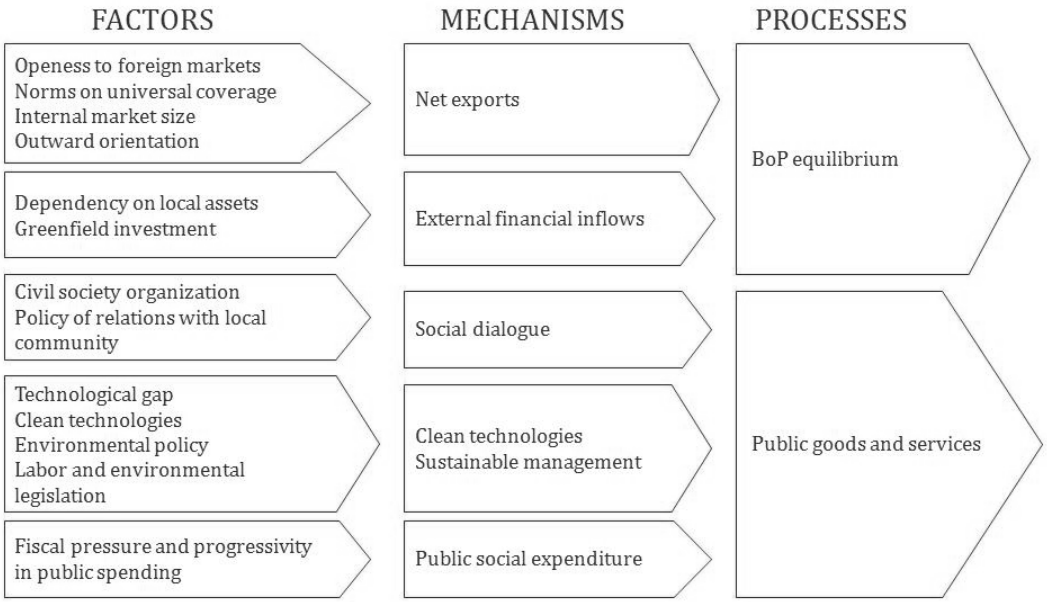
A gas field in Campo Margarita, Bolivia: an increased contribution to

development[19]

Gas is this Andean country's main export and, in recent years, it has significantly contributed to turning the current account deficit around. In more general terms, changes in the recent history of Bolivia have drawn attention not only to the role that FDI has in development, but also to the impact of new rules redefining the relationship between host States and transnational corporations. The FDI-development framework contributes to the ongoing analytical assessment of the presence of foreign investment companies and strategic projects in developing countries. In this case, by analyzing Repsol investments in Campo Margarita, Bolivia, the framework shows how contributions to development may be increased by legislative action and social corporate social responsibility (SCR).

Investment in the extractive industries in Bolivia plays a significant role in its balance-of-payments equilibrium. Despite the political rhetoric from leaders of the *Movimiento al Socialismo* (MAS) party, the government continues to express the need to increase FDI inflows in collaboration with transnational companies (TNCs) including Repsol-YPF, Petrobras, PDVSA, Total and British Gas (BG). Repsol-YPF, for example, is currently carrying out an investment plan of USD 1.2 million in the gas field at Campo Margarita.

Figure 2.5. Socio-political factors condition extractive industries' effect on development



[19] See full case study in Macías (2012).

Beyond attracting financial inflows and increasing exports, developing countries expect from extractive activities a contribution to local and global public goods. The impact on the provision of local public goods through government spending occurs primarily through progressive taxation and, in the case of Bolivia, this has resulted in a budget increase for those institutions with access to taxes derived from economic activities involving foreign investment. Taxes from Repsol and other extractive companies contribute to a complex and diverse set of local and national institutions, including police and public universities.

With the large influx of resources from extractive industries, Bolivia has also launched a series of public enterprises in order to ensure basic supplies. There is much debate about the suitability of these companies, since very few are financially sustainable. These initiatives stem from the view that it is legitimate to protect and subsidize the internal market. In this sense, the main measure taken has been to subsidize imported fuel to supply the internal market. In 2004, a government decree set a price band for oil at between USD 24.53 and USD 27.11 per barrel. The top price remains well below the international price of recent years, so the changes in petroleum product prices in Bolivia are disconnected from international markets. Bolivia produces natural gas, but little oil. Gasoline and diesel are the main imports, up from USD 650 million in 2011. At the end of 2010, a presidential decree eliminated, without advance notice, subsidies on gasoline, thus avoiding a cost that would have exceeded USD 350 million in that year. Gasoline and diesel prices rose by 73% and 82%, respectively, in a single day, causing considerable social ferment. The so-called *gasolinazo* was finally overturned, representing a major political defeat for Morales. The financial problem, however, persists.

According to our analytical framework (section 1), other mechanisms that may be contributing to the availability of public goods include social dialogue, good management of natural resources, and the uptake of clean technologies. Investment projects in Bolivia require not only environmental permits, but also the consensus of the community. Even governmental initiatives face community resistance and can be blocked for years because of social contestation (for instance, a highway of strategic relevance for exports, connecting the country with Brazil). Extractive projects can also be controversial because of the social and environmental impact of their activities, and TNCs in Bolivia must seek consensus with civil society organizations. The environmental policy of Repsol-YPF in Margarita, for example, has turned out to be more restrictive than national legislation dictates.

In the mid-1990s, conflicts arose with Guaraní communities near Margarita and Huacaya. Communities organized into the Guaraní People of Itika Guasu Assembly (or APG-IG, after its name in *Guaraní* and Spanish) began a process of meetings and discussions to analyze their main problems, prioritizing issues related to water, health, and lack of electricity. Regarding water, the problem was related to level reductions in the local stream, diminished by greater industrial use, affecting game and livestock. With regard to inadequate electricity infrastructure, the paradox was

in having to resort to diesel instead of gas for electrification, as Repsol-YPF is under legal obligation to transfer its entire production to YPF.

In 2010, Repsol-YPF decided to implement a new policy on community relations, developing internal rules involving the formalization of relations with APG-IG. This commitment is part of its policy of SCR, meeting the requirements of ISO 26000, a quality standard on social responsibility. This also applies to any of the subcontractors to operate and expand the fields. The most remarkable result was the signing of the Itika Guasu Investment Fund between the communities and the company, amounting to USD 14.8 million over 10 years. This fund will be invested by APG-IG through the Bank of Brazil; the return will be invested in health, education and housing projects, as well as other projects related to alternative economic activities like handicrafts. Some of the initiatives covered by the agreement put the communities in direct contact with the company as it considers proposals such as an on-site cooperative laundry service (currently performed externally) which could be undertaken by communities financed by the fund. This fund is a pioneering initiative in terms of its content and magnitude throughout Latin America, and it may be of great help to Repsol in reversing the negative image derived from previous conflicts.

The degree of community organization seems to have been a key factor in achieving these agreements. In the negotiation process, the communities were assisted by the international NGO Equipo Nizkor, while Repsol (at the corporate level) collaborated with Intermon Oxfam to develop its policy on community relations.

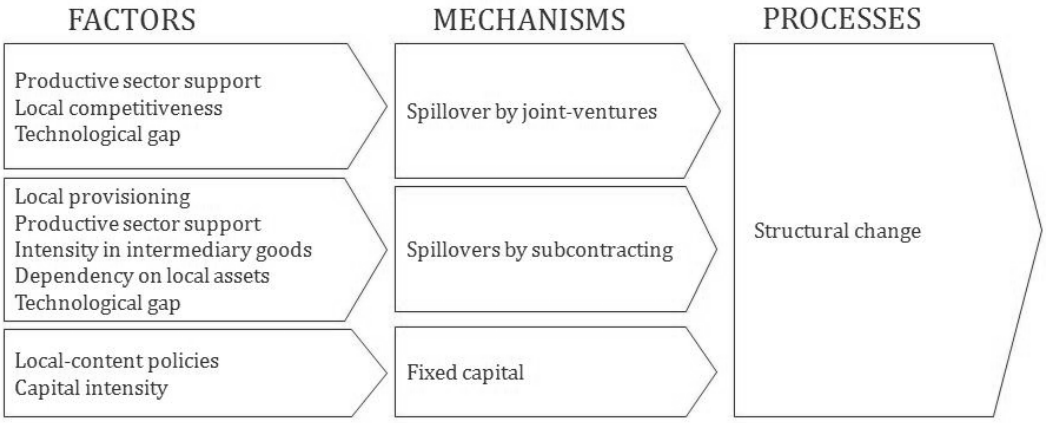
Public-private cooperation and technology transfers in the oil sector in Brazil[20]

While the previous case study in Bolivia shows how extractive industries may impact development through the balance-of-payments equilibrium and increased contribution to public goods, in Brazil the government sees FDI in its extractive sector as an opportunity for structural change. Its aim is to develop a cluster of gas and oil technologies by supporting research and development activities its supply chain.

Brazil's national oil company, Petrobras, lost its monopoly in the sector in 1997 through Law 9487/1997, which established a system of concessions and gave entry to foreign companies. This was considered a measure not only consistent with the liberal framework for foreign investment, but also conducive to the sector's development, as it would be able to improve its performance with additional financial and technological resources from foreign companies such as Exxon, Shell, Repsol or Sinopec. Brazil has become the second-largest oil producer in Latin America thanks in part to contributions from these companies.

[20] See full case study in Pérez (2012).

Figure 2.6. Can extractive industries also contribute to structural change?



However, according to Petrobras sources, technological spillovers have historically been the result of the sector being dominated by a company not under foreign control. When the public company Petrobras was founded in the 1950s, all refineries and facilities were built and equipped with foreign technology. Ever since then, the company has promoted research and development (R&D) to gradually reduce the gap between its technological capabilities and those of foreign companies. As soon as a nascent capital goods industry started to emerge, it received purchase orders from the national company, acquired oil-related foreign technology, and adapted the technology to its needs. Today, Brazilian authorities are aware that the oil companies' large volume of purchases and technological requirements enable their suppliers to gain competitiveness in domestic and international markets. Inspired by the Norwegian model, they encourage vertical spillovers, favouring the use of local suppliers in the higher value-added sectors.

In the new competitive framework, the government's strategies are carried out in close cooperation with Petrobras; something possible given its majority control in the company. But such strategies are also implemented when the operator is a foreign company, since the awarding of an oil well contract in a bidding round is decided not only in terms of price, but also in terms of political criteria, among which are exploration commitments and local content.

Aware of the complexity of procurement in the oil sector, the Brazilian government has seen successive bidding rounds as a process of technological appropriation — first by assessing voluntary reports on technology transfer and local content, then by imposing certain quotas for each type of purchase based on the estimated capacities of the national economy. This practice has become especially relevant after the discovery of the Pre-Salt.

The Pre-Salt is a geological layer on the ocean bed, beneath two kilometres of salt. The discovery, estimated at 80,000 million barrels of crude, is both an opportunity to

turn the country into one of the largest exporters of oil and a technological and logistical challenge, since the distance and depth of the deposits makes extraction very complex. To reach these deposits, it is sometimes necessary to go through two kilometres of ocean, one kilometre of post-rock salt, and a final layer of salt up to 2,000 meters deep, all at an off-coast distance of 150 kilometres.

Far from relaxing the conditions of local content to address this challenge, Brazil has committed itself to increasing its strategic control of the site with the goal of furthering technological spillovers. Indeed, the new regulatory framework (Law 22/12/2010) establishes a system of production share in the Pre-Salt oil field and other strategic sites. As a result, Petrobras maintains 30% of any operation awarded to another company and can compete for any contract in its own right. Moreover, a newly created public company, Pre-Sal Oil SA (PPSA), reserves half the votes at the operational committee for every extractive project, meaning that regardless of which companies participate in the operations, they are always under public control. In addition, a capital injection in Petrobras increased public shareholder interest in the company from 40% to 47%.

According to experts, the Pre-Salt challenge can be faced only by involving a certain number of foreign companies and fostering competitive innovation in oil extraction and its subsidiary industries. In order to combine foreign contributions to innovation and ensure local ownership, the government is favouring joint-ventures involving Brazilian academic partners (FGV, 2010). In this regard, by means of Petrobras, it has set up a network of Brazilian universities and put in place an oil technology park at Ilha do Fundao, in Rio de Janeiro. Petrobras has installed an R&D centre next to the Federal University of Rio de Janeiro's technology campus. Suppliers aiming to bid in R&D projects linked to Pre-Salt are progressively establishing themselves there. Several key foreign players, such as Schlumberger, Baker Hughes and Halliburton, have already joined the park and the related academic cooperation networks.

3. Private sector development and international cooperation. Where do we stand?

As shown in the two previous sections, there are a series of elements that determine the number, variety and sign of the effects of local and foreign investment on developing economies and societies. Moreover, some of these elements are influenced –or can be influenced– by policies: environment, education, infrastructure, to name a few. Finally, these policies can be affected by different stakeholders: central and decentralised domestic administrations, foreign and local companies, private sector associations, political parties, civil society organisations, international donors. Therefore, international development cooperation can (and does) influence investment, whether foreign or local, in developing countries; this has been called private sector development (PSD) in the jargon of international

cooperation. In practice, PSD may consist in very different interventions: improving access to finance, financing key infrastructures, providing financial and technical support to public administrations in a productive sector, adapting regulatory frameworks to entrepreneurs' needs, introducing clean technologies and green products, etc. Most of them are usually focused on local investment, but in recent years donors have also partnered with companies based in their own countries. This way, they have addressed certain global challenges, like access to vaccines, or transparency in the extractive industries, in collaboration with relevant multinational companies.

Reporting standards on aid, and more specifically the Creditor Reporting System (CRS) of the OECD Development Assistance Committee (DAC), have not foreseen a specific field to show whether or not a donor commitment is addressed to support or collaborate with private actors, making it difficult to provide a rigorous quantification and breakdown for PSD activities. As private companies become increasingly important in development cooperation, donors themselves try to quantify these types of interventions, but they do so following very different criteria (Kindornay and Fraser-Reilly, 2013).

Despite these limitations, DAC statistics offer much information that can be explored in approaching PSD. Some sector codes –like business services– and a very specific type of flow and channel –equity investment and public-private partnerships– obviously refer to activities involving private companies; but these are only a very small portion of the aid committed to private sector development. Also, grants and loans allocated to productive sectors, like agriculture or tourism, are mainly oriented to support private sector activities. The following is an overview of donors' support to private sector development based on a combination of three different features of aid flows included in the DAC data bases: type of flow, channel, and sub-sector. For the purposes of this study, we will consider as 'public aid for private investment' all ODA flows classified as equity investments, or any other flows channelled via PPP, or addressed to certain economic infrastructures (banking and business services) and productive sectors (agriculture, industry, fishing, tourism, mining, construction).

This approach lead us to conclude that donors have dedicated 10% of their aid to supporting private investment during the period 2007-11, which amounts to a yearly average of USD 16 billion, distributed as follows:

Figure 3.1. Public aid for private investment

2007-11 average

Category	Amount[1]	%
Equity Investment	1,537	10%
Banking sector	735	
Other sectors	802	

Public-Private Partnership	619	4%
Economic Infrastructure	4,029	25%
Productive Sectors	9,841	61%
Agriculture	7,360	
Other sectors	2,481	
Total	**16,026[2]**	**100%**

[1] 2007-11 Average ODA commitments, USD million

[2] 10% of overall ODA (USD 153.8 billion)

Source: OECD Stats

Equity Investment

According to the DAC, equity investment comprises direct financing of enterprises in a developing country, which does not imply a lasting interest in the enterprise. This flow is commonly channelled via financial intermediaries, as it requires to be managed more specifically than grants or loans. Also, equity investment ODA is also usually granted by financial institutions partially or totally owned by donor countries, but operating in an autonomous and sometimes uncoordinated way. In the period 2007-11, this type of aid represented 1% of total ODA engagements (figure 3.2).

Figure 3.2. Public aid for private investment: Equity

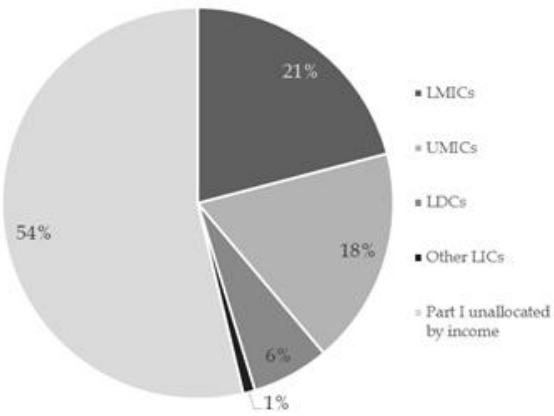
2007-11 Average

USD 1.5 billion | 10% of public aid to private sector | 1% of overall aid

Sector breakdown

Sector	Amount[1]	%
Economic Services		
Banking & Financial Services	731	51%
Business & Other Services	104	8%
Productive Sectors		
Industry	212	11%
Agriculture	113	6%
Other		
Energy	121	8%
Unallocated / Unspecified	194	13%
Social Infrastructure & Services	31	2%
Communications	31	2%
Total	1.537	100%

Distibution by Income Group



Top 5 Recipients

Recipient	Amount[1]	%
Africa, regional	183	13%
India	162	11%
America, regional	101	7%
Asia, regional	100	6%
China	86	5%

Top 5 Donors

Donor	Amount[1]	%
CDC (UK)	522	34%
DEG (GER)	395	26%
MFA (ESP)	192	12%
NORFUND (NOR)	189	12%
MFA (SWE)	50	3%

[1] ODA commitments, USD millions

Source: OECD Stats

More than half of ODA-funded equity operations were addressed to the financial and banking sector, according to the DAC. This often refers to intermediary companies rather than their final destination, which is not precisely defined prior to the engagement, and may reflect a lack of clarity in the strategic orientation of these operations (Kwakkembos, 2012). From a geographical standpoint, the target of these

funds is also very wide. The majority of them have a regional scope and cannot be allocated to a specific income category of countries.
United Kingdom, Germany and Spain appear here as main investors in equity funds, but these figures are limited to ODA-funded investments: They do not include other public resources than can be deployed under development cooperation strategies but are not accounted as ODA, for various reasons. Equity operations here amount to a yearly average of USD 1.5 billion, and refer to only 11 development finance institutions of the 33 in the European Development Finance Association, whose annual report informs of yearly investments of USD 40 billion[21]. Also, when researching the aid channelled through multilateral institutions in all forms, it becomes obvious that only a small portion of these entities' support to the private sector is accounted for: while the IDB reported investments in 2011 of USD 10 billion, only 267 were included in DAC statistics.

[21] Out of 33 entities in the European Development Finance Association, the following have reported: OeEB, MFA (DEN), FF, BMZ, DEG, JICA, NORFUND, MFA (ESP), MFA (SWE), Seco, and CDC.

Public-Private Partnership (PPP)

Public-Private Partnerships are specified in OECD statistics when aid is channelled through intermediaries formally established as a PPP. 1,778 initiatives were allocated under this channel between 2007 and 2011, amounting only 0.4% of ODA commitments. However, donors partnering with the private sector are probably consuming higher resources and are reported under other channels like multilateral organizations (figure 3.3).

Figure 3.3. Public aid for private investment: Public-Private Partnership

2007-11 Average

USD 694 million | 4% of public aid to private sector | 0.4% of overall aid

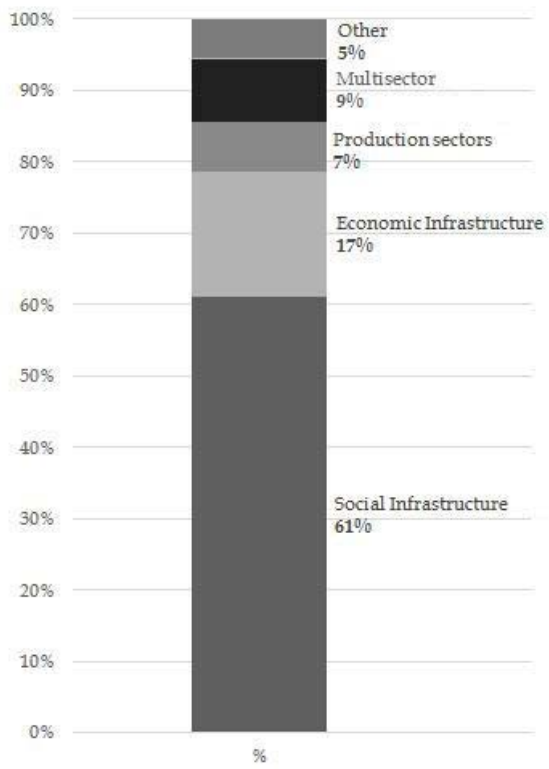
Main Projects

- International drug purchase facility (USD 192 million)
- International Union for the Conservation of Nature (USD 54 million)
- International AIDS Vaccine Initiative (USD 52 million)
- International Partnership on Microbicides (USD 20 million)
- Global Water Partnership (USD 15 million)
- Global Climate Partnership Fund (USD 10 million)
- Global Energy Efficiency and Renewable Energy Fund (USD 10 million)
- Microfinance Enhancement Facility (USD 9 million)

Top 5 Recipients

Recipient	Amount[1]	%
Haiti	25	4%
Afghanistan	19	3%
Africa, regional	19	3%
Philippines	8	1%
South of Sahara, regional	8	1%

PPP by Macrosector



As per the sector breakdown in the previous figure, PPPs seem to be an adequate channel for engaging with the private sector in infrastructure and in social sectors. Some of these are global initiatives well known for their innovative approach to

development challenges, such as the International Drug Purchase Facility or the Global Climate Partnership Fund.

Aid addressed to financial and business services

One quarter of the aid analysed in this study are grants and loans allocated under economic infrastructure and services by the DAC and addressed to two specific subsectors: business services and banking and financial services. These are considered key sectors for private sector development, as they may indirectly contribute to any productive activity.

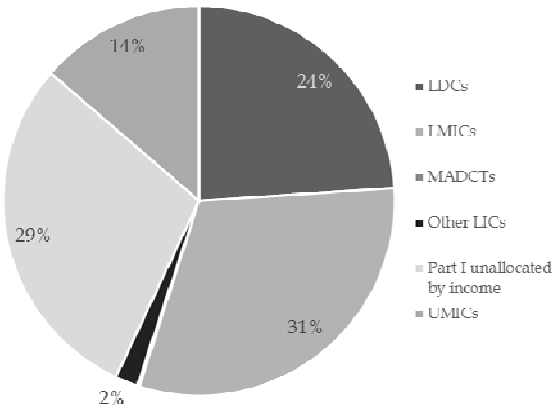
Figure 3.4. Public aid for private investment: Financial & Business Services
2007-11 Average

USD 4 billion | 25% of public aid to private sector | 2.5% of overall aid

Sector breakdown

Sector	Amount[1]	%
Banking & Financial	2.130	53%
Business & Other	1.899	47%
Total	**4,029**	**100%**

Economic Services by Income Group



Top 5 Recipients

Recipient	Amount[1]	%
Pakistan	188	5%
Afghanistan	147	4%
India	139	3%
Africa, regional	139	3%
Bangladesh	130	3%

ODA commitments, USD millions

Top 5 Donors

Donor	Amount[1]	%
Germany	733	18%
United States	718	18%
Netherlands	319	8%
EU Institutions	165	4%
France	156	4%

Source: OECD Stats

Germany and the United States have been the most active donors in this field, each providing 18% of this aid between 2007 and 2011. As explained in the equity investment section, similar interventions by multilateral organizations specialized in these sectors, such as development banks, are not reported here, as most of their activities do not account as ODA flows.

Aid addressed to productive sectors

The main portion of donors' support to private investment in developing countries are, according to DAC statistics, grants and loans oriented to productive sectors like agriculture, industry, fishing, mining, construction and tourism. This type of aid consists of programs providing support to companies either directly or indirectly, by means of public infrastructures and institutions specifically devoted to a productive sector. The agriculture sector, for example, received between 2007 and 2011 some 4.7% of the overall ODA commitments, representing 47% of what can be considered public aid for private investment. This amount includes direct company support (i.e. support to agricultural co-operatives), infrastructure development (improvement of water resources), and institutional support (i.e. agrarian reform).

Figure 3.5 Productive Sectors Breakdown

2007-11 Average

USD 9.8 billion | 61% of public aid to private sector | 6.1% of overall aid

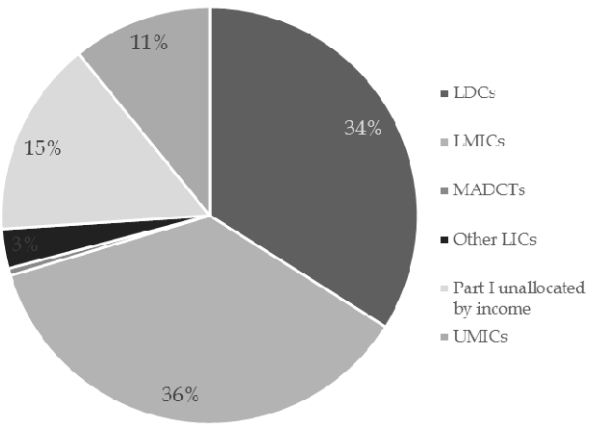
Sector breakdown

Sector	Amount[1]	%
Agriculture	7.360	75%
Fishing	416	4%
Industry	1.491	15%
Mineral Resources & Mining	412	4%
Tourism	110	1%
Construction	52	1%
Total	**9,841**	**100%**

[1] ODA commitments, USD millions

Source: OECD Stats

Productive Sectors by Income Group



Top 5 Donors

Donor	Amount[1]	%
United States	1.684	18%
EU Institutions	1.194	12%
Japan	992	10%
France	588	6%
Germany	349	4%

The need of an ODA+ reporting system

In conclusion, as per the information available from DAC statistics, donors' support to private activities in developing countries constitutes only a small share of overall ODA (10%). It mainly takes the form of grants and loans, which are usually oriented to productive sectors like agriculture (50% of public aid for private investment) and industry (15% of total ODA), or to the financial system (23%). These programs do not always consist of direct support to companies, but can also be addressed to public infrastructure and to institutions at sector scale. Only a small portion of aid is invested in partnering with (4%) and financing private companies directly (10%). However, the difficulties in gathering all these figures (and their gaps) from the reports of relevant international actors in this field, like DFIs and development banks, indicate that the official reporting system is not fit to report on the public aid supporting, complementing, and catalysing private investment. The DAC accounting rules, which are meant to rigorously measure donors' efforts in giving concessional aid to developing countries, do not respond to the reporting needs of an international cooperation system aiming to go beyond aid and promoting a greater involvement by the private sector in development strategies. This problem has in part been noted by the DAC Working Party on Development Finance Statistics DAC (OECD, 2013).

4. Case studies on PSD: the United Kingdom and the Inter-American Development Bank

Regardless of statistical limitations, the previous section attempted to quantify ODA flows addressed to private sector development, and to break this down into the most significant aid modalities in terms of real expenditure. In the current section, in-depth analysis of PSD activities by two selected donors will allow us to better understand the strategies behind every aid modality, and to assess their effectiveness further in this document. Cases were selected according to the following criteria. First, the selection had to include a bilateral and a multilateral agency, so that ODA accounting criteria would not limit the scope of aid modalities supporting PSD. Secondly, selected donors must have shown an active role in promoting investment from a development approach. This entailed a certain experience in this field and an institutional vision on the role of private sector in development; otherwise, drawing strategic lessons would have been very difficult. Finally, their operational and strategic information had to be accessible.

The second or 'active role' criterion was the most relevant. Although ODA statistics for the period 2007-11 showed that 28 donor countries and 93 multilateral channels had been involved in what we have called public aid for private investment, many bilateral donors have not articulated a clear strategy for specifically engaging the private sector. This makes it difficult to assess how these donors are engaging and supporting private sector (Kindornay and Fraser-Reilly, 2013). However, as explained in the paragraphs that follow, this is not the case with the United Kingdom, which is reshaping its aid departments to "understand the private sector"; nor with the IDB, whose original mandate consists in fostering PSD.

Given the size and complexity of the IDB group, and the necessity of this study to provide precise conclusions on PSD activities, assessment of the overall group has been complemented with a detailed analysis of its portfolio in a single country, framed under a single strategy paper. The selected country was Ecuador[22].

4.1. The DFID portfolio

The Department For International Development (DFID) is the ministerial department leading the United Kingdom's official development cooperation and managing most of its aid. Focused on poverty alleviation, its mission contains three major goals: "ending the need for aid by creating jobs, unlocking the potential of girls and women, and helping to save lives in humanitarian emergencies" (DFID, 2012). Wealth creation in poor countries is therefore one of its main priorities and the private sector is considered a strategic partner, as it "has at its disposal the right tools

[22] This case study was based on the analysis of IDB and UK institutional documents available on the internet, as well as interviews with their staff in London (United Kingdom), Washington DC (US), and Quito (EC).

to deliver and is equipped to support a vibrant, salient and growing business sector in the poorest countries".

DFID staff considers their expertise to be working with the public and non-profit sectors, but they also have an increasing interest in how to engage with the private business sector to foster inclusive growth and poverty reduction. In 2010, the then-administration decided to "recast DFID as a government department that understands the private sector". In 2011, a policy paper on how to work with and on the private sector was released, and a specific department was set up. More recently, the new administration has sent a clear message in order to reinforce links and partnerships with companies. Private sector activities are actually small in comparison to other sectors but they are expected to double in the next programming cycle.

The private sector department is not the only institution working on private sector development in DFID. Its 28 field offices have their own wealth creation projects which are designed and managed autonomously. Other central departments, like the Climate or the Health Department, also fund and partner with businesses. Finally, the DFID-owned Development Finance Institution, CDC, has its own budget completely devoted to supporting the growth of SMEs in partner countries via equity investment.

Following the definition of public aid for private investment outlined in the previous section (section 3), we can state that the United Kingdom's support to the private sector is being channelled through the following tools.

Figure 4.1. UK Public aid for private investment

2007-11 Average

Category	Amount[1]	%
Equity Investment	522	57%
Banking Sectors	*362*	*39%*
Public-Private Partnership	70	8%
Economic Infrastructure	139	15%
Banking & Financial Services	*96*	*10%*
Business & Other Services	*43*	*5%*
Productive Sectors	188	20%
Agriculture	*138*	*15%*
Industry	*34*	*4%*
Others	*16*	*2%*
Total	**919[2]**	**100.00%**

[1] ODA commitments, USD millions
[2] 14% of overall United Kingdom ODA (USD 6,6 billion)

Source: OECD Stats

Equity investment

According to DAC records for the period 2007-11, the United Kingdom allocated to equity investment operations an average of USD 522 million annually, representing 5% of its ODA. This aid was managed by CDC and channelled through third parties, mostly fund managers. More than 50% of the equity reported was allocated to the financial sector, and the rest was distributed under productive sectors like agriculture (15%) or industry (4%) and communications (4%).

As explained before, the United Kingdom's equity investments are made by its development finance institution, CDC, by participating in private equity funds managed by third parties, such as the Pan African Housing Fund (which finances construction companies) or the VenturEast Proactive Fund (which makes investments in early- to growth-stage technology businesses in India). Since 2012, under its new strategy, CDC also makes direct investments in specific companies, as it has narrowed its investment focus. Its first direct equity operation was the acquisition of Export Trading Group (ETG), an African agribusiness operating in crop buying, warehousing, distribution and merchandising.

Public-Private Partnerships (PPP)

Only a very small portion of United Kingdom's aid has been channelled through public-private partnerships, according to official aid statistics. Seven initiatives were accounted as PPP, totalling over USD 70 million. The most relevant operations reported under this category were contributions to the International Drug Purchase Facility and the International AIDS Vaccine Initiative.

Regardless of official statistics, public-private partnerships are one more tool for DFID when facing certain global challenges. Its Climate and Environment Department, for instance, according to its operational plan for 2011-15, expects to mobilise USD 610 million of private investment for climate change purposes. The Human Development Department also engages with the private sector when tackling issues like the access to vaccines and drugs by poor people. Some of these partnership programs include innovative financial mechanisms. The International Finance Facility for Immunization, for instance, converts long-term government pledges into immediately available cash resources for immunization programs like GAVI by issuing bonds in the capital markets.

Aid to productive sectors and economic services

Figure 4.1 shows that only a small portion of United Kingdom's aid is about promoting economic growth in close relation with the private sector, addressed mainly to agriculture (15%); banking and financial services (10%); and business

services (5%) and industry (4%). These interventions were grant-funded programs managed by different DFID central departments with different goals, as well as country offices pursuing wealth creation objectives.

The recently created Private Sector Department, specifically oriented to improving the lives of poor people through private sector development, runs several grant programs either incentivising new business models or reshaping existing ones, always with a view to directly create opportunities for the poor. The Business Call to Action (BCtA) program, for instance, fosters partnership opportunities for companies engaging low-income populations across value chains, and the Food Retail Industry Challenge Fund (FRICH) supports African farmers by incentivising food retail companies in Europe to find regular suppliers in Africa. ETI, the Ethical Trading Initiative, focuses on improving labour conditions by collaborating with companies, trade unions, and voluntary organizations.

At the country level, DFID operational plans include wealth creation objectives basically consisting of creating jobs and increasing household incomes. This leads each office to support different proposals from local actors, depending on the context. In Ethiopia, for example, considering that "economic growth is desperately needed to create jobs and raise incomes in what is one of the ten poorest countries in the world, where only 1 in 15 working age adults has a formal job", DFID's country operational plan expects to contribute to a 20% increase in the income of 275,000 households. The country office has set up the Private Enterprise Programme Ethiopia (PEPE), supports micro-finance institutions and banks, and offers financial products for micro and SMEs, small and medium enterprises in selected priority industries, like those related to green growth.

4.2. The IDB portfolio

The Inter-American Development Bank Group defines itself as a 'regular bank in many ways'[23]. Actually, it borrows in international markets and, through several channels, lends at market-like conditions. Still, it is a development bank –it also lends to developing countries at below market conditions, provides grants and technical assistance, and does research– and an international organisation (composed by 48 member countries, including 26 in Latin America and the Caribbean). The Group is composed of the Inter-American Investment Corporation (IIC), the Multilateral Investment Fund (MIF), and the Bank itself.

The IDB's priorities are reducing poverty and inequality by fostering development through the private sector. In order to do so, it funds both the private –through non-sovereign-guaranteed operations (NSGOs)– and the public sector –sovereign-guaranteed operations (SGOs)–. According to DAC statistics, this includes different equity operations, and mainly grants and loans addressed to different economic services and productive sectors:

[23] http://www.iadb.org/en/about-us/about-the-inter-american-development-bank,5995.html

Figure 4.2. ODA channeled via IDB to private sector
2007-11 Average

Category	Amount[1]	%
Equity Investment	11	22%
Business Services	11	22%
Economic Infrastructure	23	44%
Productive Sectors	18	34%
Total	**53**	**100%**

[1] ODA commitments, USD millions

Source: OECD Stats

However, as explained in section 3, not all funds oriented to development goals meet ODA accounting criteria and are registered under official aid statistics. According to IDB's own sources, its overall support to the private sector exceeded USD 2 billion per year, while only USD 53 million were financed by ODA and therefore recorded at the DAC.

The following is a description of IDB's support to PSD based on its own figures and reports.

Multiple institutions, multiple goals

According to the draft Private Sector Development Strategy (PSDS)[24], the Bank support to this sector is both direct and indirect, and mostly delivered under the form of loans and guarantees. In the past six years, IDB's support for Private Sector Development (PSD) –that is, SGOs– and Private Sector Operations (PSO) –non-SGOs– reached USD 13.4 billion, representing 36.1% of overall Bank lending. In addition, the Bank provided technical assistance to support non-SGO activities amounting to USD 24.8 million, or 4.1% of overall non-financial assistance during the period. This means that 40% of the Bank's efforts are devoted to promoting the private sector.

[24] http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=35573660

Figure 4.3 PSD and PSO lending as Percentage of Total IDB Approvals

2004-11 Average	
Category	**%**
Private sector operations lending	15%
Private sector development	17%
Direct to private beneficiaries	*12%*
Enabling enviroment	*5%*
Total	**32%[1]**

[1] USD 13 billion

Source: IDB

Direct funds for private companies (non-SGOs) are spread through four different IDB institutions, and these are the Structure Corporate Facility (SCF), the Inter-American Investment Corporation (IIC), the Multilateral Investment Facility (MIF), and Opportunities for the Majority (OMJ). Every IDB branch can be seen as a different modality of investing in private companies, and a simple explanation of the differing focus of these four branches can be taken from the beneficiary companies' size. While the MIF focuses on small and micro businesses and the SCF concentrates on big corporations, the IICC targets SMEs, and OMJ serves the base of the pyramid.

Indirect PSD operations (SGOs) promote development through the private sector by working primarily with governments in areas agreed upon with the national governments. In general, these operations focus on addressing specific market or institutional failures. According to the draft Private Development Sector Strategy (PSDS), this includes legal and regulatory frameworks for (i) promoting the development of local and regional capital markets, (ii) fostering financial inclusion, (iii) attracting private sponsors and investors to address infrastructure needs, (iv) reducing informality and promoting investment climate, and (v) promoting R&D and support innovation – including strengthening intellectual property rights, linking research to specific business opportunities and mitigating specific market failures in the area of innovation, upgrading skills for workers, and fostering firm and cluster productivity. Moreover, the Bank will continue to work on improving infrastructures, giving priority to energy, transportation and water and sanitation.

IDB's portfolio in Ecuador

The comprehensive approach of the IDB to PSD can be better understood by focusing on a single country. The Bank's operations in Ecuador are mostly conducted through SGOs supporting different public projects and programs aligned to the national government priorities. This includes activities in social sectors, like a childhood early development program; or general infrastructures, like roads; or interventions in productive sectors and economic infrastructures, with a clear focus on private companies. Take, for instance, a program supporting coastal artisanal fishing, or a loan covering the public funding for microfinance institutions. These two interventions would be considered PSD measures under the IDB strategy: the first being a PSD measure "enabling environment" and the second a "direct to private beneficiaries" measure.

Moreover, according to our analytical framework and the statistical methodology exposed in section 3, over 12% of IDB's SGOs in Ecuador can be said to be supporting private sector development, through either the factors defining the institutional framework or those related to the economic structure. Under this definition, IDB's activities supporting PSD in Ecuador amount to USD 409 million, nearly 62% of which are conducted through SGOs (figure 4.4).

By means of a non-SGO, the IDB has also given direct support to company projects of differing size and nature, such us the expansion of a Polytechnic University, a private equity fund in Guayaquil, or small franchises of rural pharmacies. These operations were managed by the SCF, the IIC, and the MIF, respectively.

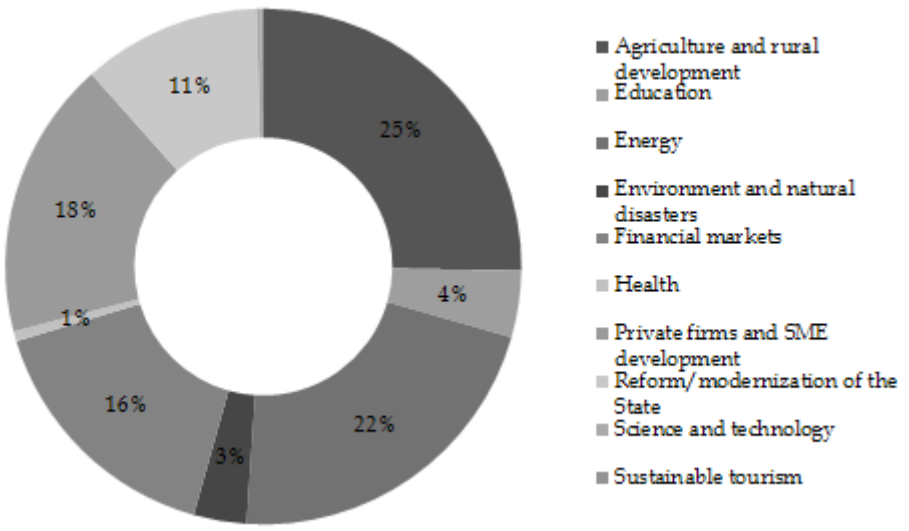
Figure 4.4 IDB's support to private sector development in Ecuador

2007-11 Average		
Operations		**Amount[1]**
SGO	• PSD enabling environment & direct to private sector	253
Non-SGO (PSO)	• MIF, microenterprises	11
	• IIC, SME's	95
	• SCF, big companies	50
Total		**409[2]**

[1] ODA commitments, USD million
[2] 18% of overall Ecuador ODA (USD 2 billion)

Source: OECD Stats

Sector distribution



As shown in the above graph on Ecuador, PSD activities can be channelled through a wide variety of sectors, meaning that traditional sector classifications might be misleading when it comes to analysing the role of the private sector in development cooperation.

4.3. What are the expected results from donor support to the private sector?

DFID: creating opportunities and making markets work for the poor

As stated in the policy paper "The Engine of Development" (DFID, 2012), DFID's mission is about generating opportunities for poor people in developing countries, and this can be done more effectively by working with the private sector. Private sector development would result in better job opportunities and incomes; better access to finance for households and small businesses; and better access to basic goods like healthcare, schooling and basic services.

DFID's support to private sector initiatives either attempt to create economic opportunities for the poor -mainly by delivering jobs- or to address their most basic needs, DFID being an important sponsor of the Markets for the Poor paradigm. Therefore, under the investment-and-development approach, it could be said that PSD activities by DFID pursue an impact on two development processes identified in our analytical framework (section 1): employment, and the provision of goods and services. As a complement, some programs may contribute to public goods, the balance-of-payments equilibrium, or structural change.

It is remarkable that DFID –as per its PSD operational plan– only engages with business and development partners with a view to achieve "identified outcomes", and it has decided not to support "any more general engagements" with the private sector. Such a results-oriented approach would be considered good practice in the international donor community, where there seems to be a lack of "clarity about which private sector is supported and why", and where PSD seems a "catch-all for ad hoc interventions that may or may not be the most effective modality to address particular development issues for poor people" (RAI, 2013).

Aid for private investment oriented to job creation

Wealth creation programs are a good example of DFID aid being oriented to job creation. Every country operational plan contains wealth creation objectives that usually manifest in the creation of jobs and the increase of household incomes. The way to achieve this objective can be, for instance, by supporting self-employment by granting local micro-finance institutions.

Some centralised programs are also oriented to job creation, either directly (the Business Innovation Facility, for example, which funds inclusive business models in certain developing countries) or indirectly (the Business Call to Action program, which engages low-income populations across company value chains; and the FRICH, which supports European food retailers in exploring potential supply markets in Africa.

Before 2011, CDC operations were oriented to develop the private equity industry in underserved markets, in order to favour PSD in general terms. It did not pursue any specific development outcome. After its strategic review –in line with the general DFID commitment to fund exclusively private sector initiatives with specific outcomes– CDC has a new business and its investment focus has been narrowed. It will now concentrate in businesses having a high potential in terms of job creation and located in the poorest countries and regions.

Aid for private investment oriented to provide certain goods and services

When addressing certain global issues (like health) where markets are failing the needs of poor people, some of DFID's programs consist of collaborating with the private sector to "make markets work for the poor". This is the case with the Advanced Market Commitments program, which tries to improve the availability of vaccines and makes them affordable by committing public aid to R&D activities on a performance basis.

Aid for private investment contributing to public goods

The DFID Climate and Environment Department also partners with private companies with a view to facing certain global challenges, looking to leverage private funds for climate change purposes. The Results-based Fund (RbF), for instance, offers grant payments to businesses, which deliver outputs within the low-carbon energy sector. Also notorious is the United Kingdom's leadership in promoting transparency in extractive industries (by means of the EITI initiative, which increases the contribution of private companies to public goods, either locally via taxation or globally via improved environmental accountability).

Different aid focuses: companies vs. institutional and economic environment

The 'Engine of Development' paper by DFID clearly opts for financing and partnering with private actors, and most of the programs analysed in the paper's Annex 2 consist of support to companies, either directly or through intermediaries. In these cases, the donor attempts to produce specific development outcomes by supporting companies of a specific profile. The new CDC strategy, for instance, seeks to invest in job-intense activities, or activities demanding inputs in job-intense sectors. These are the company features ('investment project factors' in the investment-and-development framework) that must be specified by a donor before supporting a private company with intent to pursue a specific goal.

Despite this strategic choice, DFID also influences institutional factors and is particularly active in favouring transparency in particular markets where corruption and lack of governance limit private investment's contribution to development, particularly through public goods and employment. This is the case with initiatives such as CoST, EITI, or ETI.

Based on the investment-and-development framework, the following figure shows both the focus and development of DFID aid addressed to the private sector.

Figure 4.5 DFID's development goals according to the investment-and-development framework

Aid Focus	Development goals: Employment	Goods and services provision	Global and local public goods	Structural change	Balance of payments
Company	CDC AECF	AECF	RbF	BCtA	
Economic structure	PIDG FRICH	PIDG			
Institutional framework	ETI	MeTA	EITI CoST		

AECF	Africa Enterprise Challenge Fund
BCtA	Business Call to Action
CoST	Construction Sector Transparency Initiative
ETI	Ethical Trading Initiative
FRICH	Food Retail Industry Challenge fund
PIDG	Private Infrastructure Development Group
RbF	Result-Based Financing for low carbon energy access

IDB: reducing poverty and inequality by fostering development through the private sector

As explained in the previous sections, the IDB's goals and priorities for SGO in the private sector field (development of capital markets, support to R&D, improving energy and transportation infrastructures, etc.) may impact on different development processes, as defined in our methodological framework, in a number of ways (figure 1.1). First, the Bank is aiming to hinder the institutional framework for improving the provision of goods and services –more specifically financial markets and services–, employment –for instance, upgrading skills for workers– and structural change –e.g. fostering firm and cluster productivity–. The Bank also has the goal of addressing weaknesses in the economic structure by improving infrastructure; something that may impact on the contribution to public goods (by bettering the energy supply and water and sanitation), on the provision of goods and services (through better transportation infrastructure and water supply) and on structural change (by means of a more productive and competitive supply function).

Regarding non-SGOs, different development approaches may be found in every IDB branch. The SCF's final goal is to finance large banks and private sector investments

in nearly all economic sectors in Latin America and the Caribbean[25]. It also supports the development of international trade through the implementation of the IDB's Trade Finance Facilitation Program (TFFP). So, it could be said that, in the case of the SCF, activities and development goals coincide: by supporting companies, development objectives will be systematically achieved. Moreover, by directly supporting companies, the SCF is influencing on one of the three groups of factors identified in section 1 of this report (investment promotion), rather than on the institutional or economic framework (figure 1.1). As already mentioned, there are no specific 'development-processes' goals –as defined in our methodological framework– besides the balance-of-payments equilibrium targeted through the TFFP (figure 4.6).

The IIC's mission is to promote the economic development of its member countries within Latin America and the Caribbean by encouraging the establishment, expansion, and modernization of SMEs. Unlike the SCF, the Corporation does not seem to assume an automatic effect of SME expansion and modernization on economic development. The IIC accords priority to projects that, among other targets, (i) provide incentives for job creation ('employment development process according to our methodological framework); (ii) encourage the use of capital in productive investments (structural change); (iii) help generate foreign exchange earnings and/or savings (balance-of-payments equilibrium)[26]. Moreover, the IIC is committed to development effectiveness by helping companies improve their environmental performance, and through innovation of projects helping to mitigate climate change (therefore contributing to both local and global public goods)[27]. Like the SCF, the IIC promotes PSD through the FDI/IL group of factors (figure 1.1).

Unlike the SCF and the IIC, OMJ also works with local governments and civil society organisations (CSOs), raising the opportunity to target other groups of factors, besides FDI / IL features. However, even in activities focusing on social sectors – health and education, for instance–, OMJ works mostly with private companies[28]. In terms of development-processes goals, OMJ targets structural change (as it seeks to increase productivity), employment (as it aims to create jobs), and the provision of goods and services (by bringing quality goods and services to the 360 million people in Latin America and the Caribbean who are at the base of the pyramid) (figure 4.6)[29].

Lastly, the MIF also supports and encourages PSD but it specifically targets poverty reduction, apart from economic growth30. The way for the MIF to contribute to poverty reduction is by working with low-income households, individuals, communities, and micro-businesses. Therefore, there is no assumption of a spill-over effect to vulnerable groups (through employment, the provision of goods and

[25] http://www.iadb.org/en/about-us/departments/about,1342.html?dept_id=SCF
[26] http://www.iic.org/en/about-us/mission
[27] http://www.iic.org/en/about-us/development-effectiveness
[28] http://www.iadb.org/en/topics/opportunities-for-the-majority/our-products,1466.html
[29] http://www.iadb.org/en/topics/opportunities-for-the-majority/idb-opportunities-for-the-majority-serving-the-base-of-the-pyramid-in-latin-america,1377.html
[30] http://www5.iadb.org/mif/en-us/home/aboutmif.aspx

services, and the contribution to public goods, structural change, or balance-of-payments equilibrium); rather, there is direct work with these groups. Moreover, the MIF puts a strong emphasis on access: it addresses lack of access to basic services (provision of goods and services), to finance, to markets, and to skills, with an emphasis on efficient energy and climate change (global and local public goods).

Figure 4.6 IDB's development goals according to FID/IL-D analytical framework

Aid Focus	Development goals: Employment	Goods and services provision	Global and local public goods	Structural change	Balance of payments
Company	IIC OMJ	OMJ MIF	IIC MIF	IIC OMJ	SCF IIC
Economic structure		SGO-ENV	SGO-ENV	SGO-ENV	
Institutional framework	SGO-ENV	SGO-ENV		SGO-ENV	

IIC	Support to SME-s
MIF	Supports micro-enterprises
OMJ	Serves the base of the pyramid
SCF	Supports big companies
SGO-ENV	Enabling environment to companies via financial intermediaries

As for IDB's portfolio in Ecuador, according to our methodological framework, SGO projects that might be hindering PSD do so by way of improving local economic structure – mainly through bettering the physical infrastructure. In most of these cases, the improvement of physical infrastructure is also meant to contribute to global or local public goods through more sustainable management of natural resources. Moreover, there is one SGO project aimed at improving the national system for rural land information and management. This transparency measure might also contribute to global and local public goods.

SCF projects are directed to the financial sector, therefore giving financial access and providing goods and services, and to education, with a probable indirect effect on employment and structural change. ICC activities promote SMEs both in the financial sector and in different types of productive and sustainable activities: the provision of goods and services (for instance, the support to retailers of basic goods such as flour or chicken), employment, public goods (supporting efficient energy initiatives such as construction of a hydroelectric power station), and the process of structural change (most projects aim at developing higher added-value systems or types of production). Some of the SMEs supported engage in international activity (for instance, Aglomerados Cotopaxi exports 40% of its production to Colombia and Peru). The MIF is probably making a similar contribution to development. Moreover, the provision of goods and services also includes basic social services, such as health,

as in construction of a hospital for low-income communities or support for developing a rural pharmacy franchise.

Figure 4.7. IDB's development goals in Ecuador according to the investment-and-development framework

		Development goals				
		Employment	Goods and services provision	Global and local public goods	Structural change	Balance of payments
Aid Focus	Company	SCF IIC MIF	SCF IIC MIF	IIC MIF	SCF IIC	MIF
	Economic structure			SGO	SGO	
	Institutional framework			SGO		

Is there a trade-off between PSD and poverty alleviation?

There is a debate going on in the development community about the cost of opportunity of PSD. When supporting private sector with ODA, public money may be detracted from other uses with a clear impact on poverty, mainly support to public and non-profit organizations operating in social sectors. The following conclusions, drawn from case studies on DFID and IDB, can be an input to this debate:

- Both DFID and IDB mission statements specifically refer to poverty alleviation, but their portfolio of PSD activities include different types of programs in terms of their potential impact on poverty. Some programs pursue a direct impact on poverty alleviation (i.e. micro-finance programs addressed to poor households), while others contribute to other development goals (i.e. supporting structural change by means of private equity funds). The latter can also be a good choice in terms of poverty alleviation if its impact, although indirect, turns to be broader and more sustainable.
- Private actors are not only development actors in productive sectors. Some DFID health programs are a good example of how to engage with private companies in social sectors.
- In any case, PSD activities must be oriented to specific and traceable development outcomes. The investment-and-development framework (see figure 1.3) can assist donors to define more precisely the expected results of their PSD programs. The framework contains a list of 22 mechanisms which are sequences of events triggered by private investment and having an impact on development processes. Some of them may be directly linked to poverty alleviation strategies (i.e. labour integration), some of them may have an overall impact on economic development (i.e increasing net exports).

4.4. How can public aid catalyse private flows for achieving development goals?

One of the IDB's institutions, the IIC, aims not to be the sole source of funding for any particular enterprise. In fact it seeks to mobilize other sources of funding, and it

attempts to effectively reconcile the interests of corresponding investors. The Corporation does not take part in any transactions for which, in its opinion, sufficient capital could be obtained on adequate terms without its participation. As a consequence, the IIC monitoring system (DIAS) includes indicators relative to additionality criteria. In this context, the IIC should be a catalyst for private sector investments. Examples of specific indicators on how to track this target are (i) that alternative financing (on similar terms, pricing, tenor, currency and time lines) is not available; and (ii) resource mobilization.

The British aid program that pursues a similar catalytic effect is CDC. As a development financial institution, its development outcomes may or may not be precisely defined, but the principles of additionally, catalysis, and sustainability constitute part of its DNA. CDC achieves this by investing in funds at first close, managed by first-time managers in challenging markets. This has a demonstration effect on other investors which might be very relevant in parts of the world facing a shortage of capital. Catalytic effect indicators –such as others' resources mobilized over CDC's resources invested in every operation– make up part of the CDC's business plan.

During 2012, CDC's total mobilization amounted to GBP 252 million and represented 148% of CDC's own resources. This was much diminished from its performance in 2011, when it catalyzed GBP 511 million; the decrease seems a consequence of CDC's new priority for the less-developed markets of Africa and South Asia, where third party investors are less willing to commit capital. CDC and DFID staffs agree that there might be a trade-off between development impact and catalytic effect.

DFID's main concern is direct impact on poverty alleviation, rather than the leveraging of other funds. However, it does pursue certain catalytic effects according to interviews with their staff. The M4P paradigm, for instance, attempts to trigger other investments by moving certain constraints or by reinforcing certain incentives. Interventions are carefully selected and obstacles to competition avoided, in order to ensure sustainability (i.e. continuity of development outcomes, once the aid stops). Moreover, when supporting financial or micro-financial institutions, they do so in a way that permits other investors to participate. In any case, CDC and DFID programs try to play a pioneering role.

Also remarkable is DFID's support to innovative financial mechanisms, mobilising private sector funds and knowledge towards development goals. This is the logic beneath some of the already mentioned health and environment programs such as: the AMC (Advanced Market Commitments) in the vaccine industry; the IFFIm, converting funding pledges into AAA-rated bonds providing cash to GAVI; IDEAS, an award programme which supports the development of innovative ideas that promote renewable energy and helps to improve energy efficiency and access across the Caribbean; and results-based financing for low carbon energy access (performance grants to businesses delivering pre-specified outputs within the low-carbon off-grid energy sector).

The following criteria can be drawn from UK best practices in order to ensure a

catalytic effect. Some are shared with the EDFI consensus on this issue.

Box 4.1. Criteria for favouring a catalytic development-oriented investment through public aid

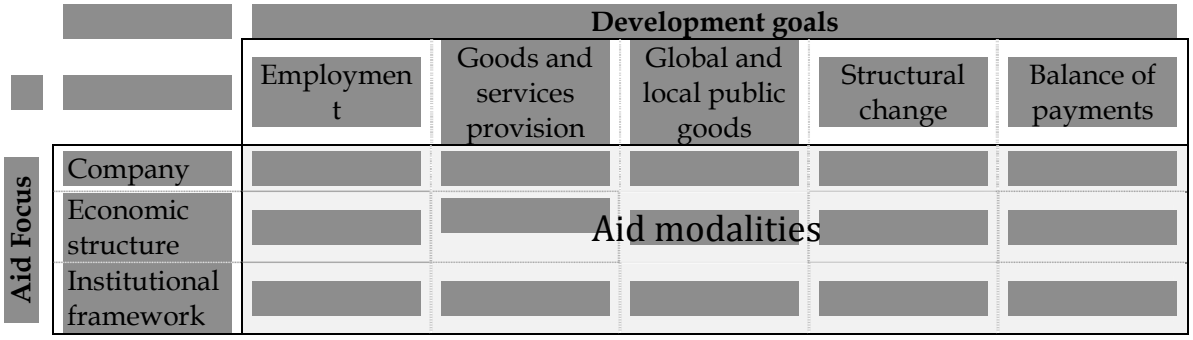
- Additionality. Donors must intervene in those regions and sectors unattended by private initiative. This is a precondition for any catalytic effect.
- Leveraging others' funds: the most evident catalytic effect consists of leveraging other investors' resources as a result of one's investment. (This matches the definition of catalytic effect adopted by DFIs)
- Triggering others' investments: In sector- or country-based interventions, focused on institutional and economic factors, public aid can trigger private investment by removing constraints to businesses.
- Sustainability. When public aid favours profitable businesses, they and their development outcomes persist when aid stops.
- Demonstration effect. Successful pioneer investments can show the path for new investors and multiply development outcomes.

5. Conclusions and recommendations

Public aid for private investment can favour different development outcomes, which can be framed in five development processes: employment, provision of goods and services, contribution to public goods, balance-of-payments equilibrium, and structural change. This can be done by incentivising companies to make certain types of investments, and/or by reshaping the surrounding institutions and economic structure.

Development goals and aid focus therefore determine different modalities of public aid for private investment:

Figure 5.1. Public aid for private investment: modalities



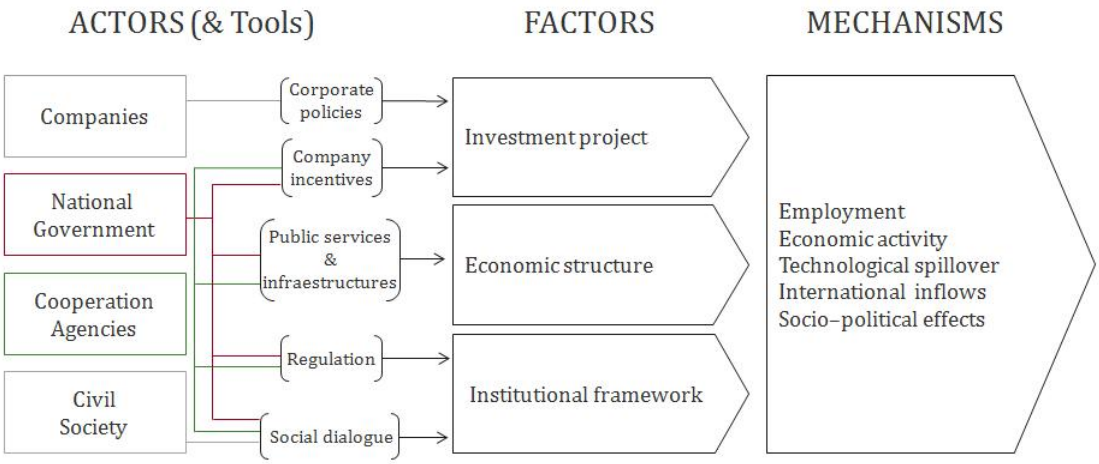
Regarding development goals, it must be said that although several works describe private sector development as a catch-all without a clear proposal for achieving development results, the case studies in section 3 show that a more strategic approach to private sector development is possible. Both donors analysed demonstrate that aid addressed to private sector is a means to an end when facing unemployment and income poverty (i.e. microfinance programs); when contributing to public goods (i.e. performance grants for the low-carbon energy industry); when providing certain goods and services (i.e. R&D incentives in the vaccine industry); or when accelerating structural change (i.e. funding capital-intense activities by SMEs).

The relevance and effectiveness of each aid modality depend on the strategic choices of each actor, but can only be assessed when both aspects are clearly defined: What development outcomes are expected from private companies? Where should cooperation focus on in order to get the best value for public aid? Employment can be improved, for instance, by participating in equity funds focused on job-intense activities, or by funding infrastructures to better connect rural areas with industrial and commercial poles, or by providing technical assistance to the local institutions regulating labour markets.

The answer to the question of aid efficiency may require a sector-by-sector or case-by-case analysis, such as those shown in section 2. Theses analyses are particularly relevant for identifying development bottlenecks that can be removed by public intervention. In some cases, both questions –the why and the how– are addressed in national development strategies, and therefore donors need only to align their strategies to national guidelines. Some other challenges, like those related to climate change or access to medicines, may require the deployment of aid-funded programs at a global scale, and markets need to be analysed globally.

The way that different sets of factors (the institutional framework, the economic structure, and the investment project itself) influence different development outcomes also shows that private sector development is not only about financing private companies. Civil society organizations have been key to improving the environmental performance and fiscal contribution of extractive industries, as shown in section 2, and the donor community is increasing its contribution to transparency and accountability initiatives in different sectors (extractive industries, the construction sector, and the consumer goods industry), showing that strategic partners for private sector development depend (again) on expected development results and the circumstances of each and every sector and country.

Figure 5.2. The investment-and-development framework: actors, factors, and mechanisms



Knowing that (in a post-2015 era) both recipient and donor governments are expected to put into practice the Busan consensus on private sector involvement in development cooperation, the following are some elements to take into account when rethinking public aid as a catalyst for development-oriented investment:

(e) Clear development goals

Donors must engage with the private sector only with a view to achieving identified outcomes. As donors' interest in the private sector increases, criticism by NGOs and some analysts also increase, and the question of the donors' own interest is raised. While it is true that an international consensus exists on the contribution of the private sector to development, these are just general political statements. At a strategic or operational level, precise definition of goals, outcomes, and outputs is required before allocating public aid to this or any other sector. Clarity on the development orientation of these types of activities is also key for ensuring accountability of aid.

(f) Knowledge-based interventions

Although we cannot draw general lessons from the economic literature on FDI and development, section 2 shows how a case-by-case or sector-by-sector analysis of particular investment projects would be very useful for policy-makers, for instance when approaching private companies to join private-public partnerships. Furthermore, analysis of typical investment projects in a specific region or sector may provide information on development that can influence the design of development strategies on a larger scale. As explained in the previous paragraphs, some sectors may require certain incentives for companies (i.e. equity investment for capital-intense activities), and others demand an intervention at country level (i.e. an environmental legislation reform). This can only be known after rigorous analysis.

(g) Alignment to national strategies

A diagnosis of countries' main economic sectors and their contribution to development is usually contained in a national development strategy. This paper also states a national government's agenda for private sector development, which can be influenced by different political values and priorities in every case. Following aid effectiveness principles, donors must align their PSD programs to national development strategies. This also affects local governments, which must adopt national strategies containing clear guidelines for international donors.

(h) Additionality

When private sector contribution to development is possible with the private sector's own resources, there is no need to detract public aid from other purposes. However, additionality of aid in private sector development may consist in interventions by public and civil society actors on the institutional and economic structure conditioning such contribution to development. Also, in direct financial support to private companies, additionally may exist if private companies do not obtain resources on reasonable terms in the financial markets.

(i) Leveraging other resources when possible

In a post-2015 era, the possible catalytic effect of investing public aid in private activities has increased donors' interests in private companies. Once a relevant donor, such as a multilateral bank or a bilateral DFI, has invested in a specific company or in a private equity fund, other investors will likely join the project and increase the effects of the donor's initial investment. However, as explained in section 4, unless other investors also have a development mandate, this can only happen under certain risk-and-profit conditions, which are not always met by business involving the poorest communities and therefore having a greater development impact. Leveraging other resources can therefore be a second-level objective, but it should not reduce the pro-poor orientation of aid.

(j) Favouring other catalytic effects

A catalytic effect may be obtained in more ways than simply leveraging others' resources. Removing certain constraints to business development by building infrastructures, or adapting regulation to 'pro-development' investors' needs, can trigger private investment in a sustainable way. Also, financing inclusive businesses seeking a demonstration effect may not leverage additional resources in the investment phase, but it may mobilise others' resources when the experience winds up successfully.

(j) ODA+ accounting system

On a project basis, monitoring and evaluating PSD programs may be improved by

making a clearer definition of goals, beginning with the identification and formulation phase. However, to keep track of PSD at a global scale, the official reporting system run by the OECD Development Assistance Committee needs two specific adaptations.

First, reporting on aid flows should include a procedure to inform whether or not a commitment is addressed to PSD, regardless of its sector, channel, and type of flow codes. Aid-funded programs based on collaboration with private actors do not always consist in private equity and are not necessarily channelled via private intermediaries, nor are they uniquely addressed to productive sectors. For instance, a program incentivising companies to produce affordable vaccines may be recorded in the OECD statistics as a grant given to a public or a non-profit institution and allocated to the health sector, within the social services macro-sector.

Secondly, all public international flows from development agencies to PSD activities should be recorded in OECD statistics. This would include development banks whose portfolio is funded mainly by resources obtained in the capital markets, and DFI activities that do not have incentives to report investments as ODA. Currently, the DAC accounting rules are meant to rigorously measure rich countries' solidarity (resources form public budgets devoted to development goals in concessional terms), but they do not respond to the reporting needs of an international cooperation system aiming to go beyond aid, promoting greater involvement of the private sector in development strategies.

Both adaptations would make possible to provide a structured analysis of aid as a catalyst for other flows like FDI, and would be a good basis for assessing the contribution of development finance to poverty eradication. This would be a relevant input for the on-going debates on the use of blending instruments or the achievement of MDGs through market-based interventions.

Annex 1: Quantifying donors' support to private sector

Quantifying donor resources addressed to PSD is difficult, as the official reporting system does not record many flows not accounted as ODA, mainly loans, guarantees, and equity investments from DFI and development banks. Further, as explained in section 3, reporting standards on aid, and more specifically the Creditor Reporting System of the OECD Development Assistance Committee, does not include a "tick box" to show whether or not a donor commitment is framed under a PSD strategy or not. Other relevant goals of the international development consensus do have a tick mark of this type and can easily be tracked at the OECD stats.

Figure A.1.1 Traceable development goals at the OECD Stats

Feature	Description
Gender	Gender equality incorporation Women in Development (WID) marker
Environment	Project intended to benefit the environment
Trade	Trade Development marker
Pdgg	Identifies projects which are intended to enhance elements of participatory development, democratization, good governance, and the respect for human rights
FTC	Indicates whether project is free-standing technical cooperation
PBA	Programme-based approaches
investmentproject	Investment Project
assocfinance	Indicates whether record has associated financing
biodiversity	Indicates if flow is intended to promote biodiversity
climateMitigation	Climate Mitigation Project
climateAdaptation	Climate Adaptation Project
desertification	Indicates whether flow is intended to address desertification

Source: OECD Stats

This limitation in OECD data bases makes an accurate quantification of ODA budgets for PSD impossible. However, official aid statistics contain five qualitative fields that can be used to approach this aid modality, and even break it down into its main categories.

Figure A.1.2 ODA non-geographic features recorded by the DAC

Feature	Content
Flow	Equity Investment, ODA Loans, ODA Grants
Aid Type	Budget Support, Core Contribution, Administrative Cost…
Purpose	Water Resources, Agricultural Research, Business Support…
Sector	Education, Health, Banking, Energy, Construction…
Channel	Public Sector, PPP, Multilateral Organisations, International NGOs….

Source: OECD Stats

The quantitative analysis contained in section 3 is on a combination of three different features of aid flows included in the DAC data bases: type of flow, channel, and sub-sector.

Of the three types of flow listed above, one obviously refers to private actors: equity investments. This is precisely defined by the DAC as direct financing of enterprises in a developing country, which does not (as opposed to direct investment) imply a lasting interest in the enterprise.

Figure A.1.3 ODA features: type of flows

Equity Investment	
ODA Loans	
ODA Grants	

Source: OECD Stats

A very specific type of channel –PPP– also refers to private companies, although the term PPP may be subject to interpretations by donors and its content may not include all initiatives presented as PPP by other sources.

Figure A.1.4 ODA features: channels

Public Sector Institutions	
Donor Government	
Recipient Government	
Third Country Government (Delegated co-operation)	
International NGOs	
Donor country-based NGO	
Developing country-based NGO	
Public-Private Partnerships (PPPs) and Networks	
Public-Private Partnership (PPP)	

Network	
Multilateral Organisations	
United Nations agency, fund or commission (UN)	
European Union institution (EU)	
International Monetary Fund (IMF)	
World Bank Group (WB)	
World Trade Organisation	
Regional Development Bank	
Other multilateral institution	
Other	
University, college or other teaching institution, research institute or think-tank	
Other	
	Source: OECD Stats

Regarding sector codes, the distinction is more difficult. Some of them (like business services) can be directly marked as PSD initiatives, and others can be easily excluded as more likely to target public and non-profit actors. All social sectors –including humanitarian and commodity aid, and action related to debt– were excluded, although micro-data showed certain involvement of private companies in some specific projects.

Difficulties come when differentiating whether economic infrastructures and productive sectors could be considered PSD or not, especially understanding that PSD covers not only direct support to companies, but also indirect support to infrastructures and institutions facilitating business development. The following are the sub-sectors considered to be articulated around private actors after a detailed analysis of the purpose and project descriptions contained in the micro-data for every sector.

Figure A.1.5 ODA features: sectors

Social Infrastructure & Services	
▪ *Education*	
▪ *Health*	
▪ …	
Economic Infrastructure & Services	
▪ *Banking and Financial Services*	
▪ *Business and Other Services*	
▪ *Energy Generation and Supply*	
▪ …	
Production Sectors	
▪ *Agriculture*	
▪ *Forestry*	
▪ *Fishing*	

▪ *Industry*	□
▪ *Mineral Resources and Mining*	□
▪ *Construction*	□
▪ *Trade Policy and Regulations*	
▪ *Tourism*	✓
Other Multisector	
▪ *General Environmental Protection*	
▪ *Other Multisector*	
Commodity Aid	
▪ *General Budget Support*	
▪ …	
Action Relating To Debt	
▪ *Debt Forgiveness …*	
Humanitarian Aid	
▪ *Emergency Response*	
▪ …	
Other	
▪ *Administrative Costs*	
▪ …	
Source: OECD Stats	

While economic infrastructures like energy or water were excluded because they usually target overall populations, most of the productive sectors were included as they referred to activities involving private companies. Analysis of productive sectors in detail also showed that economic infrastructures, when addressed to specific productive needs (e.g. water resources in the agriculture sector), were classified as agriculture instead of water and sanitation.

The result of this approach was the following classification of "public aid for private investment":

Figure A.1.6 Public aid for private investment, a typology proposal based on available information from the ODA official statistics

Feature	Description
Equity investment	Direct financing of enterprises in a developing country which does not imply a lasting interest in the enterprise. They can be either indirect, when channeled through financial intermediaries, or direct.
PPP	Aid channeled through associations formally established as a PPP, excluding Equity Investment.
Economic Services	Aid allocated to Business & Banking services, excluding aid channeled via PPP or Equity Investment.

Productive Sectors	Aid allocated to Agriculture, Industry, Fishery, Mining, Tourism & Construction sectors, excluding aid channeled via PPP or Equity Investment.

Although the figures provided in section 3 are only an approach to PSD, a literature review on this topic shows that more accurate information is not available. The North South Institute and the Canadian Center for International Cooperation have compared how donors quantify their support to private sector development and growth; they concluded that each donor includes different codes in their reporting (Kindornay and Reilly - King, 2013).

In other words, statistical standards are still not fit to report on the increasing role of private companies in development cooperation.

Annex 2: PSD by DFID

Policy frameworks

The Engine of Development

"The Engine of Development" is a policy paper containing DFID's vision on PSD. This paper defines DFID's mission as generating opportunities for poor people in developing countries and considers that working with the private sector would make that effort more effective and efficient. The paper highlights the following expected results from private sector activities: better job opportunities and incomes; better access to finance for households and small businesses; and better access to basic goods like healthcare, schooling.

Making Markets Work for the Poor (M4P)

Making Markets Work for the Poor (M4P) is an approach to poverty reduction that some donors, including DFID, have been supporting over the past few years. The central idea is that the poor are dependent on market systems for their livelihoods. Therefore, changing those market systems to work more effectively and sustainably for the poor will improve their livelihoods and consequently reduce poverty.

Institutional set-up

DFID's Private Sector Department

The Private Sector Department was established in January 2011 in order to make possible DFID's PSD operational plan. It is meant to be a highly skilled and flexible department that catalyses innovation, leads DFID's overall engagement with the private sector, and runs directly certain centralized programs.

Other DFID central departments

Other central departments, like the Climate or Health Departments, also collaborate with private actors and are especially active in promoting PPP and innovative funding mechanisms.

DFID's country offices

At the country level, DFID also runs private sector development programs designed and managed autonomously by its field offices and framed under DFID country operational plans and national partners' strategies.

CDC

CDC is the United Kingdom's development finance institution and supports SMEs in developing countries by participating in private equity funds managed by third parties. Its investment focus has been narrowed recently and now concentrates in

businesses having a high potential in terms of job creation and located in the poorest countries and regions.

Activities

Equity investment

Until recently, United Kingdom equity investment operations have consisted simply of making pioneer investments in private equity funds across a large domain of developing countries. Since 2012, however, under its new strategy, CDC also makes direct investments in specific companies expecting relevant employment creation.

Figure A.2.1 A few examples of CDC Equity Investment Activities

Operation	Description
Pan African Housing Fund	Financing construction companies.
VenturEast Proactive Fund	Investments in early- to growth-stage technology businesses in India.
Export Trading Group (ETG)	African agribusiness operating in crop buying, warehousing, distribution and merchandising.
	Source: www.gov.uk

Private sector centralised programs

These are grant-funded programs aiming to mobilize pro-poor investment and managed by the recently created Private Sector Department.

Figure A.2.2 DFID Private Sector Department Programs

Acronym	Program	Description
BCtA	Business Call to Action	Partnership opportunities for companies developing inclusive business models. Engaging low-income populations across company value chains
BIF	Business Innovation Facility	Support to companies setting up inclusive business models in certain developing countries
CoST	Construction Sector Transparency Initiative	Exploring how construction projects could be more transparent, reducing the mismanagement, waste and corruption
ETI	Ethical Trading Initiative	Information about ETI, an alliance of companies, trade unions, and voluntary organizations improving the lives of workers who make consumer goods
FRICH	Food Retail Industry Challenge Fund	FRICH supports African farmers by bringing their produce to European markets and shoppers

Acronym	Program	Description
PIDG	Private Infrastructure Development Group	Aims to encourage private infrastructure investment in developing countries that contributes to economic growth and poverty reduction
AECF	Africa Enterprise Challenge Fund	A fund offering grants to private sector companies to support new and innovative business models in Africa

Source: www.gov.uk

Other centralised programs involving the private sector

The Climate and Environment Department, for instance, according to its operational plan 2011-15, expects to mobilise USD 610 million of private investment for climate change purposes. The Human Development Department also engages with the private sector when tackling issues like access to vaccines and drugs by poor people.

Figure A.2.3 Other DFID Centralised Programs

Acronym	Program	Description
AMC	Advanced Market Commitments	Improving availability of vaccines and making them affordable
MeTA	Medicines Transparency Alliance	A funding scheme to improve access to medicines by increasing transparency and accountability in the healthcare market
RBF	Results-Based Financing for low carbon energy access	Offers grant payments to businesses, which deliver outputs within the low-carbon off-grid energy sector
AECF	Africa Enterprise Challenge Fund	A fund offering grants to private sector companies to support new and innovative business models in Africa
IFFIm	The International Finance Facility for Immunization	By issuing bonds in the capital markets, converts long-term government pledges into immediately available cash resources for immunization programs like GAVI

Source: www.gov.uk

Wealth creation projects, by country offices

DFID's country operational plans include a wealth creation component with specific results in terms of household income increases and job creation. This gears country offices to give support to different local initiatives aiming to foster economic activity involving poor populations.

Figure A.2.4 Wealth creation results in a sample of DFID country operational plans

Country	Indicator	Baseline	Expected results
Ethiopia	Number of household incomes raised by 20% or more (C)	0 (2011)	275,000 (by 2015)
Bangladesh	Increased income for selected groups	0 (varies by project)	$140m increase in income for 1.15m farmers/businesses by 2013
Nigeria	Number of poor people whose income increases by between 15% and 50% due to DFID projects	0	600,000 (of whom 250,000 women) (Partially attributable to DFID).
	Number of people with access to formal financial services	30.7 million	40.7 million (44% women) (DFID contribution)

Source: www.gov.uk

Annex 3: PSD by IDB

Policy frameworks

The Private Sector Development Strategy (PSDS)

Still not publicly available, the IDB's draft "Private Sector Development Strategy" (PSDS) aims at building a common framework for all IDB's operations supporting the private sector.

Figure A.3.1 Preliminary areas and topics for IDB interventions

Area	Topic
Enhancing access to finance and investment	Reduce funding gaps
	Promote funding for SMEs
	Reduce vulnerability to internal and external shocks
	Promote development of local and regional capital markets
	Support the development of new financial services
Infrastructure for competitiveness and integration	Promote investment in infrastructure, particularly transportation, energy and water and sanitation
	Improve the legal and institutional framework for PPPs
	Improve regulatory frameworks for utilities
	Support a trade facilitation agenda
Enabling environment for private sector development	Modernize regulatory framework for SME activities
	Promote formalization by easing the process of business registration, and work on tax systems and simplification of procedures
	Lower cost of doing business (bankruptcy, hiring workers, etc.)
Enhancing innovation capacity and building human capital for productivity	Improve institutional capacity to supply business development services
	Promote productive integration of SMEs and large firms
	Public-Private dialogues for competitiveness
	Improve managerial capacity
	Enhance training and skills
	Promote innovation through R&D
	Develop instruments to finance innovation
	Expand and develop tailored products and services to

	maximize Private Sector Development
Institutional knowledge and innovation development for private sector development	Establish consultation mechanisms for dialogue with the private sector
	Support the development of technical notes for the Country
	Strategy

Source: IDB

Institutional set-up

IDB Bank Group

The Inter-American Development Bank Group an international organisation of 48 member countries. It has four subsidiary branches: the Inter-American Investment Corporation (IIC), the Multilateral Investment Fund (MIF), the Structure Corporate Facility (SCF), and Opportunities for the Majority (OMJ). While these branches work managing mainly non-sovereign guaranteed operations, the Bank itself concentrates most of the sovereign operations (SGOs).

SCF

The Structure Corporate Facility (SCF) is the IDB's institution that concentrates on big corporations.

IIC

The IDB's Inter-American Investment Corporation (IIC) targets small and medium enterprises (SMEs).

MIF

The Multilateral Investment Fund (MIF) is the IDB institution that focuses on small and micro-businesses.

OMJ

The IDB's Opportunities for the Majority (OMJ) institution serves the base of the pyramid.

The New Vice-Presidency for the Private Sector

In the framework of the ongoing IDB reform, a vice-presidency for the private sector was put in place in 2008, aiming to reduce the dispersion of PSD activities throughout the Bank.

Activities

According to the IDB's latest annual report[31], at year-end 2012 the Bank's active portfolio of sovereign-guaranteed projects in execution comprised 622 operations with an undisbursed balance of USD 25.3 billion. Of total undisbursed resources, 61% corresponded to the infrastructure and environment sector, 24% to institutions for development programs, and 14% to social sector programs. As for non-sovereign guaranteed operations, in 2012 the Bank approved 45 non-sovereign guaranteed operations for a total amount of USD 1.5 billion. Also in 2012, the SCF had approvals of 35 projects (loans and guarantees) accounting for the vast majority of the lending volume, with 43% in so-called 'countries with insufficient markets' and in least developed countries. Disbursements to year-end 2012 totalled USD 942 million. OMJ approved 10 projects (loans and guarantees) for USD 57.2 million in 2012, in seven countries. With this, OMJ now has a total of 42 approved projects, committing USD 247 million of the total amount for that facility. MIF approvals for the year totalled USD 97 million for 76 projects, 67 of which were technical assistance grants, the remaining 9 being loan or investment operations combined with grants. During 2012 the MIF leveraged additional financial resources totalling over USD 263 million. Over half of projects approved in 2012 benefited countries with insufficient markets and least developed countries. At the end of 2012, the MIF had an active portfolio of 540 projects for a total approved amount of USD 714 million. According to its latest annual report[32], the IIC approved a total of 73 operations for USD 379 million. Geographically, its outstanding portfolio greatly focuses on Central America and Mexico and in the Southern Cone; sector-wise, it concentrates in the financial sector.

PSD and PSOs

IDB's activities supporting the private sector are classified as Private Sector Operations (PSOs) and Private Sector Development (PSD).

While PSOs are composed by lending operations to private companies, PSD activities include also to private sector beneficiaries but always through financial intermediaries. PSD also consist of enabling business environment.

PSD enabling environment

PSD enabling environment' covers Competitiveness Enhancement Programs and Competitiveness PBL Programs. Its topics are the following: modernize the regulatory framework for SME activities; promote formalization by easing the process of business registration; work on tax systems and simplification of procedures; and lower the cost of doing business (bankruptcy, hiring workers, etc.).

[31] Inter-American Development Bank (2013), *Inter-American Development Bank Annual Report 2012: The Year in Review,* Inter-American Development Bank, March.

[32] Inter-American Investment Corporation (2013), *2012 Annual Report. Embracing Change Always*, Inter-American Investment Corporation.

Figure A.3.2 SGO, PSD enabling environment operations in Ecuador
Project title
Support for a coastal artisanal fishing project
National system for rural land information and management and technology infrastructure
Modernization of pumping stations on the Esmeraldas-Quito multiproduct pipeline
Strengthening of the pre-investment cycle

PSD direct to private beneficiaries

PSD direct to private' offers support to private company beneficiaries through financial intermediaries like: Global Multisector Credits, Financial Sector Programs, and the Liquidity Program for Growth Sustainability.

Figure A.3.3 SGO, PSD direct to private operations
Project title
Programa de Crédito Global de Apoyo a las microfinanzas en Ecuador
Financial inclusion support investment program
CTH Warehouse Facility
Banco Bolivariano SME Finance
Aglomerados Cotopaxi

PSO with micro-enterprises

The MIF operations target poverty reduction and are addressed to low-income households, individuals, communities and micro-businesses.

Figure A.3.4 MIF, micro-enterprises operations
Project title
Central Finance Facility and Financial and Technological Services
Bucay development through tourism as dynamic axis of the local economy
Mobilization of rural savings through cell phones
Strengthening telecenter business model through e-commerce
Technological entrepreneurship and employment for the Amazonian youth
From Santo Domingo to the Coast: extending financing and rural development
Franchises for rural pharmacies in Ecuador
Poverty reduction through improved processing and marketing of high-value products

ICT to strengthen the business operations of SME the Nal. Dairy Consortium
Sustainable development with rural productive micro-enterprises in the South
Expanding access to medical care for low-income patients
MSME expansion through public procurement
Consumer protection and financial literacy in micro-finance

PSO with SMEs

IIC provides equity and loans to SMEs directly (e.g. Aglomerados Cotopaxi, Agripac) or by means of financial intermediaries (e.g. Procredit Ecuador IV) including private equity funds (e.g. Guayaquil Equity).

PSO with the base of the pyramid

OMJ promotes and finances market-based, sustainable business models that engage private sector companies, local governments, and communities in the development and delivery of quality products and services for the Base of the Pyramid.

PSO with big companies

Operations with big companies by the Structure Corporate Facility (SCF) fund large banks and private sector investments in nearly all economic sectors in Latin America and the Caribbean. This also includes a specific facility on international trade called the Trade Finance Facilitation Program (TFFP).

Figure A.3.5 SCF, operations big companies

Project title
CTH Warehouse Facility
Banco Bolivariano SME Finance
Universidad Politécnica Salesiana Expansion Project

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