

Private sector development – business plan or development strategy?

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List of Abbreviations

ADA	Austrian Development Agency
BDS	Business development services
CSR	Corporate social responsibility
DAC	Development Assistance Committee
DFIs	Development finance institutions
EC	European Commission
EIB	European Investment Bank
EU	European Union
EUBEC	EU Platform for Blending in External Cooperation
FDI	Foreign direct investment
FfD	Financing for Development
GPEDC	Global Partnership for Effective Development Cooperation
IFC	International Finance Corporation
LED	Local Economic Development
M4P	Making Markets Work for the Poor
MDGs	Millennium Development Goals
MoFA	Dutch Ministry of Foreign Affairs
NGOs	Non-Governmental Organizations
ODA	Official development assistance
OECD	Organisation for Economic Co-operation and Development
PPPs	Public-private-partnerships
PSD	Private sector development
SDG	Sustainable Development Goals
SME	Small and medium-sized enterprises
TNCs	Transnational corporations
TRIPS	Trade Related Intellectual Property Rights
UN	United Nations
WTO	World Trade Organization

Abstract

Private sector development (PSD) has taken on an increasingly prominent role in both the debates as well as budgets of international development cooperation in recent years. While the promotion of private sector activities in developing countries has for a long time been part of development cooperation strategies, in the past years there has been a shift towards a more proactive role of the private sector, defining it as a partner to address development challenges. The paper illustrates the growing prominence of the private sector in development cooperation and identifies reasons for this trend. It shows that PSD is not a “technical solution” but that there are different theoretical approaches to PSD that favour distinct policy measures, discussing the structuralist, neoclassical and neostructuralist approach. Finally, it presents reflections on the relationship between current PSD strategies and sustainable economic and inclusive development.

Keywords: *Private Sector Development, Development Cooperation, Economic Development, Inclusive Development, Industrial Policy, Transnational Corporations*

1. Introduction

Private sector development (PSD) has taken on an increasingly prominent role in both the debates as well as budgets of international development cooperation in recent years. While the promotion of private sector activities in developing countries has for a long time been part of development cooperation strategies, in the past years there has been a shift towards a more proactive role of the private sector, defining it as a partner at the national or global level to address development challenges. As a consequence, the private sector is increasingly granted space in international and national policy discussions, proposing development solutions and designing, financing and implementing development activities together with official development actors.

Important questions emerge in this context: What are the reasons for this trend? Which activities are currently subsumed under the term private sector development? What strategies, concepts and theoretical approaches are being pursued? To what extent do PSD interventions reflect the interests of the private sector in partner countries or of businesses hosted in donor countries? Do PSD interventions contribute to inclusive development and poverty reduction?

This paper addresses these questions in seven sections. After this introduction, the second section discusses the growing prominence of the private sector in different development cooperation fora. The third section identifies important reasons for this trend. The next section outlines the main theoretical approaches to PSD, discussing the structuralist, neoclassical and neostructuralist approach. This is followed by a description of different types and various levels of PSD intervention in development cooperation. The sixth section reflects on the theoretical approaches behind and the strategies of PSD and their connection to sustainable economic and inclusive development, asking if current PSD interventions correspond with a “business model” or a “development model”. The final section concludes.

2. The increased importance of PSD in developing countries

The growing prominence of the private sector in development cooperation is reflected in all main international development fora and discussion processes. The important role of the private sector is stressed in declarations and final documents and private sector actors are increasingly invited to participate in policy discussions and the formulations of documents. In line with multilateral efforts to increase collaboration with the private sector for development, also bilateral donors have stepped up their endeavours to support PSD and to cooperate with the private sector in their development programmes (Kindornay/Reilly-King 2013b). The increasing role of the private sector in international development fora, bilateral development cooperation and budgets is discussed in this section.

2.1. PSD in international development fora

One of the first documents that reflected the increased importance of the private sector in international development cooperation was the final document of the UN Conference on Financing for Development (FfD) (“Monterrey Consensus”) (UN 2003), stressing the importance of the private sector through e.g. the promotion of private sector financial innovations and public-private partnerships. At the 2010 UN Millennium Summit, 11 bilateral donors¹ issued a statement that recognized “the private sector as equal partner around key

¹ Austria, Denmark, Finland, Germany, Japan, Netherlands, Norway, Sweden, Switzerland, the United Kingdom, and the United States.

development issues” (Kindornay/Reilly King 2013a). The preparation process for the 3rd International FfD Conference in Addis Ababa in July 2015 assigns a central role to the private sector – in the draft documents and as a prominent actor in the process itself. Corporations are included in the implementation of the new development agenda via multi-stakeholder partnerships; private-public partnerships are being promoted as a channel for business involvement, and governments are called to increase their skills to better work with the private sector (ICC 2015; Adams/Luchsinger 2015; Bissio 2015). This trend is also reflected in the Post-2015/Sustainable Development Goals (SDG) process, which attributes an important role to the private sector.² In September 2014, the UN Secretary General launched the UN Global Compact report “Building a Business Engagement Architecture for the Post-2015 Agenda” stating that “(t)his architecture is designed to drive and scale up corporate actions to directly advance United Nations goals” (Fogelberg/Bertazzi 2014).

In the EU development cooperation framework “Agenda for Change” (EC 2011a), the private sector is of utmost importance. The framework aims at employing innovative ways of financing development such as blending loans and grants³ and at promoting public-private-partnerships (PPPs) via up-front grant funding and risk-sharing mechanisms, in order to encourage private investment and partnerships in development. It is stated that “the search for synergies with the private sector will become an increasingly important consideration in EU development cooperation” (EC 2011a: 15). In order to operationalize the Agenda for Change and to provide a strategic framework for mainstreaming private sector development and engagement across sectors, the European Commission (EC) launched a communication in May 2014 (EC 2014), outlining principles, actions and tools for supporting – or cooperating with – the private sector.

The significance of the private sector as an essential partner in development was also confirmed by the international development community at the fourth High Level Forum for Aid Effectiveness in Busan (OECD/UNDP 2011). The Busan Partnership Agreement (2011: 10) describes “(...) the central role of the private sector in advancing innovation, creating wealth, income and jobs, mobilising domestic resources and in turn contributing to poverty reduction.” The follow-up event, the first High Level Meeting of the Global Partnership for Effective Development Cooperation (GPEDC) in Mexico City in April 2014 also assigned public-private collaboration an important role in implementing the new aid agenda⁴ (GPDEC 2014a).

Also at the G20 level, private sector-related issues feature high on the agenda. The G20 Working Group on Development has recommended a number of ways for the private sector to engage in development. This includes overcoming infrastructure challenges in developing countries through private sector financing models and institutional arrangements that support and promote PPPs. The working group also suggests that more incentives are needed to encourage private investment and job creation and to engage the private sector in development. The latter should also be stimulated by changing the business model of multilateral development banks, which should support private sector engagement in development through subsidies, public guarantees and innovative finance risk mitigation products (CPDE 2013).

² For example, the CEO of Unilever was appointed as a member of the UN Secretary General’s High Level Panel of Eminent Persons.

³ Blending is a mechanism that links a grant element, provided by official development assistance (ODA), with loans from publicly owned institutions or commercial lenders. While blending is not a new instrument, there has been a substantial increase in development finance institutions (DFIs) and EU donors using blending mechanisms to increase support and lending to private companies and to partner with private financiers (Eurodad 2013).

⁴ The private sector was given a seat on the Steering Committee of the GPEDC, while labour unions had to share a seat with the rest of civil society and were only given a seat after numerous claims two months before the conference (GPDEC 2014b).

2.2. PSD in bilateral development cooperation

The UK Development Agency DFID launched its first PSD strategy in 1997 as part of its poverty reduction mandate. In 2008, DFID formulated a stand-alone PSD strategy. In 2011, following a decision of the UK Government that greater emphasis should be put on working with the private sector, DFID established a Private Sector Department. Its aim is to support DFID to step up its private sector engagement and to embed private sector culture and expertise across DFID. DFID plans a significant increase in expenditure on PSD-related work in the context of its new Economic Development Strategic Framework and is forecasting that, by 2015-16, it will spend £1.8 billion a year on economic development activities, more than doubling the amount spent in 2012-13 (ICAI 2013, 2014).

The Dutch Ministry of Foreign Affairs (MoFa) which oversees the Dutch Development Cooperation puts cooperation between the government, the private sector and civil society organizations increasingly at the centre of Dutch development policy (DCED n.d.). MoFa states that public-private partnerships, business instruments and economic diplomacy can lead to gains in both commercial profit and poverty reduction and therefore a larger proportion of the development budget will be spent on those instruments. The Dutch policy framework is explicitly “putting Dutch interest first, more so than in the past” (MoFA 2011: 1, cited in Byiers/Rosengren 2012: 15; DCED n.d.).

Also other bilateral agencies place increased emphasis on engagement with the private sector, with a focus on their national private sector such as Sweden or Denmark. E.g. the Swedish agency SIDA states that “it is in Sweden’s [...] interest that Swedish businesses are suppliers in development assistance-financed calls for tender, in order [...] to contribute to economic growth in partner countries as well as in Sweden” (SIDA 2011: 9, cited in Byiers/Rosengren 2012: 15). The Danish agency Danida notes that “it is a strategic priority in Danish development cooperation to work for a stronger private sector [...] and that Danish business participates actively in this endeavour.” (DANIDA 2012: 1, cited in Byiers/Rosengren 2012: 15).

The Austrian Development Cooperation has defined PSD as one of three priorities in its strategic programme 2013-15 (BMeiA 2012). The Austrian Development Agency (ADA) implements PSD by promoting an enabling business environment and by supporting micro, small and medium enterprises in developing countries e.g. through Value Chain Interventions. Another PSD-instrument is the so called “Business Partnership program“, supporting enterprises from Austria or the European Economic Area to invest in developing countries (BMeiA/ADA 2010). ADA plans to increase the budget and number of Business Partnerships in the coming years. The selection of new partner countries (e.g. the Caucasus region) is also a result of the prioritisation of PSD. In addition, partnerships between NGOs and the private sector are encouraged.

2.3. Budgets devoted to PSD

Due to a lack of systematic reporting, it is impossible to assess the funds donors are allocating to private sector development and to partnerships with the private sector. The OECD Development Assistance Committee (DAC) High Level Meeting in December 2014 recognised that the “present statistical reporting system does not fully reflect the changing way in which members are engaging with the private sector” and agreed to “undertake further work to reflect in ODA (official development assistance) the effort of the official sector in catalysing private sector investment in effective development” (OECD 2014: 3). The available data shows that funds for PSD of multilateral development banks increased by a factor eight, from \$5b to \$40b between 2000 and 2010 (as reported by Kwakkenbos and

Romero 2013). ODA to sectors oriented towards the private sector (e.g. economic services and production) increased by 58 % between 2005 and 2010 (RoA 2012). Donor funding for Aid for Trade⁵ has grown in scale and importance, representing the single largest component of OECD-DAC donors combined ODA (CPDE 2013). USAID is reported to plan to program 40 % of its funding through PPPs, up from 8 % in 2009. At the EU level, ODA being channeled through EC blending facilities rose from Euro 15 million in 2007 to Euro 490 million in 2012, and the EU hopes to make greater use of these blending facilities in the near future (Actionaid 2014).

3. Reasons for the increased importance of PSD

The increased importance of the private sector's role in international development cooperation is due to various reasons. They can be partly attributed to trends in development cooperation but also to broader trends in economic and development policy more general. Four main reasons are outlined in this section.

3.1. Paradigm shift in economic and development policy

The key significance of the private sector in development cooperation since the early 1990s has been accompanied by a paradigm shift in economic and development thinking and policy, which began in the 1980s, away from the central role of the state as the prime engine of development towards the private sector (Schulpen/Gibbon 2001). The key role of private enterprise, market forces and competition in furthering economic growth and development, generating employment and reducing poverty has been stressed. In the 1980s especially multilateral development organisations, most importantly the World Bank whose private investment arm – International Finance Corporation (IFC) – has considerably increased in importance in lending activities (Küblböck 2004), promoted this shift. During the 1990s, bilateral donors also adopted this paradigm and developed their own strategies and programmes to promote the private sector, often through channelling private sector lending through development finance institutions (DFIs) (Gössinger/Raza 2011).

This shift is closely related to the privatisation of state-owned enterprises, liberalisation, deregulation and strengthening of market forces, increasing competition and reducing and refocusing the role of the state (Schulpen/Gibbon 2001). The state has been discredited in its active economic policy role and as a direct provider of infrastructure and services. Many formerly public enterprises have been privatised and diverse sectors deregulated and liberalised under pressure from development organisations. The state's role in most PSD approaches is to create stable framework conditions and a positive investment climate and business enabling environment with as few restrictions and interventions in the market as possible. The financial crisis since 2008 as well as the economic and political rise of emerging economies (especially China, India and Brazil), which is due inter alia to a strong role of the state and interventionist economic policies, have however initiated a gradual change in thinking and discussions (see below).

3.2. Declining ODA funds and increased private capital flows

Despite various declarations in favour of a substantial increase in ODA, the figures point in the opposite direction. In 2012 for the first time since 1996/97, the OECD announced a decline in ODA over two years; the EU has also reported falling ODA rates. In 2013 and 2014 funds increased again. But the average DAC ODA level still only accounted for 0.3 %

⁵ Aid for Trade is about supporting developing countries to build the trade capacity and infrastructure they need to benefit from trade liberalization (WTO n.d.).

of GDP in 2013 which falls far short the 0,7 % ODA target (OECD 2015). With low public development cooperation budgets, there has been a greater emphasis in recent years on developing countries taking responsibility for mobilising domestic resources (OECD 2005), on engaging the private sector in development cooperation, and on the development potential of private capital flows. Regarding the latter, even though the last two decades have witnessed an important increase in private capital flows to developing countries, these flows are very volatile given their cyclical nature. In addition, outflows (e.g. loan repayments, profit repatriation, divestment) can also be very high. For example, in 2011 outflows of profits on foreign direct investment (FDI) from developing countries amounted to almost 90 % of FDI inflows in the same year (Griffiths et al. 2014). It is therefore important to review the net contribution of these investments.⁶

In development corporation particularly a combination of public and private funds has been promoted. The EU has, for example, developed various PSD financing mechanisms known as “blending” where development cooperation grants are combined with loans from public and private financial institutions to increase their leverage. This often takes place through the granting of guarantees or the tying of government subsidies for companies to private loans. In December 2012, the EU Platform for Blending in External Cooperation (EUBEC) was launched, where existing blending mechanisms are to be reformed and new financial instruments developed to increase the volume of this type of financing. Many development banks and DFIs have increased their use of blending mechanisms under the auspices of the EC that set up eight facilities covering all the geographical regions of EU development cooperation (Eurodad 2013). In this context, the European Investment Bank (EIB) is a major actor, being involved in more of half of the projects going through blending facilities managed by the EC (Eurodad/Counterbalance 2012), as well as managing blending facilities itself.

3.3. Growing competition following the rise of emerging economies

The rapid economic rise of emerging economies such as China, India or Brazil also leads to their increased presence in developing countries and increasing competition for resources and markets between states and “their” companies. Against this background, the promotion of the national private sector is increasingly becoming an explicitly declared foreign policy objective of the EU and the US (as well as other donors). The EU Agenda for Change mentions explicitly that development policy is intended to help address other global challenges and that it should make a contribution to implementing the EU-2020 Strategy – whose goal in the wake of the Lisbon Strategy is to stimulate the international competitiveness and the growth potential of the EU (EC 2011a: 3). The European Commission’s small and medium-sized enterprises (SME) strategy (Small Business – Big World) talks of implementing existing EU foreign policies in order to promote the international growth of European SMEs and mentions in this respect the joint Africa-EU Strategy (EC 2011b; Byiers/Rosengren 2012). The EU raw materials strategy aims at securing affordable access to natural resources for European companies and seeks to use all policy instruments, including development policy, to reach this goal (EC 2008; see also Küblböck 2013).

⁶ Moreover, many developing countries started to accumulate high levels of foreign currency reserves as risk insurance against sudden capital outflows, leading to significant net resource transfers from developing to developed countries, estimated at 971 billion in 2014 (UN 2015), compared to 135 billion of total ODA in 2014.

3.4. Rising influence of TNCs in policy decisions

Especially large companies have exerted growing influence on economic and development policy debates as well as on policy making. In the last three decades, the conditions under which transnational corporations (TNCs) operate have increasingly changed to their advantage through liberalisation of markets, privatisation of public infrastructure, tax benefits and options for avoiding taxes. Due to their increased power and the view that the private sector should be given a greater voice as a development partner in development policy, TNCs are often able to assert their interests also through their participation in different development fora. TNCs increasingly influence the definition or framing of causes for and solutions to poverty. In this context, poverty tends to be defined as a market failure, which can be alleviated by integrating the poor into capital and product markets, and therefore solutions lie within the competence of business. Prominent approaches like the “Bottom of the Pyramid” (Prahalad 2004) see an important business potential in poor consumers and producers. While these approaches present important opportunities in improving access to markets, finance and infrastructure, they risk transforming complex problems of development into business opportunities – such as redefining concerns around diseases into market opportunities for bed nets or concerns around combating diarrhoea and child mortality into market opportunities for companies producing soap (Blowfield/Dolan 2014).

4. Theoretical approaches to PSD

There is generally broad agreement in development thinking and practice that a dynamic private sector plays a crucial role in the economic development process as an engine of investment, innovation, and growth that offers an effective way to create employment, incomes, and prosperity. However, there is no consensus on which type or segment of the private sector is best suited for economic growth and inclusive development and particularly which policies are required to develop such a private sector. PSD is often portrayed as a problem that requires a “technical solution” of putting in place certain broadly accepted policies. The disagreements on preconditions and policies for successful PSD are based on diverging theoretical approaches or paradigms concerning economic development more broadly. Three broad theoretical approaches that implicitly underlie PSD interventions can be identified – the structuralist, neoclassical and neostructuralist approach – that are discussed in this section (see also Reiner/Staritz 2013).

4.1. Structuralist approach

After the Second World War until the late 1970s, the structuralist approach originating mainly in Latin America (see Bielschowsky 2009) was promoted, which considers government interventions and policies crucial for growth and structural change as a key engine and outcome of economic development. Essentially, it is suggested that economic growth and development requires shifting production factors from low-productivity to high-productivity activities which allow for learning, externalities and higher profits and wages. A focus is put on manufacturing and hence industrialization given its high potential for employment and productivity growth as a result of economies of scale, learning and specialization effects (Kaldor 1967). While productivity growth is of importance for development, industrialization has the potential to also contribute to social goals. This has taken place historically most importantly through the generation of employment, higher skill jobs and increases in wages. Manufacturing activities, in particular low- and medium-technological ones, are often labour-intensive providing employment, in cases also particularly for women. Higher wages and improved working conditions have however often only been achieved after long struggles and are limited where institutions that represent labour are weak. Agriculture and natural

resources are however still often less inclined to foster social progress in a comparable manner (World Bank 2009).

The structuralist approach assumes that in a free global market developing countries would be losers in the international division of labour. Furthermore, market forces alone would provide inadequate or even misguided signals for sustainable market development and industrialisation, due to the existence of substantial market failures and coordination problems. In particular in the context of industrial development and structural change, it may be required to go against markets and perceived comparative advantages in developing broader industrial capabilities and sustainable competitive advantages. Hence, governments are required to shape the economy by interfering with markets, pursuing selective policies favoring certain sectors that are more productive and offer higher learning possibilities and externalities, or by being directly involved in production activities (Amsden 1989). State planning and public enterprises play an important role to achieve industrialisation, an improved position in the global market, a strengthening of the internal market and economic development. Certain protectionist measures and import substitution are regarded as key policy elements for late-economic developers (Chang 2002; Reinert 2007).

4.2. Neoclassical approach

In the early 1980s, the pendulum swung the other way. Since then, the dominant neoclassical approach has assumed that the private sector develops best in response to market forces and without state intervention, as long as the state guarantees property rights and a competitive environment. This is based on the view that markets are generally efficient and that the costs of market failures are lower than the costs associated with government interventions. In this view, countries should focus on their comparative advantages based on natural endowments rather than actively attempting to transform their economic structures via selective policies. Governments should provide a level playing field and a business-enabling and investment friendly environment focusing on horizontal or neutral policies that facilitate the economic sphere by improving infrastructure, ensuring property rights, reducing regulatory burdens through deregulation, and providing low taxes and tax or financial incentives. Thus, the state provides facilitating mechanisms for private business accumulation without direct interference in inter-firm relationships or markets (Fold/Larsen 2008).

Since the 1990s, the neoclassical approach has been amended in international development policy by what Altenburg and von Drachenfels (2006) call the new minimalist approach. This approach also focuses on market forces and a business enabling environment but differs in its explicit pro-poor reasoning and its optimistic stance with regard to the growth potential of the informal sector (Altenburg/Drachenfels 2006). Deregulation and property rights are highlighted as pro-poor measures as the poor are particularly negatively affected by market access barriers, overregulation and uncertainty due to non-existing property rights. This approach is the basis for the highly influential *Doing Business* reports by the World Bank that assume that simple and low cost conditions for establishing and running enterprises lead to the creation of dynamic, productive private sectors and poverty reduction (see below; Altenburg/Drachfels 2006).

4.3. Neostructuralist approach

A so-called neostructuralist approach has regained ground in recent years, at least in academic and development policy debates (see Bielschowsky 2009; Rodrik 2010; Lin 2011). While this approach emphasises the importance of elements of the neoclassical approach with regard to the creation of a business enabling environment and the importance of market

forces, it also stresses that this is not sufficient for sustainable private sector and economic development. Market failures and coordination problems such as non-existent markets, asymmetric information, barriers to entry and power imbalances are considered as widespread particularly in developing countries which requires government intervention and selective policies that directly shape the economy, interfere in markets and focus on structural change. In the context of this approach, strategic trade and investment policy, industrial policy measures, skills development and support for individual sectors, enterprises and institutions are promoted. More recently, policies focus on market access and upgrading in the context of global value chains (so-called Value Chain Interventions) or promoting clusters and business linkages (see Staritz 2012a; Pietrobelli/Staritz 2013).

5. Types and intervention levels of PSD

The definition of PSD in international development policy documents and strategies can be very broad and includes various types and levels of intervention. Even though basic agreement exists among various donors that the private sector plays a major role in the growth and development process, the content and form of their strategies differ substantially. Some donors have formulated explicit and detailed PSD strategies, while others limit themselves to broad guidelines (Kindornay/Reilly-King 2013; Kwakkenbos/Romero 2013). In addition to supporting the private sector, cooperation with the private sector is taking on an increasingly important role with the role of the private sector shifting from being a “development tool” towards being a “development agent” (Blowfield/Dolan 2014). We define four types of PSD interventions in this section. .

5.1. Improvement of frameworks conditions

PSD programmes (in accordance with general development policy) were broadly based on neoclassical or the new minimalistic approach opposing selective interventions and putting emphasis on comparative advantage, an enabling business environment and horizontal/neutral policies (Schulpen/Gibbon 2001; Altenburg/von Drachenfels 2006; Staritz 2012a). A particular focus is on the improvement of framework conditions for local and international investors in partner countries. This includes especially the creation of a business enabling environment, i.e. deregulation and improvement of the legal framework for enterprises, most importantly in the fields of property rights, market access, competition, low taxes and often also the deregulation of labour markets. In broader terms it also includes improved access to infrastructure, financing and business development services (BDS) as well as the importance of political stability and good governance.

5.2. Support of firms and sectors in partner countries

PSD continues to involve strategies for building or strengthening the private sector in partner countries. This includes the direct promotion of specific firms or sectors in developing countries, such as providing financing, skills development or capacity building measures. The neoclassical approach criticizes such direct support which has therefore declined in importance in recent decades. However, more recently the debate has partly shifted and more direct interventions have become en vogue again. In this context, donors use, on the one hand, market system approaches, the most prominent one being the “Making Markets Work for the Poor (M4P)” approach, and, on the other hand, approaches to support specific sectors, value chains or services, such as Local Economic Development (LED), Value Chain Interventions or Business Development Services (BDS) (DCED n.d. b). The growth of emerging countries such as China, India and Brazil and the use of interventionist economic policies, particularly in China, has also reactivated a broader debate about industrial policy

within the international development community which is aligned to a shift to the neostructuralist approach (see below; Aghion et al. 2011; Reiner 2012; Wade 2012; Altenburg 2011; Reiner/Staritz 2013).

5.3. Support of businesses based in donor countries

PSD strategies also include the support of activities of the donors' national private sector in partner countries, with the aim of achieving or reinforcing positive development outcomes. This is often attained by aiming to increase investment in, sourcing from, or other activities in developing countries. The improvement of the development impact of businesses can also be targeted by ensuring longer term commitments and contracts with local firms and fostering knowledge transfer, supplier development, training of local workers and compliance with higher labour and environmental standards and tax legislation. Supported activities may also involve charity or corporate social responsibility (CSR) projects outside of the lead firms' core business such as establishing or supporting schools or medical facilities. There is, however, often no good reason why (foreign) businesses would have a particular advantage and should be involved directly as implementing agents (Staritz 2012a).

5.4. Private sector engagement for development

A relatively new aspect of PSD interventions entitled “engaging the private sector for development” refers to the collaboration of development cooperation in particular with the international private sector. Collaboration can consist in establishing public-private policy dialogue mechanisms such as the UN Global Compact or the Extractive Industry Transparency Initiative, or the integration of the private sector in policy processes such as the Post-MDG process. This intervention level also comprises the creation of common financing mechanisms such as challenge and innovation funds or the above mentioned blending mechanisms. The objective of collaboration is to harness private sector expertise and finance to address development challenges and to create win-win situations (Kindornay/Reilly-King 2013). The perception of the private sector therefore moves from being an “unintentional actor” in development to becoming an actor in “intentional development”, where business sees itself as bringing solutions to poverty, not just through the act of conducting business but because of conscious decisions to reduce poverty (Blowfield/Dolan 2014).

6. “Business model” versus “development model”

The ultimate question is whether PSD interventions contribute to sustainable economic and inclusive development. This is addressed in this section by pointing out main considerations regarding the theoretical approaches behind and the strategies of PSD asking if current PSD interventions correspond with a “business model” or a “development model”.

6.1. Shortcomings of the “business enabling environment” discussion

The predominant PSD approach continues to focus on the creation of a business enabling environment and a favourable investment climate in the context of the neoclassical approach. A strong influence in this regard is exerted by the *Doing Business* reports of the World Bank. The reports collect data on the administrative costs of establishing and running enterprises and rank countries accordingly and have been a driving force behind regulatory reform in many developing economies – the ranking also influences the World Bank's lending activities.

There is however scepticism if the *Doing Business* indicators are actually the main barriers for PSD in partner countries. Simplified conditions for setting up businesses might save a company time and money but do not necessarily result in more enterprises being established or improved success and sustainability of these enterprises. Complex and expensive regulations can be problematic but are often not the main obstacles for the development of local enterprises. Greater hurdles are often, for example, low productivity and linkages to other firms; access to information, markets and financing; lack of well-trained staff, technical or managerial expertise, and missing infrastructure. Such obstacles are however not addressed by deregulation and the creation of property rights but require complementary policies such as public investment in infrastructure or vocational training. In the labour market, for example, rather than “overregulated” labour markets, it is often a lack of trained workers that hinders PSD (UNIDO/GTZ 2008).

Some business enabling criteria may even be in direct conflict with broader development goals. These include the deregulation of labour markets that were for a long time included in the rankings. Since 2009 they are no longer included in response to pressure from trade unions and civil society but the reports still publish the World Bank’s estimates for these criteria. Deregulation of labour markets is often associated with a reduction in labour standards. Corporate taxation is another striking example for conflicts between business and development interests. In the *Doing Business* report, a country that lowers corporate taxes can improve its ranking position.⁷ As adequate tax revenues are crucial for social and economic development, lowering corporate taxes can, however, directly contradict development goals. For a development oriented tax strategy, the creation of equitable tax systems and measures to stop harmful tax competition should be supported.

But even if the expectations associated with the *Doing Business* reforms are met and more companies are set up or become more successful, this still does not necessarily lead to a dynamic economy and inclusive growth. The operations of markets supported by an enabling business environment may not provide the conditions for sustained and inclusive economic growth, particular in the context of global competition. As Kaplinsky and Readman (2001) state: “Global competition is so intense that unless deliberate policies are introduced to foster a systematic program of upgrading, producers may engage in a race to the bottom, entering a trajectory of immiserizing growth in which economic activity expands, but real incomes fall” (Kaplinsky/Readman 2001: 1). Further, not all sectors and enterprises have the same effects on dynamic and inclusive development. (Neo-)Structuralist approaches emphasise the importance of structural change and upgrading for economic development. This means shifting production factors from activities with lower to those with higher productivity, which are characterised by higher potential for learning and externalities and higher profits and wages.

A major part of the private sector in developing countries comprises informal activities and micro-enterprises. While approaches linked to the neoclassical approach, especially the minimalistic approach (Altenburg/Drachenfels 2006), emphasise the growth potential of the informal and micro-sector, (neo-)structuralist approaches highlight the generally low productivity and missing linkages with other firms and sectors which leads to limited opportunities for an advancement from informal to formal enterprises. Furthermore, a major part of the informal sector is not based on freely chosen entrepreneurial activity but consists of activities people have to engage in under precarious circumstances, as they lack other formal employment alternatives. The discussion about “right” and “wrong” types of enterprises shows that for economic development it is not the number of companies that is

⁷ In the coming reports it was agreed to introduce a minimum threshold for corporate taxation. Countries with lower taxes than this threshold will not be ranked better.

crucial but their potential to increase productivity, generate innovation, cooperate with other companies and develop networks (Bateman 2013).

The PSD strategies and programmes of some donors focus not only on creating a business enabling environment but also on selective policies, e.g. by supporting individual enterprises or business associations, skills development or vocational training institutions, entrepreneurship or business linkages between companies. In particular due to the successful industrialization of emerging economies such as China and the global financial crisis, these more interventionist strategies have grown in importance. Industrial policy is being “rediscovered”, not only among bilateral donors but also partly by organisations such as the World Bank and the OECD, which are well known for their negative attitudes to selective interventions (OECD 2011; Lin 2011; Wade 2012; Reiner/Staritz 2013). Yet, this paradigm change is still in its infancy. For instance, the past World Bank chief economist Lin, reports that less than 10 % of World Bank economists are sympathetic to his arguments pro industrial policy (Wade 2012).

Despite the importance of more interventionist policies to support private sectors, lessons should be learned from the errors of the past. High subsidies should be provided prudently to individual companies and projects, and consideration should be given to principles for the design and evaluation of projects as well as transparency criteria and accountability of costs and benefits (Reiner/Staritz 2013). Further, it has to be ensured that selective interventions result in systemic and dynamic effects (Altenburg/von Drachenfels 2006) and that no parallel structures are created (Reiner/Staritz 2013). Collaborative structures within the private sector and between the private and public sector play a decisive role. Specifically the creation of an environment and processes, which enable and reinforce communication, cooperation and mutual learning between government/public institutions and the private sector are of major importance but are often non-existent in many developing countries (Rodrik 2007; Morris 2010). Civil society also has an important role in identifying problems and opportunities for PSD and in contributing to new models of inclusive development (Raworth et al. 2008). Finally, for successful economic development not only a business enabling but a development-enabling environment is necessary, i.e. a combination of measures at various levels such as macroeconomic policies, infrastructure, education and social policy, a strategic trade, investment and industrial policy, and the integration of these policies in a broad-based development strategy.

6.2. Critique of “one size” perspective on private sectors and homogenous interests

Debates about the private sector as the engine of development often disguise the fact that the private sector comprises very different players with partly conflicting interests. This is particular problematic in the shift of large businesses from “development tools” to “development actors” that influence policy debates and concrete programmes and policy outcome. Particularly interests of local private sectors in partner countries, the private sector in donor countries and the international private sector, which is dominated by TNCs, are different but interventions to support them are often subsumed under “private sector development”. For example, a free market and global competition tend to help large, well-established and often global companies. Local SMEs, however, often require protective measures or selective support. Micro-enterprises in the informal sector could possibly be given more help by an effective social security system than with deregulation or loans. This means a level playing field between very different players – large foreign or transnational companies and local ones – could destroy local structures and have negative social and developmental effects.

With regard to donor countries' businesses, their interests and the interests of firms in partner countries and broader development objectives are often portrayed as homogenous leading to win-win situations. Supplier development and knowledge transfer programs may align TNC, local supplier and public interests as TNC's sourcing may become more efficient while at the same time local spillovers are ensured leading to employment generation, improved competitiveness and technological skills in local firms. But there are also conflicts of interests. "Wherever firms seek to suppress technology transfer, to externalize social costs or to restrict competition, this creates a conflict of interests with governments and other local stakeholders. Further conflicts may arise with regard to the distribution of gains along the chain. Lead firms often try to diversify their supply base in order to weaken the bargaining power of suppliers and to be able to appropriate a larger share of value added. If they succeed in doing so, they restrict capital formation in local firms and may even drive local firms into bankruptcy." (Altenburg 2007: 30) TNCs may further put pressure on the partner country government to cut taxes and exempt them from certain requirements such as national equity shares, contributions to skill development, and local content that have the explicit objective to increase local spillovers and value added and make foreign firms and their investment and sourcing strategies more locally embedded (Staritz 2012a).

An analysis of PSD-flows shows that a major portion of funds goes to large companies based in industrial countries (Kwakkenbos 2012). These large companies profit from public funding for their investments, such as subsidies, low-interest loans or acceptances of guarantees. The aim of such financing through public development cooperation funds is to enable additional projects or to achieve additional development impacts. For projects of large companies it is, however, often in particular difficult to assess the additionality or windfall gains, i.e. whether the projects would not have been carried out anyway in this form without public funding. A systematic review of additionality looking at several Multilateral Development Banks and DFIs found that 55 % of the projects would have been realized without the public finance (Spratt/Ryan-Collins 2012). Due to the increase in public pressure, large companies increasingly have a commercial interest in improving their market position and image on both an international and local level by introducing standards or investments in social or educational programmes. Hence, the boundary between business interest and development outcomes may be unclear and there is the danger that scarce ODA funds could be increasingly used for business promotion neglecting the development dimension (Kwakkenbos/Romero 2013; Kwakkenbos 2012; European Think Tanks Group 2011). At the development corporation side, the profit pressure that some bilateral and multilateral development banks are confronted with may result in "following" the market and avoiding riskier projects and may hence also reduce the additionality and development dimension (Kwakkenbos/Romero 2013).

Apart from the private sector's considerable heterogeneity, when discussing PSD, consideration should also be given to which sectors or companies should be private at all and which responsibilities are best met by public providers. After a focus on the privatisation of nearly all sectors in the 1990s, the view has gained ground again in recent years that the public sector has an essential role to play in central infrastructure and services such as health and education. For financing infrastructure projects in developing countries, the combination of public and private resources in the context of PPPs or infrastructure funds has become a popular mechanism. However, recent studies of the involvement of public bodies in private infrastructure funds indicate the risk that the investment decisions might be mainly based on private financial interests rather than on the social objective of providing necessary public goods (Hildyard 2012). There is growing evidence that PPPs have proved a very expensive method of financing, due to, for example, demands from equity funders and other lenders for 20-25 % annual returns or due to costs of up to 10 % for arranging the financing. PPPs also involve high risks. In developed countries 25-35 % of such projects fail

to deliver as planned due to cost overruns, poor work specification etc. In developing countries – with lower negotiation and management capacity – the failure rates have been even higher (Griffiths et al. 2014). In this context, important questions relate to the balance of risks and the governments' capacity to put necessary legal conditions in place and to insist on their compliance.

6.3. Necessity to include the international level in PSD

Policy measures necessary for sustainable PSD need policy space by the respective governments. The economic policy space today is, however, very restricted compared with the time when today's industrialised countries were developing. Multilateral and bilateral trade and investment agreements confine the use of classical industrial policy tools such as import and export restrictions, tariffs and taxes, subsidies for local businesses or conditions for foreign direct investments in order to increase local added value (such as local content regulations or trade balancing requirements). Knowledge transfer is also made difficult by strict intellectual property rights, especially those under the WTO Trade Related Intellectual Property Rights (TRIPS) agreement. Conditions tied to bilateral and multilateral development aid may also reduce the policy space of partner countries (Chang 2012).

In addition, changes in global trade and the dominance of export-based development models, especially in large countries like China and India have increased global competition in particular in agricultural and labour-intensive industrial goods. The proliferation of global value chains may have enabled access to international markets for many developing countries. But their positions are often uncertain and exposed to fierce competition and opportunities for upgrading and generating higher rewards are contested (Staritz 2012a). This is related to highly asymmetric market and power relations in these networks and in the global economy more general that may lead to "immiserizing growth" where economic activity is increasing (in terms of output and employment) but returns are falling with negative development outcomes (Kaplinsky/Readman 2001).

The discussion of appropriate conditions for PSD thus has to include the international level in addition to the national and local one. In the past decades, the conditions for international investment, trade and finance have been defined in such a way that freedom and benefits for TNCs were enhanced while the economic policy space for developing countries was often restricted (Kozak/Küblböck 2011). Hardly any binding measures have been implemented in the context of PSD that would expand the policy space and create a level playing field in the interest of inclusive development such as international tax agreements, environmental and social standards, and the regulation of banks and financial institutions. An extreme outcome of this development is that even PSD funds are increasingly channelled through tax havens (Kwakkenbos/Romero 2013, Vervynckt 2014), which is highly contradictory given the very negative effects of tax havens on development policy and revenues in developing countries. Further, policy coherence between donors' PSD and other development programmes and their economic, finance, trade and investment policies are required, including a commitment to pro-development trade and investment policies.

7. Conclusions

The private sector has to play an important role in sustainable economic and inclusive development as it provides an engine of investment, innovation, and growth and for the creation of employment, incomes, and prosperity. However, PSD is not a “technical solution” as it is often portrayed but there is disagreement on which type of private sector is best for development and most importantly which policies support such a private sector. Opinions range from the neoclassical approach that focuses on an enabling business environment and free markets to the structuralist approach that stresses the importance of structural change and active state interventions. The neostructuralist approach emphasises the importance of market forces and government interventions for sustainable private sector and economic development. Recently, the need for selective and strategic industrial policies is increasingly acknowledged in international policy discussions but this remains to be translated into the practice of many bilateral and multilateral donors that still largely focus on a business enabling environment and a favourable investment climate.

Further, there is no “one” homogenous private sector but different firms with distinct interests. Measures supporting TNCs and businesses from donor countries may look very different than policies to support a local private sector in partner countries. There are important win-win opportunities in particular in influencing the investment and sourcing strategies of foreign firms in partner countries and making them more long-term, locally embedded and inclusive and furthering local supplier development, knowledge transfer and high standards. But there are also important interest conflicts and the interest of foreign firms should not be equated with the interest of the local private sector and even less with national development concerns. In particular the growing involvement of the international private sector in framing development debates and formulating concrete policies involves the risk of hiding these interest conflicts as well as redefining complex problems of development as business opportunities.

Lastly, in order to implement PSD policies for sustainable economic and inclusive development, governments need policy space. The discussion of suitable conditions for PSD thus has to include the international level in addition to the national and local one. A pro-development international policy environment in particular in the areas of trade and investment policies is crucial but in the past decades TNCs’ interests have been centre stage in these negotiations. Policy coherence between donors’ PSD and other development programmes and their economic, trade and investment policies are a prerequisite in this respect.

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