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- Private sector development (PSD) is becoming a major development policy area. PSD has enormous potential to function as a catalyst for private sector investment in developing countries, creating inclusive and sustainable growth and alleviating poverty.

- PSD is still being (re)formulated. A decrease in the importance of official development aid (ODA), the economic crisis, the challenge posed by emerging powers in development cooperation, the EU's institutional development, and the partnership with the African, Caribbean and Pacific Group of States (APC) have affected PSD in the EU.

- PSD is interlinked with the EU's coherence challenges. PSD has paradoxically been seen as a retreat back to protecting national interests or as an ambitious attempt to achieve common development goals. Loose groups of member states are beginning to form around PSD. The EU Commission, together with the most advanced member states, functions as a concept and policy generator for PSD.

- There is growing competition for the decreasing funds allocated to more traditional development cooperation, to PSD, and in certain cases to finance the costs of the refugee crisis. A major concern is that private sector development reduces financial flows to the least developed countries (LDCs).

- The success of PSD is also strongly linked to the success of Agenda 2030, the Addis Ababa International Conference on Financing, and climate financing. The EU plays a pivotal role in these global commitments, which also have a major impact on shaping PSD within the EU.

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Introduction

Throughout the world, the private sector functions as an engine for economic growth. Micro-businesses and small and medium-sized enterprises in particular provide a lion's share of jobs in developing countries. A competitive, local private sector has a pivotal role in the fight against poverty. It creates new middle classes and can, under the right conditions, foster an inclusive society in developing countries. Many developing countries need to build their private sector infrastructure with bilateral aid and the assistance of international organisations, including the European Union.

Private sector development (PSD) aims to promote sustainable and inclusive economic growth in developing countries by helping governments to design and implement policies for economic transformation through investment, productivity growth, business expansion and employment. PSD aims at strengthening the business environment via an improved legal framework, strengthened economic institutions, financial infrastructure, physical infrastructure, and access to markets. For example, a PSD project may exert leverage by combating corruption, or channelling climate financing into initiatives that reduce carbon emissions in the developing world, or train women or young entrepreneurs.

A part of European PSD is private sector engagement (PSE), which is sometimes seen as an issue separate from, but related to, PSD. In industrialised countries, development agencies often engage the private sector through encouraging productive investment, and using public official development assistance (ODA) to leverage private sector finance.[1] The brunt of the scepticism, but also expectations, towards PSD is aimed at PSE, where ODA is invested in partnerships with private companies.

Development agencies often work with companies via public-private partnerships (PPP). A common approach is to use publicly financed funds to share risks with companies by providing long-term financing for promising projects in challenging markets where commercial financing is hard to obtain. PPPs aim to leverage the development impact of companies' core business activities. For example, development agencies have cooperated with mobile financial service providers to provide the mobile industry not only with financial tools and insights, but also with support in the creation of a regulatory environment for digital financial inclusion. This has given millions of people in developing countries access to mobile financial services. It is hoped that private sector development financing would have a strong multiplier development impact.

Companies may mobilise funds for specific social and development goals that are directly linked to the companies' interests, such as occupational health or the vocational training of workers. There are many Non-Governmental Organisations (NGOs) working together with companies and government entities in multi-stakeholder PSD projects. NGOs typically get involved with those parts of PSD they know best, including sustainable development, health, education, women's issues, small farmers or corporate social responsibility and labour rights.

The private sector is becoming one of the main development cooperation drivers for national governments, the European Union and international organisations. The EU is a global leader in development cooperation, but it is still formulating its framework for private sector development.

The focus of this briefing paper is the role of private sector development in the development policy of the EU. The paper describes the major drivers behind PSD intensification. Furthermore, the paper aims to describe the potential impacts of PSD on the coherence between the EU institutions and between the member states. In addition, the relationship between PSD and Agenda 2030 is studied, followed by concluding remarks.

The intensification of private sector development

The development cooperation architecture is changing. Private sector development is a major rising trend in development cooperation, since the role of Official Development Aid (ODA) is insufficient in making developing countries self-sufficient. The growth of PSD in the EU and its member states is due to multiple factors: the global economic crisis, the challenge of emerging powers, a decrease in the

1 Byiers, B. & Rosengren, A.: Common or Conflicting Interests? Reflections on the Private Sector (for) Development Agenda. Discussion Paper No. 131. ECDPM, 2012.

importance of ODA in financial flows, the EU's own institutional development, and partnerships with the African, Caribbean and Pacific Group of States (ACP).

Financial flows between the North and South are changing. The relative importance of official development aid (ODA) is decreasing, whereas private financial flows – including money sent home by diaspora members and financing from billionaire philanthropists – are consistently increasing. Net private capital flows to developing countries increased from $155.7 billion in 2005 to $327.7 billion in 2013. Foreign direct investment rose in net terms from $246.4 billion in 2005 to $448 billion in 2013. ODA flows developed from $82.0 billion in 2000 to $134.7 billion in 2013.[2] It should be noted that a significant proportion of the trade of developing countries is conducted with other developing countries, and money sent by diasporas comes to a large extent from other developing countries.

The economic crisis that started in 2008 has resulted in considerable budgetary pressures and cuts in development cooperation budgets in EU member states. At the same time, many European companies have become more hesitant about investing in developing countries. PSD appeared to be a win-win situation for many European decision-makers and European companies, lowering business risks and offering new business opportunities in developing countries.

Emerging powers are challenging the EU's leadership in international development cooperation. China, India, Saudi Arabia, and Venezuela, among others, have become significant donor countries. Development cooperation is no longer a Western privilege. China in particular can be seen as a competitor or ally of the EU. Chinese foreign policy integrates diplomacy, security, trade and development policy. The private sector is an essential part of the Chinese development policy. China's investments in Africa more than tripled in 2008 and have been increasing steadily thereafter.[3] Yet China's approach to PSD has been criticised for benefitting China but not the developing host countries. China's primary interest has been claimed to be raw materials and new markets. In many developing countries, the Chinese model with its different set of values and requirements is seen as an attractive but also criticised alternative to the EU.

The partnership with the ACP Group has played a key role in the EU's development policy since 1975. A Communication was adopted on PSD in ACP in 1998. The EU and ACP are currently working on a new cooperation framework for private sector development in ACP countries, at the level of thematic programmes that address private sector engagement. It is designed for mainstream engagement with the private sector in agriculture, sustainable energy, infrastructure, and in green and social sectors. As the Cotonou Agreement expires in 2020, the EU has started to re-examine the partnership with the ACP Group.

PSD and the EU's policy coherence

PSD and other new development policy areas are interlinked with the EU's efforts for policy coherence as a way to streamline its external relations. The Lisbon Treaty that came into force in 2009 also had considerable consequences for the EU's relations with developing countries, including development cooperation. The EU's development policy remained a shared competence between the EU and the member states. However, the treaty was aimed at integrating development policy into a more comprehensive EU foreign policy system. The EU wanted to enforce its external action, bringing diplomacy, security, trade and development closer together.

Importantly for PSD, responsibility for development policy programming was divided between DG DEVCO of the Commission and the European External Action Service (EEAS). Thematic programmes are mainly prepared by the Commission under the guidance of the Commissioner responsible for International Cooperation and Development and presented to the College of Commissioners in agreement with the High Representative and other relevant Commissioners. The EEAS, on the other hand, contributes to the programming at country- and regional-level PSD and is also more broadly linked to several areas of policy coherence, such as trade,

2 UN: World Economic Situation and Prospects 2015. New York, 2015, pp. 66–67, 71.

3 Xiaofang Shen: Private Chinese Investment in Africa: Myths and Realities. Development Policy Review, 2015, 33 (1): p. 104.

agriculture and fisheries, environment, energy, climate, health and fiscal issues. These issues are dealt with primarily by other directorates of the Commission. Furthermore, for several years, the EU and the governments of developed countries have dealt with PSD both directly under EU development policy and indirectly in other fields of the EU's external relations. In addition to DG DEVCO, it has been dealt with in the context of other policy areas, including trade liberalisation negotiations, which fall under the remit of DG Trade of the European Commission.

As the Vice-President of the EU Commission, High Representative Mogherini coordinates the commissioner cluster responsible for international cooperation and development, humanitarian aid and crisis management, trade, as well as European neighbourhood policy and enlargement negotiations. This cluster should be able to coordinate horizontal issues within the cluster. As PSD is a broader issue, however, and linked to several policy areas, broader coordination and cooperation within the Commission is needed.

Private sector development work in European institutions

The role of the private sector is becoming increasingly important for the EU's development policy. The European Commission, and DG DEVCO in particular, is becoming an important PSD concept generator in cooperation with more advanced member states. The PSD work restarted more intensively after the Lisbon Treaty and the onset of the economic crisis in 2008.

The European Union currently devotes more attention to the private sector, and attempts to implement programmes which act as catalysts and facilitators for enterprises to establish themselves, to grow, to transfer technology, acquire finance, and reach developing markets. The EU provides substantial grant funding in the area of PSD. The primary aims are poverty alleviation and sustainable and inclusive growth in developing countries through the local private sector. Some of the new financing tools are aimed at reducing the prevalent business risk of operating in developing countries, thus making them more attractive as investment destinations for European companies. Over the last decade, support by the Commission for PSD has averaged EUR 350 million per year. This, combined with development assistance and private investment from member states, makes the EU a key player in supporting PSD in partner countries.[4]

The importance attached to private sector development is clearly set out in several documents that the Commission and the Council have adopted since the late 1990s. However, the focus of the PSD work of the Commission has changed during the last five years.

In 2003, the Commission released its first Communication on PSD, which covered action at a macroeconomic level and was related to the work of international organisations around the role of the private sector on financing and investment. However, more intensive and broader private sector development work started at the end of the 2000s. The EU Expert Group with Member States on Private Sector Development in Third Countries was founded in 2010. In 2014, the European Commission released its second Communication on PSD (COM 2014 263 final). The new Communication focuses on the impact that European and local private sector actors can have on inclusive and sustainable growth in developing countries under the right business environment. The Communication also seeks to step up support for micro, small and medium-sized enterprises and for mainstream private sector development within EU development cooperation, and to catalyse private sector engagement for development.

Recent Presidencies of the Council of the European Union have also played an important role in promoting PSD. The Greek Presidency conclusions on PSD were mainly at a thematic level, whereas the Italian Presidency conclusions reflected more on the technical implementation of PSD. The Dutch Presidency during the first half of 2016 is prioritising PSD and its relationship to Agenda 2030.[5]

The European Parliament's Committee on Development started its own work on PSD after the

4 A Stronger Role of the Private Sector in Achieving Inclusive and Sustainable Growth in Developing Countries. Brussels, 13.5.2014, COM(2014) 263 final. p. 2.

5 Ministry of Foreign Affairs of the Netherlands: Programme of the Netherlands Presidency of the Council of the European Union 1 January – 30 June 2016. The Hague, 2015. p. 15.

European Parliament election in May 2014. The work has progressed slowly, which indicates the sensitive nature of the subject. Within the Committee, its own initiative report procedure gave rise to a lively debate, and differing parties have become entrenched in their party political positions. The political right (EPP, ECR) emphasises the role of the private sector in decreasing poverty and creating inclusive growth, namely income growth, job creation, tax income, technology and innovations. The political left and the Greens do not deny the role of the private sector in development, but think its role should not be exaggerated. They fear for the future of the least developed countries (LDC), the role of civil society, and the weakening of international standards for human rights and labour if development becomes corporate-driven.

EU member states on a stronger role for the private sector in developing countries

It has been suggested that the economic crisis has lowered the level of ambition among member state governments to agree on common positions in development cooperation.[6] Private sector development has paradoxically been seen both as a retreat back to protecting national interests and as an ambitious attempt to achieve common development goals.

Critics argue that national export promotion interest plays a strong role in private sector development and therefore it is difficult to coordinate the work between the member states. Those in favour of private sector development argue that the primary ambition of the EU and its member states is the inclusive and sustainable growth of the private sector in developing countries. This is best achieved by good coordination between the EU and its member states. Private sector development can potentially offer a window of opportunity for new common positions in development policy.

Many EU member states have set up programmes to build effective partnerships with the private sector for development, but efforts are still fragmented. Better coordination at the European level is necessary for a more coherent and integrated approach for engaging with the private sector as a means to enhance the EU's support for private sector growth in developing countries.

There is a shortage of development cooperation money. Particularly in member states where development cooperation funds are reduced, there has been a concern that private sector development takes resources from other development cooperation areas and reduces financial flows to the poorest. In certain member states, ODA funds the costs of the current refugee crisis, which then further reduces aid to LDCs. However, at the EU level, funds to LDCs have increased simultaneously with the intensification of PSD.

In the EU, the member states have progressed at very different paces in integrating PSD into their development cooperation policies. Member states have different agendas and interests, and loose groups of member states are beginning to form around PSD issues.

Large member states have multiple interests in the developing world. They tend to have broad approaches to development policy, including stability, security and trade issues. Size matters: companies in the largest member states have well-established business contacts in most parts of the world. The largest member states have integrated PSD into their development cooperation and have welcomed PSD in the EU. Analogously to other EU processes, one or two large member states often take the lead in development issues and smaller member states rally around them. For example, if the United Kingdom, Germany, the Netherlands and Denmark are active regarding an issue, other member states give their support to the issue.

The Nordic member states, the Netherlands and Luxembourg have solid traditions in development policy. They have achieved or are committed to achieving the target of 0.7 per cent of ODA/GNI and they are within reach of 0.15 to 0.20 per cent of ODA/GNI to the least developed countries. These countries have well-established civil society organisations that plan and execute development cooperation projects. They also have strongly export-driven economies with private enterprises keenly looking

6 Keijzer, Niels: Offense is the Best Defense? The EU's Past and Future Engagement in Promoting Effective Development Cooperation: Ideas for Busan. Briefing Note 30, Maastricht, May 2011.

for business opportunities in new markets. This group of countries has been actively promoting private sector development in the EU.

The new member states have been supporting private sector development and some have expressed their interest in export opportunities. These countries are still developing their development cooperation for both the governmental and private sectors.

Global challenges on the EU's development agenda

The importance of the private sector is increasing further due to the sustainable development goals (SDGs) of Agenda 2030, the Action Agenda of the Addis Ababa International Conference on Financing for Development, and the COP21 climate financing summit. PSD is strongly related to the global development agenda. The EU plays a pivotal role in these global commitments, which have a major impact on shaping PSD within the EU. If the EU wants to remain the most important player in development cooperation, it must take PSD seriously. The success or failure of major global development commitments is strongly linked to private sector development.

The Sustainable Development Goals (SDGs) address the economic, social, and environmental dimensions of development. The SDGs embrace private sector growth as a means of development and poverty reduction. The private sector is linked to all 17 SDGs. The role of the private sector is particularly important in the achievement of goals 8, 9 and 12, which deal with economic growth, employment, industrialisation, innovation, and production and consumption patterns, underlining the importance of inclusive and sustainable approaches. The private sector is estimated to be able to help achieve 70 of the 169 SDG targets.

The EU member states are drafting their own national action plans for Agenda 2030. During 2016, the EU Commission under the leadership of First Vice-President Timmermans will work with the European approach to Agenda 2030. It has to determine how EU institutions, governments, the private sector as well as other actors will establish effective partnerships to achieve the goals of Agenda 2030.

The Action Agenda of the Addis Ababa International Conference on Financing for Development expressed an optimistic view on PSD. It stressed corporate social responsibility and human rights as an integral part of corporate life. The countries participating in the Addis Tax Initiative are committed to working for the development of tax collection and the equality, openness and effectiveness of tax systems. However, during the meeting, only the EU made concrete proposals on development financing, with a target of 0.7 % of GNI by 2030, and a target of 0.15 % in 2020 and 0.20 % in 2030 for the LDCs.

Climate financing remains a challenging issue. Even after COP21 in Paris, climate financing will originate from multiple sources: from the UNFCCC's climate financing redistribution mechanism (known as the Green Climate Fund), from other multilateral funds, and from bilateral development aid. The current economic situation will most probably lead to a growing role for the private sector in climate financing because of the scarcity of new and additional financial resources.

Concluding remarks

General expectations on private sector development as a means of tackling global challenges run extremely high. There is a lot of enthusiasm – perhaps even overenthusiasm – surrounding the issue. The most optimistic proponents predict that PSD could gradually contribute to a development process in Africa similar to the Chinese economic success. In certain cases, decision-makers may find it easy to convey development responsibility to the private sector.

Private sector development (PSD) is still being (re)formulated. The major trend in PSD is the rising tide of private sector engagement, not only in the EU context but also internationally. Different understandings and approaches regarding the roles of the private sector, public actors and civil society remain. In any case, PSD is here to stay. Questions remain on the quality and measurement of PSD as well as the conditions under which the private sector contributes to sustainable development. If handled properly, companies can become positive change agents in the developing world, while also making a profit.

PSD plays a pivotal role in the major global commitments that the EU has undertaken. This increases pressure on the EU and its member states to further develop private-sector development tools and coordinate policy-action work more closely with the different actors in both developing and developed countries. Agenda 2030 may serve as a broader context under which the EU, the member states, various industries and civil society organisations may agree on further rules and values for PSD.

At the EU level, it is important to commit the President and the Collegium of European Commissioners to PSD. They are above the other EU administrative levels and sufficiently neutral to be able to promote this vital issue horizontally and tackle potential coherence challenges. The Dutch presidency is an opportunity to strengthen PSD in the EU's development policy and its relation to Agenda 2030. PSD should also be integrated into the EU's existing development policy areas and their norms. An EU-wide compromise on PSD, including the EU's financial commitments to LDCs, should be the common goal.

It is important to strengthen the PSD dialogue between the public sector, the private sector and civil society. This dialogue needs to take place within the EU, between and within the member states, and most certainly with developing countries. The expertise and resources of different stakeholders are required to develop PSD and tackle the relevant development challenges.

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