Policy brief on the role of the private sector in Europe’s development cooperation

8th December 2014

The private sector has an important role to play in overseas development, both as a creator of decent jobs and as a key component in achieving economic growth, but there are clear limitations to its role that must not be ignored. It is clear that Overseas Development Assistance (ODA) is not enough to finance the future development framework and that public funds are scarce. However, placing private finance at the centre of the development agenda is a major cause for concern without an equal focus on building strong and effective regulatory environments. The EU must acknowledge and proactively seek to tackle power imbalances in order to ensure that people living in poverty share the benefits of growth and do not bear the costs of growth in terms of greater inequality, environmental degradation, corruption and marginalisation.

While the private sector has great potential to play a positive role in improving the lives of the most marginalised people, to reach this potential the EU needs to have a more balanced approach to private sector engagement; recognising the diversity of the sector and its limitations in poverty alleviation. The EU needs to prioritise investment in domestic small and medium sized enterprises (SMEs), micro enterprises, in particular, smallholder farmers as they offer the greatest potential to drive equitable development in countries. A major oversight is in targeting women’s economic empowerment, support for female entrepreneurs, smallholder farmers and empowering and supporting the innovations of women in developing countries. This will require both social and economic interventions, as well as a broader policy coherence for development approach, which ensures that the rights of women are not undermined by EU policies.

A strong policy framework that institutes appropriate incentives and safeguards, as well as accountability, monitoring and evaluation systems is crucial to ensure businesses and economic growth help lift people out of poverty and cause no harm. The European Commission (EC)’s communication on “A stronger role of the private sector in achieving inclusive and sustainable growth in developing countries”¹, published in May 2014, sets out a strategic framework that contains seven principles and six criteria aimed at “harnessing the potential of the private sector as a financing partner, implementing agent, advisor or intermediary to achieve more effective and efficient delivery of EU support”. While these principles and criteria are welcome, the way they are currently presented makes it difficult to identify how the EC is planning to put them into practice or make private sector companies comply with them. There are already key internationally agreed principles that should be the basis of this framework and lead this agenda, such as the Busan Development Effectiveness Principles, the UN Guiding Principles on Business and Human Rights and the Voluntary Guidelines on the Responsible Governance of Tenure. These principles must

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¹ European Commission Communication: “A stronger role of the private sector in achieving inclusive and sustainable growth in developing countries” COM(2014)
form the backbone of implementation and a checklist before implementing the private sector in development initiatives.

The European Union publicly recognises that smallholder farmers and SMEs are the section of the private sector capable of generating the kind of jobs needed for poverty eradication\(^2\). It is the micro-level programmes (e.g. training women farmers) that have a much larger redistributive impact for poor and marginalised populations. However, in reality the EU prioritises interventions at the macro (e.g. business enabling environment and international Corporate Social Responsibility (CSR) support) and meso (e.g. public-private partnerships and blending mechanisms\(^3\)) levels. It is stated that this new strategic framework will benefit both EU companies and developing countries but it is questionable whether EU companies should be supported through development policy given the need for additional development resources and the risk of increasing aid tied to the delivery of European goods and services.

When considering using scarce overseas aid money to leverage private finance and to support private sector activities, the EU should learn from mistakes made in the past\(^4\) and from the experience of other donors such as the World Bank\(^5,6\). Private finance cannot be seen as a substitute of public finance\(^7\) and the private sector cannot, and should not, substitute the role of governments in their obligation to safeguard human rights and in investing in the provision of basic services like health and education. There is evidence\(^8\) that a “business model” (as opposed to public provision) in these sectors does not work for the poorest on a large scale. Instead, the EU should help support states’ capacities to regulate and rapidly expand free publicly provided health care and education, on the basis of increased domestic resources, and in conformity with the International Covenant on Economic, Social and Cultural Rights. Therefore, the EU should keep the focus on supporting small local businesses rather than large foreign multinational corporations.

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\(^2\) European Commission Communication: Increasing the impact of EU Development Policy: an Agenda for Change, COM(2011)


European donors need to take a more critical approach when engaging with the private sector and demand more evidence and set up a stronger framework before further developing policies and practices, so that they deliver real results for those living in poverty.

Therefore leading international organisations Oxfam, ActionAid and Eurodad are calling on European Governments and the European Commission to:

- **Recognise not only the diversity of the private sector but also the limitations of their contribution and growth to the reduction of inequalities and poverty alleviation, due to its for-profit orientation.** The selection of the right private sector actors to work with is essential; it is not the same to support local private sector actors rather than EU private sector interests.

- **Acknowledge that the core of the framework needs to go beyond the criteria and principles set out in the EC Communication and should be based on internationally agreed principles such as,**
  - **Development effectiveness principles:** The EU should make clear how private sector finance will be aligned to development priorities of national governments and should be accountable for this. The highest should be given to country-owned development strategies, including national industrial and agricultural policies and strategic priorities for private sector development, which reflect the views of local stakeholders (governments, parliaments, trade unions, the local private sector and communities). It must clearly show that Development Effectiveness principles are being met as a minimum, and therefore increase the robustness of the monitoring systems of the Global Partnership for Effective Development Cooperation (GPEDC) and EU member states.
  - **UN Guiding Principles on Business and Human Rights:** It’s the duty of businesses to respect human rights and ensure proper reporting on adherence to the framework. There should be access to remedy measures in place for all parties, for example complaint mechanisms accessible to small holders, local communities and CSOs.
  - **Voluntary Guidelines on the Responsible Governance of Land Tenure:** these guidelines, aimed at achieving food security for all, were signed off by the Committee on Food Security in Rome in 2012 and are the gold standard principles on land which are now being implemented by countries around the world.

- **Develop a robust regulatory framework, which will require:***
  - That the private sector should not be subject to a framework which is any less clear and robust than that which other development actors are subjected to.
  - Ensuring full compliance by all actors with international principles and support existing standards for the protection of the environment and of human rights.
  - Establish clear and transparent mechanisms to pre-assess, monitor and evaluate private sector projects with a clear focus on development objectives.
  - That the pre-assessment phase should include mandatory ex-ante poverty and social impact assessments (PSIA), ensuring free and prior informed consent by intended beneficiaries and affected populations.
  - Strong and robust due diligence mechanisms.
That the monitoring and evaluation phase should also include the views of people directly or indirectly impacted by the projects and negative spillovers.

- **Develop clear financial and development additionality criteria** to prove that the EU is using public resources to finance projects that would not have taken place otherwise.
  - There should be due consideration to the opportunity cost of using public money to support private enterprises to avoid crowding out private finance and to subsidise the private sector.
  - A clear accountability mechanism, including legitimate public oversight (for example parliaments, CSOs in their role as watchdogs).
  - Due diligence mechanisms, including social, environmental and human rights safeguards to ensure compliance with the highest possible standards.
  - Equitable in risk and benefit sharing.
  - Women’s rights should be taken up as clear criteria in planning and project outcomes, at least at a minimum, demonstrate that they do not have a detrimental impact on such rights.
  - Transparency at all stages.

- **Make clear how it will pursue Policy Coherence for Development (PCD),** specifically in relation to adopting regulation to curb financial opacity, tax avoidance and tax evasion to ensure that EU companies fulfil their obligations in partner countries. The EU must ensure that any private sector actor that utilises ODA ‘does no harm’, in the spirit of the PCD principle where the EU is bound according to the Lisbon Treaty. The EU must also address other areas of EU policy, such as trade, investment, agriculture and tax, where many of these current policies have the biggest negative impacts on developing countries and their domestic private sector.

- **Promote and design Public Private Partnerships (PPPs) in a way that delivers real results for the poor.** PPPs should be approached cautiously, and only considered if other less expensive and risky financing options are not available. When designing PPP projects, it needs to be fully owned by the ostensible beneficiaries where their development needs should be explicitly assessed and equity concerns addressed in terms of equitable and affordable access to infrastructure and services. It is important to mitigate any negative spillovers. As there is not always an easy win-win-win, the focus should be on the best possible financing arrangements to deliver for the poor.

- **Before EU governments call on the Commission to expand the scope of the blending activities** (combining loans from financial institutions with grants), the following considerations are recommended:
  - As a start, the Council of the EU should request a report from the EC and the EU Platform on blending in external cooperation to take stock and publicly disclose what they have been working on since December 2012, especially as a follow up to the findings of the Court of Auditors report³;

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Take note and use cautionary language in line with the Court of Auditors report, which casts serious doubts on the financial and development additionality of blending.\(^\text{10}\)

Take a cautious approach in relation to the creation of an Africa blending facility. While donor coordination is needed, it is not enough to ensure concessionality of resources that serve the needs of local people. Clear mechanisms should be in place to ensure debt sustainability for African countries.

ActionAid, Eurodad and Oxfam firmly believe that positive progress on poverty reduction will be made if the following 3 steps were taken:

1. Build a private sector in development framework that focuses on smallholders and SMEs, empowering women entrepreneurs, encouraging local job creation and sparking equality-oriented outcomes so that there are more resources to redistribute.
2. Fill development financing gaps through higher levels of domestic resource mobilisation, including through allowing the necessary policy space to implement reforms towards progressive taxation and financing public services.
3. Work to ensure fairer EU policies across the board, from tax to energy and agriculture, affecting the most marginalised people in developing countries.

\(^\text{10}\) From the Court of auditors press release: Mr Pinxten referred to the risks which arise when blending is not used with sufficient care and attention - “Firstly, it may lead to a waste of EU development funds when programmes/projects, that would have been undertaken anyway, are subsidised. The Commission, when using blending instruments, must make sure that it does not become the “sponsor” of financial institutions. Secondly, if not used with great care, blending may lead to a debt bubble in some third world countries with limited revenues to service their debt.”