The role of the private sector in promoting economic growth and reducing poverty in the Indo-Pacific region

A submission to an inquiry of the Foreign Affairs and Aid sub-committee of the Australian Federal Parliament's Joint Standing Committee on Foreign Affairs, Defence and Trade

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1 Introduction

1. This submission draws on past and ongoing work undertaken both jointly and separately by the authors on public-private partnerships for development, the contribution of corporations to development, modes of engagement between official development agencies and private actors, and the design of enterprise challenge funds.[2] It builds upon but further develops a framework for thinking about public-private partnerships for international development which was previously presented in the authors' Development Policy Centre Discussion Paper, 'When Business Meets Aid', in 2013.[3] That paper also contains background information and case studies which we have not repeated here but which may be of interest to the inquiry.

2. The inquiry's general objective is to examine 'opportunities to expand the role of the private sector in promoting economic growth and reducing poverty in the Indo-Pacific region'. Its specific terms of reference encompass:

i. The current role of the private sector in accelerating the pace of economic growth and in reducing poverty in poor countries in the Indo-Pacific region.

ii. Current Australian Government support for private sector development through bilateral and multilateral investments.

iii. Legislative, institutional, social and policy constraints that may reduce the ability of private sector agencies to engage in development.

iv. Additional partnerships, activities or financial instruments the Australian government could use to enhance the role of the private sector in development in the Indo-Pacific region.

v. The role of public-private partnerships in leveraging private sector investment in developing countries.

vi. Risks related to current and possible future approaches to enhancing the role of the private sector in development, and their management.

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[2] The authors' views on enterprise challenge funds have also been informed by contributions from Dr Kerri Elgar during her time as a Visiting Fellow at the Centre in 2013.

[3] Margaret Callan and Robin Davies, 'When Business Meets Aid: Analysing Public-Private Partnerships for Development', Development Policy Centre Discussion Paper 28, April 2013. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2252309.

vii. The role Australian and international businesses could play to support development and inclusive growth in partner countries.[4]

3. The present submission does not seek to address all elements of the terms of reference. For the most part it leaves the first three of the points listed above to be addressed by others, most notably the Department of Foreign Affairs and Trade (DFAT) and international development contractors. The bulk of the submission is relevant to the other four points above (points (iv)-(vii)), though we do not seek to address these pointwise. Our primary aim is twofold: to argue for clarity of concepts and objectives, and to present a small number of practical recommendations in relation to the deployment of Australian government resources within public-private partnerships for international development.

4. An important overarching point is that our specific interest is in how the Australian aid program might work best with private actors, in practical mode, to achieve better development outcomes across all areas in which development assistance plays a role. We are less interested in, and devote less discussion to, private sector development as such.

5. The submission is in eight sections including this introduction. In the following section, section 2, we draw several key distinctions which are useful in framing discussions about the role of the private sector in development, and on which we draw at several points in subsequent sections. In section 3 we provide a brief treatment of aid for private sector development, placing Australia's aid in a broader donor context. In section 4, we summarise the recent history of efforts to establish various forms of engagement between the Australian government and business in relation to international development assistance. In section 5, we identify four distinct objectives that public-private partnerships for development might have and identify some principles that should govern their formation, as well as some risks to be watched. In section 6, we discuss specific strategies and tools for pursuing each of the objectives identified in section 5. In section 7 we provide a brief discussion of aid tying as a degenerate strategy for engaging the Australian private sector in development. Section 8 collects recommendations.

2 Framing the discussion

6. The several distinctions made in this section, which we have tried not to labour, will be useful in the sections that follow.

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[4] The full terms of reference are at http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Foreign_Affairs_Defence_and_Trade/Indo-Pacfic_Economic_Growth/Terms_of_Reference.

2.1 Private sector development vs PPPs for development

7. A fundamental distinction which should be drawn at the outset, and already alluded to in paragraph 4, is that between, on the one hand, efforts in support of private sector development in developing countries and, on the other hand, efforts to engage the private sector in development assistance to developing countries.

8. Private sector development is an objective of development assistance which is pursued alongside the development of health and education systems, agriculture, the institutions of government, public infrastructure and other things. Private sector development benefits from and contributes to progress in the other areas just mentioned, indeed so much so that it is almost a cross-cutting objective. However, it is in a clear sense just one among many objectives of development assistance.

9. The engagement of the private sector in international development assistance, by contrast, has the potential to serve development ends across any and all sectors—including that of private sector development. In this submission we place such engagement between official development agencies and private actors under the rubric 'public-private partnerships for international development' or, for short, 'PPPs for development'.[5] The most common form of such engagement is via commercial contracting, with an official development agency as principal and a private actor as agent. However, commercial contracting is well established, if less dominant than it used to be, and raises only mundane issues (other than those discussed in section 7 on aid tying). The inquiry's terms of reference encompass a much broader range of possible partnerships, most largely unrealized at present.

10. The distinction just drawn is obvious enough but not always clearly observed. In fact donor agencies have tended to speak in quite general terms about their determination to increase engagement with the private sector without specifying whose private sector is intended or what might be the objectives of such engagement. The resultant ambiguity is sometimes also reflected in agency policies and structures. For example, the Private Sector Department of the UK's Department for International Development has a role description which is largely about supporting DFID's private sector development work across all partner countries and in the major development sectors where private sector activity is prominent, but also talks about helping DFID 'to step up its engagement with the private sector in-country and UK businesses'. Its

[5] Not to be confused with PPPs aimed at securing private participation in the provision of public infrastructure and services, such as PPPs for infrastructure or hospital management. These are PPPs for national development, where a national or subnational government partners with private sector actors.

structure includes, in addition to programming-oriented units, a 'business engagement' team.[6]

2.2 Consultative vs practical engagement

11. A second distinction which should be drawn is that between engagement that is primarily consultative in nature and engagement that involves the coordinated deployment of resources by both the public and the private partners in pursuit of shared development ends—which we term 'practical' engagement.

12. Consultative engagement is by no means unimportant, and it can reasonably be argued that there is not enough effective engagement between official development agencies and private sector actors on matters of policy and strategy, at least by comparison with the level of engagement that exists between official development agencies and civil society organisations. However, it is practical engagement that throws up the most difficult and interesting questions and has the most potential for development impact. In the starkest terms, the fundamental question with respect to practical engagement is how official development agencies can use 'soft' money and expertise to increase the development impact of private sector activity without distorting the functioning of markets or providing windfall gains to private partners.

2.3 Enterprise development vs business transformation

13. A third distinction which can usefully be drawn is that between, on the one hand, support for the development of specific business ventures which are judged likely to be economically important in poorer geographic areas—which we will refer to as support for enterprise development—and, on the other hand, support for the incorporation of specific disadvantaged populations into the supply chains of established businesses, which we will refer to as support for business transformation.

14. Enterprise development and business transformation both aim to create 'inclusive' businesses, which target what C.K. Prahalad dubbed the 'bottom of the pyramid'—that is, the four billion people whose annual consumption is below about $US3,000 in local purchasing power terms.[7] The businesses in question might interact with them as suppliers of business inputs (produce, semi-processed goods or labour), consumers of business outputs or participants in the supply chain in some other capacity. It will often be the case that the greatest benefits are consumer benefits, as

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[6] 'DFID's Private Sector Development Work', Independent Commission for Aid Impact, UK, Report 35, May 2014, Annex A5, p. 48.

[7] See Prahalad, C. K. & Hart S.L. (2002), 'The Fortune at the bottom of the pyramid', Strategy + Business, 26, pp. 2-14. Available at http://www.stuartlhart.com/sites/stuartlhart.com/files/Prahalad_Hart_2001_SB.pdf.

firms will often engage a relatively small number of suppliers and employees but sell goods or services that reach, and are considered essential by, quite large populations of poor people.

15. The distinction between enterprise development and business transformation might not seem all that sharp in practice. Generally donor-supported enterprise development programs will employ investment criteria which favour ventures benefiting poor workers, suppliers or consumers, though the weight given to such criteria ranges from high to fairly low. The International Finance Corporation, for example, subscribes to a 'whole of pyramid' approach rather than biasing its investments toward the bottom of the pyramid. Bilaterally-funded enterprise development programs that operate at a more microscopic scale are likely to adopt quite a thoroughgoing approach to ensuring direct benefits for poor people. Nevertheless, enterprise development is not always inclusive, and business transformation does not always involve enterprise development.

3 Aid for private sector development

16. Though the primary topic of this submission is public-private partnerships for international development, we discuss in this section the overlapping topic of Australia's assistance for private sector development—in part because firm-based support for enterprise development, one of our interests, sits at the intersection of the two topics.

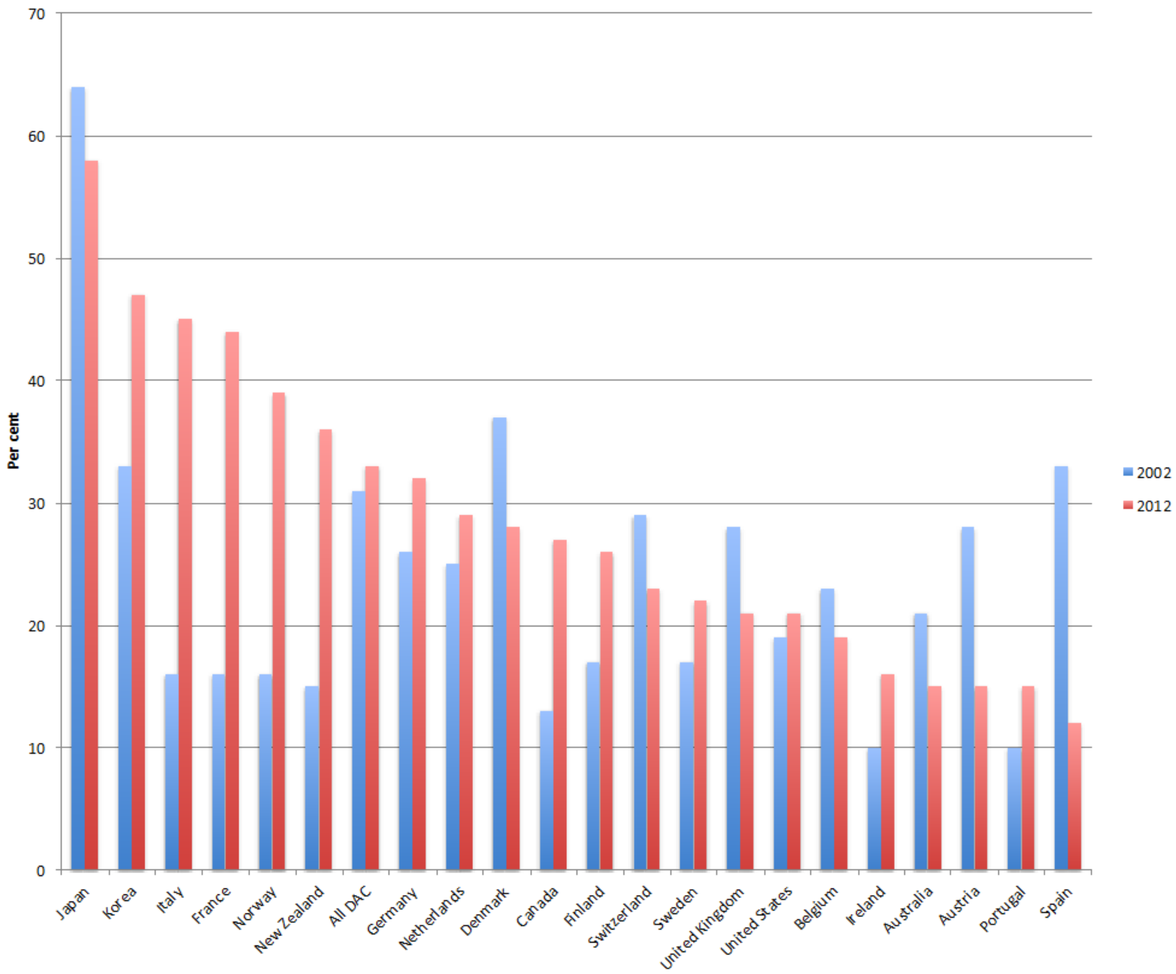
17. Official bilateral donor agencies provide most of their aid to governments to help them discharge their responsibilities to their citizens. Aid program strategies and activities are negotiated with partner governments, who do not generally favour the allocation of substantial resources to non-government actors in their countries. This might be for several reasons. They might see such resource allocation as their own responsibility, or they might actually be hostile to private enterprise or the activities of civil society organisations, or they might simply prefer to preserve scarce resources to supplement or complement their own public expenditures. In addition, donor governments themselves are biased toward the provision of aid on a government-to-government basis, since aid plays an important role in diplomacy. As a result, while much aid can be said to contribute to strengthening the enabling environment for trade and industry, rather little of it is allocated directly to, or for the specific benefit of, private actors.

18. There is no good measure of the quantity of aid for private sector development, simply because the latter term has no precise meaning and cannot really be given one for the purposes of statistical reporting. As noted above, private sector development verges on being a cross-cutting objective of aid. Almost anything supported by aid will

have some benefits for the private sector, including education, health and governance programs. For this reason, aid statistics make no attempt to distinguish between public and private benefits.

19. However, it is possible to examine the level of aid that the member countries of the OECD's Development Assistance Committee (DAC) allocate to the economic infrastructure and production sector groupings[8] as a very general proxy for their level of support to private sector development, allowing that much of this aid is in fact delivered through government-to-government projects, such as a loan-financed roads, bridges and ports. The results are interesting. If one takes a snapshot in 2002 and then another in 2012, the most recent year for which data are available, the result is as shown in Figure 1.

Figure 1: Aid for economic infrastructure and production as a share of sector-allocable aid, selected DAC donors



Data source: OECD Development Cooperation Directorate, QWIDS database, accessed 25 May 2014

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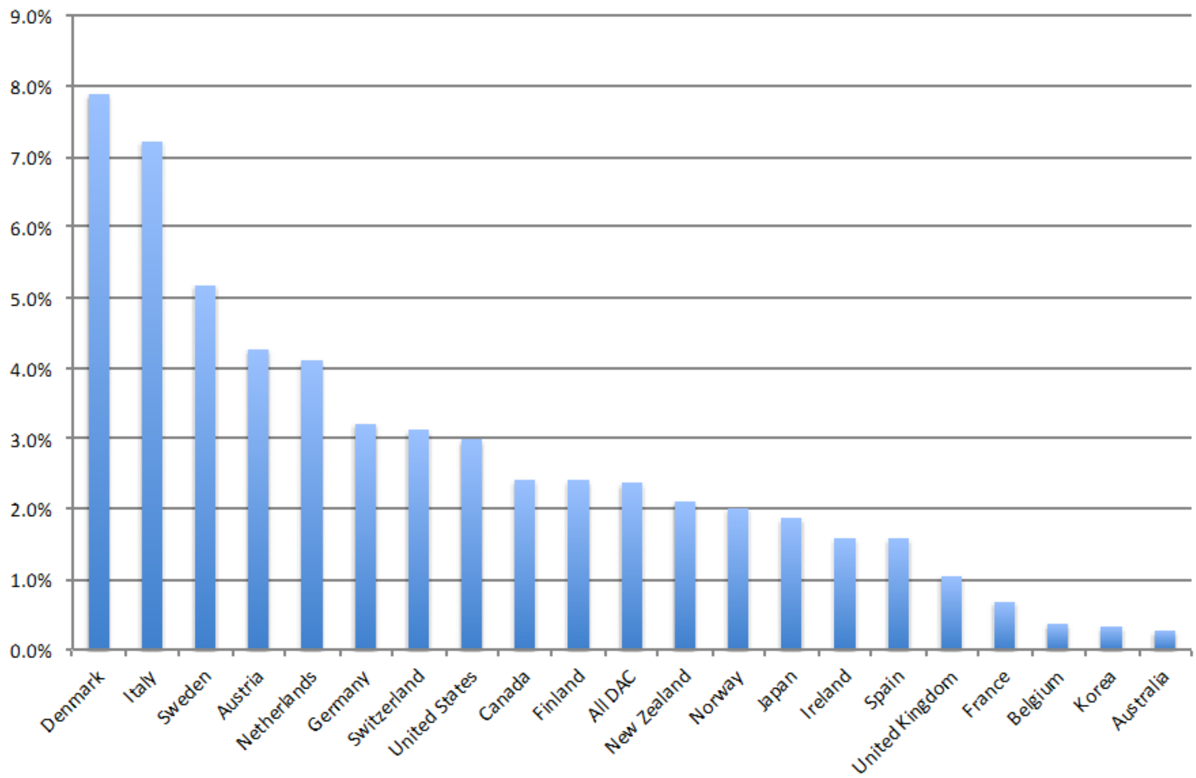
[8] Information on the purpose codes used by the DAC for statistical reporting is available at http://www.oecd.org/dac/stats/purposecodessectorclassification.htm.

20. Between 2002 and 2012, the overall share of DAC aid allocated to economic infrastructure and production did not vary much, increasing from 31 to 33 per cent. However, there was very considerable variation at the level of individual donors. Particularly large share increases were recorded by Korea, Italy, France, Norway, New Zealand and Canada. Offsetting falls—less dramatic in proportional terms but having more impact on the weighted average—were recorded mainly by two large donors, Japan and the United Kingdom. Among the 21 DAC member countries which are included in the above chart (some small donors are excluded for lack of data), Australia was around the middle of the pack in 2002, in eleventh place with 21 per cent of its aid allocated to economic infrastructure and production. However, in 2012 Australia had fallen to eighteenth place, with only 15 per cent of its aid ($568 million) allocated to these sector groupings, less than half the DAC average. The rest of Australia's aid fell into the 'social infrastructure and services' or 'multi-sector and cross-cutting' sector groupings.

21. It is also possible to isolate in DAC statistics the quantity of aid that is allocated to two very specific subsectors: business support services and SME development. This provides a sort of lower-bound proxy for spending on private sector development. Figure 2 below shows the total amount of aid, as a proportion of sector-allocable aid, allocated to these purposes by a selection of DAC donors (all for whom there was data).

Figure 2: Aid for business support services and SME development as a share of sector-allocable aid, selected DAC donors, 2012



Data source: OECD Development Cooperation Directorate, QWIDS database, accessed 25 May 2014

22. The results are consistent with those presented in Figure 1, but even more dramatic. Australia is in last place among the 20 donors included in this selection. It allocated only 0.3 per cent of its sector-allocable aid, which was $10 million, to business support services and SME development, one-eighth the weighted DAC average of 2.4 per cent. Five donors spent more than four per cent of their sector-allocable aid in these areas.

23. The two proxies used above for spending on private sector development are both extremely rough. The first is both very inclusive and not quite able to capture some forms of assistance relevant for private sector development. It is a fairly poor proxy for spending on private sector development in a narrow sense of that term—i.e. spending that is actually directed to, or used for the direct benefit of, private sector actors. The share of aid allocated to private sector development in this narrower sense, both generally and by Australia in particular, might well be an order of magnitude lower. The second proxy, on the other hand, is excessively narrow, but at least not likely to include anything not relevant. Deficiencies aside, both proxies tell the same story: Australia would appear to present a particularly slender profile in support for private sector development.

24. As one would expect from the data shown above, a catalogue of the 'pure' private sector development activities supported by the Australian aid program would be rather short. We are aware, for example, of the following relatively few activities:

- the Enterprise Challenge Fund for the Pacific and South East Asia (now closed) and a similar UK-managed fund which operates in Africa,
- several International Finance Corporation private enterprise development facilities in the Pacific, Indonesia and the Mekong sub-region,
- a new Pacific Business Fund (also known as the Pacific Business Investment Facility), announced by foreign minister Julie Bishop during a visit to the Pacific in December 2013,
- the Private Infrastructure Development Group, a UK-conceived project development and equity financing mechanism,
- a Pacific Private Sector Development initiative managed by the Asian Development Bank
- the AgResults program, a plurilateral initiative launched under G20 auspices to trial the use of incentive payments to spur private sector innovation in agriculture
- agriculture 'value chain' programs in Indonesia and Cambodia,

- an 'output-based aid' program which provides water and sanitation services in Indonesia, and
- various financial inclusion programs, particularly in the Pacific region.

25. In addition there is a second circle of activities that do not involve direct support for the private sector but by their nature involve a reasonably high degree of interaction with it, yielding both social and private sector benefits. These include:

- the Mining for Development Initiative,
- the Australia-Pacific Technical College, and
- the Better Work Program in Asia, which is a joint initiative of the International Labour Organisation and the International Finance Corporation (now possibly defunded).[9]

26. Beyond this, and short of including just about all activities, there is a third circle of activities that involve less direct interaction with the private sector, or sometimes none, but are of particular importance in generating private investment and also improving access to markets. These include:

- technical advisory services for PPP[10] development in the Philippines and Indonesia,
- the Indonesia Infrastructure Initiative, under the Australia-Indonesia partnership, and
- the Cao Lanh bridge in Vietnam.

27. Though Australia appears to be spending less than almost all other donors on private sector development, it should not be assumed that Australia ought to be spending a great deal more. If one looks at the nature of Australia's major aid recipients, some constraints are obvious. The private sector barely exists in some Pacific island countries, and is rather hard to grapple with at scale in the larger countries of Southeast Asia. It is also worth noting that the recent report of the UK's Independent Commission for Aid Impact was quite critical of what it sees as the UK government's overly-

[9] The Coalition government's revised 2013-14 aid budget, released on 18 January 2014, zeroed funding for the International Labour Organisation. It is unclear whether any support for the Better Work Program will continue from bilateral or regional allocations.

[10] In this case we are talking about PPPs for national development.

ambitious spending plans (and, related to these, a habit of overly ambitious target-setting) in this area.[11]

28. Increasing spending by a large amount may not be necessary, feasible or in fact even possible in the current Australian budgetary environment. There does, however, seem to be scope to do more. The key is to ensure that all Australia's country programs thoroughly assess the scope for action in this area, and also to make some central provision to support innovative public-private partnerships for development, since anything of this nature is not easily embraced by country program personnel with other things already on their plates. Nor is it always of much interest to partner governments concerned about protecting existing programs supported by scarce bilateral aid. There are parallels with the situation facing the Australian Agency for International Development (AusAID) around six years ago, when it was charged with putting in place new climate change mitigation and adaptation programs. Most of these were centrally funded, and only later were some incorporated into bilateral programs.

Recommendation 1: In light of the low level of activity in support of private sector development in the Australian aid program, DFAT should systematically survey opportunities to transfer resources from under-performing projects to projects aimed at building productive capacity, enhancing economic infrastructure and improving the enabling environment for private sector activity. A central financing capacity should also be created.

4 Business engagement: the story so far

4.1 Under Labor, 2011 to 2013

29. In 2011 the Independent Review of Aid Effectiveness recommended, somewhat vaguely and without much by way of argument, that 'the power of business should be harnessed and business innovation should be encouraged, including through an annual consultative forum' (Recommendation 21). Expanding on this recommendation, the review panel said:

> The aid program should also consider establishing a mechanism to assist Australian businesses which are seeking corporate social responsibility and/or inclusive business opportunities in developing countries. This could provide information on local context and capacity in developing countries, and link businesses with relevant organisations.

[11] Independent Commission for Aid Impact, 'DFID's Private Sector Development Work', 15 May 2014. Available at http://icai.independent.gov.uk/reports/dfids-private-sector-development-work/.

The panel added that 'country managers should think at an early stage about the potential for engagement with the private sector'.

30. The former government accepted the above recommendation and proceeded, by early 2012, to elaborate a 'business engagement agenda'.[12] This laid heavy stress on strategic consultation, said 'development prompted by business drivers can complement development promoted by social drivers' and somewhat disparagingly referred to a contrasting 'corporate social responsibility model where the community engagement may be considered an add-on to the company's core business'. In practice, the former government's business engagement agenda was confined to broad-brush consultation with business organisations and taken forward by means of a one-off, high-profile summit in August 2012[13] and a number of country- and region-specific round tables[14] during the following year to July 2013. None of these events appears to have issued in concrete outcomes.

31. The above, rather skeletal business engagement agenda was reflected in passing in a thematic strategy on private sector development which was released at the abovementioned summit in mid-2012.[15] The strategy said, 'it will be important for AusAID to engage the Australian business community on private sector development initiatives since many Australian companies have an established and growing presence in developing countries'. Why this was important, or why non-Australian businesses might not be as worthy of engagement, was unexplained. In describing modes of engagement, it talked mainly about consultation and information-sharing.

32. Also in the first half of 2013, AusAID commissioned Accenture Development Partnerships and the non-government organization Business for Millennium Development to undertake a study 'to provide a basis for informed discussion on AusAID's business engagement agenda'. Released in October 2013, the resulting report, 'Business in Development 2012'[16], usefully mapped the involvement of major Australian businesses in developing countries and found them increasingly interested in increasing

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[12] At the time of writing, this could be found at http://aid.dfat.gov.au/partner/pages/business.aspx.

[13] See http://aid.dfat.gov.au/HotTopics/Pages/Display.aspx?QID=778.

[14] Indonesia, the Pacific, Papua New Guinea, Burma and Africa.

[15] This strategy, unlike other thematic strategies of the former government has been removed from the website of the Department of Foreign Affairs and Trade (DFAT). It has also been removed from the 'agency strategies' section of the website of the Donor Committee for Enterprise Development, a central repository of publications on enterprise development. We have placed a crude HTML version of it here: https://www.dropbox.com/s/lio3w11220gjxyn/AusAID%20%282012%29%20PSD%20strategy.docx.

[16] Inexplicably, this report too has been removed from the website of the Donor Committee for Enterprise Development. It can still be found here: http://www.accenture.com/SiteCollectionDocuments/PDF/Accenture-Business-Development-Study-2012.pdf.

the poverty reduction impact of their core business operations for reputational reasons. However, it had little to say about opportunities for practical engagement. In general, business interlocutors appeared either unsure about how they might 'work with' AusAID or else keen for AusAID, in normal aid mode, to do more in support of improvements in enabling environments for business activity. Support of this kind, we note, might involve some level of consultation but not practical partnerships.

33. Further, in early 2013, AusAID commissioned the London-based Overseas Development Institute to undertake a two-year 'Business-Development Exchange' research project (May 2012 to May 2014) to 'build knowledge on why and how donors should engage with business' with a particular but not exclusive emphasis on opportunities for engagement with Australian business.[17] Few outputs are evident at this stage, other than a useful but general taxonomy of the ways in which donor agencies currently engage with businesses.[18]

34. At the programmatic level, little changed with the advent of the business engagement agenda. No resources were allocated to new programs aimed at increasing the development impact of business activity. One partial exception was the allocation in late 2012 of $10 million to support selected health-sector product development partnerships (on which more below)—but this allocation was made pursuant to the former government's medical research strategy, developed in response to a separate recommendation of the Independent Review of Aid Effectiveness (Recommendation 23).[19] Another seeming exception, also in conception independent of the business engagement agenda, was the Mining for Development Initiative. Launched at the Commonwealth Heads of Government Meeting in Perth in 2011, and promoted at an international conference in Sydney in 2013, this initiative featured some senior Australian private sector figures at its launch and at the Sydney conference. It might be assumed to involve some kind of assistance to or through mining companies, and in fact that assumption has regularly been made by critics of the initiative.[20] In reality it is essentially a government-oriented, university-based training and technical assistance

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[17] See http://www.odi.org.uk/projects/2565-business-development-indonesia-myanmar-papua-new-guinea-vietnam for details of the project and its outputs.

[18] William Smith, 'How donors engage with business', Overseas Development Institute, July 2013. Available at http://www.odi.org.uk/sites/odi.org.uk/files/odi-assets/publications-opinion-files/8502.pdf.

[19] Recommendation 23: 'There should be more aid funding for research by Australian and international institutions, particularly in agriculture and medicine'. The medical research strategy, released in 2012, can be found at http://aid.dfat.gov.au/aidissues/health/Documents/medical-research-strategy.pdf.

[20] See this ABC news report: http://www.abc.net.au/news/2013-05-16/an-ngos-question-australia27s-mining-for-development-initiative/4692906.

program in the area of mining sector governance[21], not a program that seeks to influence private sector investment strategies. In addition, the scheduled closure of the Enterprise Challenge Fund for the Pacific and Southeast Asia[22] in October 2013, after six years of operation, was not preceded by any evident effort to design a follow-on program with similar objectives.

35. Overall, the business engagement agenda under Labor, had it continued along the same path, seemed destined to fizzle out. It was approached essentially as a constituency development exercise, with the over-riding purpose of engagement being to build understanding in the business community of the scope and objectives of Australia's aid program—the same sort of understanding that already exists among non-government organisations by virtue of their many interactions with the aid program. In fact it seems likely that the main intent of the recommendation which launched the business engagement process, Recommendation 21 of the Independent Review of Aid Effectiveness, was in fact to develop a broader constituency for development assistance rather than to stimulate cooperation of a more practical nature.

4.2 Under the Coalition, 2013-14

36. Before the September 2013 election, the now Minister for Foreign Affairs, Julie Bishop, spoke often of the Coalition's determination to accord higher priority than the former government to supporting 'aid for trade'—that is, aid that supports trade policy and regulation, builds productive capacity and finances economic infrastructure and trade-related structural adjustment. More generally, she spoke of 'leveraging private sector investment to support economic growth and job creation'.[23] Most recently, Ms Bishop set out a 'new paradigm' for Australian aid of which 'sustainable economic growth driven by the private sector' is the first and most prominent element.[24] 'Our new development paradigm', she said, 'will involve new kinds of partnerships between the

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[21] The core of the program is the International Mining for Development Centre (IM4DC), whose 2013 Highlights publication (http://im4dc.org/wp-content/uploads/2013/05/IM4DC-Highlights-2013.pdf) states, 'To the end of June 2013, IM4DC will have delivered 30 courses, workshops and study tours over 5,000 participant training days, to more than 900 people from 36 developing countries. We will also have commissioned 20 research projects, hosted 11 fellows and presented two international conference events for 700 delegates'. The other principal component of the Mining for Development Initiative is support for the multilateral Extractive Industries Transparency Initiative.

[22] See http://www.enterprisechallengefund.org/.

[23] See this speech delivered in Adelaide on 19 July 2013: http://juliebishop.com.au/address-to-national-dialogue-on-the-role-of-the-private-sector-in-development-and-aid-for-trade/.

[24] See this speech delivered in Melbourne on 29 April 2014: http://foreignminister.gov.au/speeches/Pages/2014/jb_mr_140429.aspx?ministerid=4. Also this speech delivered in Canberra on 14 February 2014: http://foreignminister.gov.au/speeches/Pages/2014/jb_sp_140213.aspx?ministerid=4.

private sector and government. The private sector brings with it innovative approaches, and different business models, which may provide solutions for otherwise intractable development challenges'.

37. Thus far, despite the understandable urge for product differentiation, there is in fact little to differentiate the stated policies of the present and former governments with respect to business engagement and private sector development. Likewise at the programmatic level, it is not clear at this point that a great deal of change can be expected. It is notable that when Ms Bishop speaks about specific instances of support for private sector development, she refers approvingly to initiatives of the former government, such as the Philippines Public-Private Partnership Centre, the Cao Lanh bridge in Vietnam and the umbrella partnership with Carnival Australia in the Pacific, or in one case to a program—the Enterprise Challenge Fund for the Pacific and Southeast Asia—which was established by the Howard government in early 2007 but embraced, after some initial hesitance, by the subsequent Labor government. (We note that Ms Bishop said in mid-2013 that she intended to continue with the Enterprise Challenge Fund, expecting that it 'will pass any key performance benchmarks that I would establish to judge our aid program against'.[25]) She has, to our knowledge, so far been silent on the Mining for Development Initiative but one would expect the government to regard that initiative as consistent with its interest in using aid to promote economic growth and opportunity.

38. There is, however, a potential point of real differentiation. The former government, like the Howard government, did not seek to use aid to subsidise the activities of Australian companies wishing to enter or expand in developing country markets, and maintained a policy of not tying the procurement of good and services under the aid program to Australian suppliers. Its private sector development strategy stated explicitly that business engagement would be 'consistent with Australia's untied aid policy which recognises openness in trade and competition and prohibits discrimination based on foreign ownership, affiliation or location'.

39. While the present government has not explicitly stated any intention to vary from the above policies, there is an ambiguity about its notion of 'economic diplomacy'. In speaking about this, and the Coalition's decision to fold the former AusAID into DFAT, Ms Bishop has said that 'DFAT will have a clear focus on promoting the economic interests of the Australian people and Australian businesses in its international engagement' and that Australia's aid program should shift toward support for 'sustainable economic partnerships' with developing countries. It is worth noting that that Canadian government, which also speaks of 'economic diplomacy' and has recently

[25] See the speech referenced in footnote 23.

folded its aid agency into its foreign ministry[26], has been quite explicit about 'better aligning Canada's development and trade interests to ensure that the investments we make abroad deliver maximum value to both our development partners and our Canadian investors and traders'.[27]

40. The Secretary of DFAT, Peter Varghese, has interpreted the present Australian government's intentions quite differently, saying that 'when the government talks about aid and trade, they're not talking about using the aid program to promote Australian exports. Their front-of-mind concern is the role for the aid program in building up the capacity of developing countries better to engage in the international trading system'.[28] On another occasion Mr Varghese said, 'when I talk about aid for trade I am not talking about using the aid program to advance the commercial interests of Australian companies'.[29] These are firm and unambiguous statements but, to date, no similar statement has been made at the political level.

4.3 Where next?

41. In sum, both the present and the previous government have in fact exhibited similar levels of interest in both private sector development and business engagement. The former government made little progress with business engagement, in part because it established no mechanism to support practical cooperation and confined its efforts to seemingly unstructured consultation. The present government has so far emphasized the general benefits of private sector-led growth and has taken quite a broad view of what constitutes support for private sector development, including aid for infrastructure and social services. It remains to be seen what approaches the government might take to working directly with the private sector, whether at the local level in developing countries, or at the level of Australian-headquartered multinationals and/or SMEs.

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[26] See http://devpolicy.org/o-cida-dismantling-ausaid-the-canadian-way-20131115/.

[27] For more reflections on the speech from which this quote was taken, by Canadian trade minister Ed Fast, see http://devpolicy.org/in-brief/a-trans-pacific-sea-change-aid-and-economic-diplomacy-in-canada-and-australia/.

[28] See this interview with Michelle Grattan in *The Conversation*: http://theconversation.com/dfat-secretarys-tough-message-about-ausaid-integration-19799.

[29] Testimony to the Senate Foreign Affairs, Defence and Trade References Committee's inquiry into Australia's overseas aid and development assistance program, 21 February 2014. Transcript available at https://www.dropbox.com/s/a39x3c8v90zr7j6/Foreign%20Affairs%2C%20Defence%20and%20Trade%20References%20Committee_2014_02_21_2241.pdf.

42. Specifically, it remains to be seen:

- to what extent the government might wish to pursue public-private partnerships for development, as distinct from private sector development;
- how interested it might be in practical cooperation with business as distinct from consultative engagement; and
- whether its performance assessment framework will include inclusive business outcomes as distinct from business outcomes measured in financial terms (funds invested, revenues generated, etc.)

5 Public-private partnerships for international development

43. We turn now to the substance of public-private partnerships for international development, considering what the specific objectives of such partnerships might be, what principles should govern their formation and what risks need to be kept in view.

5.1 Objectives

44. At the most general level, there are two quite distinct objectives which PPPs for development might be established to pursue, both of which in turn have variants. The first of these high-level objectives is to increase the inclusion of the poor in business activity; the second is to leverage the capabilities of business to achieve public benefits. For short, we will say the two objectives are business inclusiveness and business citizenship.

5.1.1 Inclusiveness

45. Drawing on a distinction made in section 2.3, we can say that business inclusiveness is achieved either through enterprise development or business transformation.

46. **Enterprise development**. Enterprise development is achieved through direct engagement with firms against a relatively constant or slowly changing enabling background. PPPs for enterprise development can proceed in either of two quite different ways. They can:

i. share investment risks that local financial institutions, where these exist, could not reasonably be expected to assume, or

ii. compensate for government failures which substantially constrain the ability of a firm to operate, such as the absence of adequate education and training for employees or basic financial literacy among potential consumers of mobile banking services.

47. **Business transformation**. PPPs for business transformation are quite different in character from those for enterprise development. As noted in section 2.3, enterprise development partnerships will tend to preference investments that offer broad-based benefits for local communities, and are in that sense 'inclusive'. However a business transformation partnership as here understood is one whose express purpose is to increase the participation of poor people in significant, often international, value chains. It will therefore generally involve an established, probably multinational firm, and will seek to extend or modify the operations of that firm in ways that make its business model more inclusive of the poor. In many cases, no partnership with a donor agency is needed to make this happen; many businesses are undertaking this kind of transformation for purely commercial reasons. But, in some cases, PPPs can bring about change that might not otherwise happen. There are two main ways in which donors can play a useful role within PPPs for business transformation:

i. through education, training and capacity-building partnerships which build labour forces and management cadres equipped with the specific skills that firms need but also yield individual and societal benefits, and

ii. through three-way partnerships between donors, firms and communities, mediated by specialized civil society organisations, which build community capacity to supply business inputs and allocate associated profits fairly and efficiently to individual producers and the community as a whole.

5.1.2 Citizenship

We use 'business citizenship' as shorthand for the willingness of business to make available its capacities, developed in the course of carrying on its core business, for public-good purposes. A business might do this in order to provide public goods in a more or less restricted domain, or to contribute to the provision of global public goods.

48. **Restricted public goods**. PPPs for the provision of restricted public goods will generally take the form of service delivery partnerships of one kind or another. A company might run health and education programs for its own workforce and immediate families, or broader programs for communities in the areas where it operates. With donor funding, the company might agree to extend the scope of these programs to benefit individuals and communities that are outside the scope of its business interests. Or a company might simply make available its storage and distribution networks to convey an essential, donor-procured product to poor communities.

49. **Global public goods**. PPPs for the provision of global public goods will generally involve innovation and a process of product discovery and development. A donor might

make resources available in the form of ‘pull’ financing (e.g. prizes or other results-based payments) to create incentives for innovation, or else in the form of funding for platforms that allow multiple public and private actors to coordinate their work, with at least some private actors contributing on a pro bono basis.

5.1.3 Other objectives

50. While what we have termed inclusiveness and citizenship are the two major objectives of PPPs for development, there are others of which we mention two below.

51. **Financing**. Occasionally a donor agency works with a private actor in much the same way as it works with another donor agency, through financing partnerships. Under such partnerships, the donor agency and a firm or philanthropic actor engage in joint financing of development activities, based on cooperative assessment of their merits.

52. **Capacity-building**. Health and education services for the poorer sections of the community are often delivered by the private sector in developing countries—but often by huge and shambling non-profit organisations rather than sleek corporations. These non-profits are not exactly NGOs; they are run on business lines and they run businesses: hospitals, schools and health clinics. However, they lack basic resources and skills. Their services could undoubtedly reach more people, have more impact and be delivered more efficiently if they were to benefit from partnerships with official donor agencies.

5.1.4 Consultation

53. As a final point in this section, it should be emphasized that there are other forms of possible engagement between development agencies and private actors, not included above, which fall into the category of consultative rather than practical engagement. The two main forms of such engagement are:

i. consultation on matters of policy and strategy, both at the level of the aid program as whole and in relation to the specific countries, regions or development sectors, and

ii. consultation on voluntary corporate codes and standards which place self-imposed constraints on corporate conduct in or toward developing countries.

54. These consultative forms of engagement may well be important at certain times. However, in general private actors have limited patience for engagements of a general nature on matters of policy and strategy, even in a country-specific context. They will happily engage once or twice to see what might come of the interaction, but will soon lose interest if there is no answer to the question, ‘what next?’

55. As for engagement with respect to corporate conduct, it is unclear that this would add value to the quite well-developed processes that already exist in the private sector, including those overseen by the UN Global Compact Network of Australia and various international processes relating to the implementation of numerous codes, norms, standards, principles and best-practice guidelines.[30] Here the priority should be that DFAT fully informs itself about the key development- and sustainability-related norms to which major businesses subscribe so that it does not find itself subsidizing, directly or indirectly, actions that businesses should already be undertaking in order to comply with relevant norms.

56. The treatment of objectives given above is not a standard one; it is of our own devising. There is in fact no standard way of articulating the objectives of engaging business in development. It is alarmingly rare to hear any official donor agency talk in specific terms about the objectives of its engagement with the private sector. The term engagement itself is extraordinarily fuzzy and, like the formulation 'working with the private sector', extends blandly across all the above categories of PPP for development, both practical and consultative. Yet each of the partnership objectives identified above requires a different way of engaging with private actors, different agency structures and different types of call on agencies' financial and human resources.

Recommendation 2: The government should clearly articulate, by means of a policy statement, what are the main objectives of its engagement with business, encompassing both consultative and practical engagement.

57. Before discussing some strategies and tools for pursuing the objectives identified above, we will highlight some general principles that PPPs for development should be expected to observe, and then some risks that should be considered in their formation.

5.2 Principles

58. There are some common principles which prospective PPPs for development, regardless of their objectives, should be expected to observe or at least take into consideration. We identify five such principles below. Partnerships that fail to observe these are more likely to be short-lived, ineffective and wasteful, or even harmful.

i. They should capitalize as far as possible on **private sector ingenuity** to propose and develop projects. Ideally, donor funding should be used for purposes of the

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[30] These include the UN Global Compact Principles, the Equator Principles, the standards contained in the Global Reporting Initiative and the Principles for Responsible Investment. For a discussion of these, see Margaret Callan, 'What do we know about the private sector's contribution to development?', Development Policy Centre Discussion Paper 11, January 2012. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2012145.

private sector proponents' own devising within parameters determined by the donor.

ii. They should convincingly demonstrate **additionality**. Subsidised investments must be ones that would not otherwise be made, or else would otherwise be delayed for so long as to create substantial welfare loss. Determining whether additionality will be or has been achieved is a difficult and subjective matter, but this principle is universally espoused.[31]

iii. They should involve **co-investment**. Public funds should not relieve the private partner of all costs and risks. As is sometimes said, the partner firm should have 'skin in the game'. For service delivery partnerships, the co-investment is likely to be in-kind.

iv. They should seek to preserve **competitive neutrality**. Donor subsidies or other preferential arrangements between a donor and a partner firm should not give the firm a long-term or extreme competitive advantage over other firms operating in the same market.

5.3 Risks

59. There are some significant risks involved in the formation of PPPs for development, which have the potential to affect both the public and the private parties as well as the quality of the specific activities on which they might collaborate. We identify five such risks below.

i. **Marginality**. The bilateral, government-to-government nature of most official aid programs means that PPPs for development, which are likely to be accorded low priority by partner governments, tend to be run through multi-country initiatives with limited visibility to partner governments. As a result, they tend to be thinly spread, complex and costly to run, and poorly integrated with country strategies. This reduces opportunities to create synergies between them and existing bilateral activities, and makes it much less likely that the role of the public partner might in time pass to partner governments.

ii. **The culture of disbursement**. Aid agencies exist fundamentally to allocate and distribute money through contracts and agreements. They are in practice, and

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[31] For a very recent discussion of the challenges associated with determining additionality, see Melina Heinrich, 'Demonstrating Additionality in Private Sector Development Initiatives – A Practical Exploration of Good Practice for Challenge Funds and Other Cost-Sharing Mechanisms', Donor Committee for Enterprise Development, April 2014. Available at http://www.enterprise-development.org/page/demonstrating-additionality.

with some notable multilateral exceptions, generally poor at the direct provision of public goods such as knowledge and convening services. They have little inclination or capacity to work with private actors in ways that do not involve the disbursement of funds, or perhaps involve only small amounts of funding for third parties (e.g. NGOs).

iii. **The profit motive**. Just as donors exist mainly to spend money, firms exist mainly to make it. Some firms might see donor subsidies as potential additions to their bottom line, particularly where such subsidies are allocated on the basis of counterfactuals that only the firm itself is truly in a position to evaluate. It is easy for a firm to argue that its board or investment committee would not approve a certain investment because the ratio of cost to expected revenue within a given timeframe was too high, and that a grant is needed to reduce the cost, lower the ratio and trigger the investment. This is in fact the classic logic used to justify the use of donor funds to reduce partner risk in enterprise challenge funds.[32] But it is impossible for anybody outside the firm to know if this story is accurate, or whether the firm's cost-benefit calculations were well-founded.

iv. **Failure**. Failure is of the essence of entrepreneurialism, and donors generally cannot abide it. If a donor is providing funds to a venture that is so high-risk that it cannot raise money even where the banking system is well-developed, or if it is co-financing a change of corporate strategy about which a multinational firm is not really sure, then failure must surely be expected in at least a large minority of cases. Provided that the returns from successful activities exceed the losses from failed ones by a reasonable margin, this is not a problem. In principle this is well recognized by donor agencies. In practice, though, the fear of project failure influences decision-making, with two impacts. First, it biases activity selection toward activities that are lower-risk but simply lack access to finance. Second, it biases program design toward small activity sizes, so that no individual failure will involve a large loss of funds.

v. **Moral hazard**. The perceived availability of official aid over long periods can erode incentives for firms to pursue non-commercial value. A firm that engages in service delivery financed by official aid but contributing its own infrastructure

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[32] For example, a 2012 DFID document relating to the development of a new enterprise challenge fund for Vietnam gave the following rather stylised rationale for the provision of donor subsidies to established firms. 'Among firms, a risk-return hurdle typically exists that can prevent innovative projects, with potentially high social impacts and potential commercial viability, from going ahead. Such projects are likely to be passed over by a firm's investment committee when compared with projects offering less risky or greater financial returns.' (Document available here: iati.dfid.gov.uk/iati_documents/3717559.doc.)

and other resources could eventually conclude that it is in a unique position to establish an aid implementation division and bid for aid contracts, thus doing the same service delivery task but at a profit.

6 Strategies and tools

60. We now proceed to a discussion of some strategies and tools for taking forward PPPs for development, taking our headings from the main objectives identified in section 5.

6.1 Enterprise development

61. A donor agency whose interest is in PPPs for enterprise development would logically focus its resources on local firms, place the onus on them to generate proposals and confine its support to proposals that offer the potential for high development returns combined with a level of risk that is beyond the threshold that a bank could be expected to accept. Where firms have bankable proposals but simply lack access to finance, the response should be support for the development of financial institutions rather than direct support for firms. Donors should not allow themselves to become de facto bankers with low-risk, low-return portfolios. Likewise, where firms have good ideas but simply cannot generate bankable proposals, the response should be support for business advisory services. Only in cases where risks and potential development returns are high, and capacity is strong, should donors work directly with firms.

62. In some cases a whole venture might be considered unbankable, in which case a donor will play the role of financier. Here finance would ideally be provided as what the UK calls 'returnable capital' above some reasonable threshold, with repayment contingent on the firm's achieving some level of profitability on a sustainable basis. However, there are practical barriers to the implementation of this idea[33], and grant financing is defensible. In other cases a bank might be willing to finance a venture provided that project risk is wholly or partially guaranteed by a donor, or provided that additional investments, important for the success of the venture, are financed by a donor. Financing for additional investments is likely to fall into the 'missing public goods' category, as it will usually involve financing for things that the public sector would normally be expected to provide for the benefit of individuals and the private sector generally, such as financial literacy training.

[33] Not the least of which is that the donor is unlikely to be around long enough to collect repayments, given that it might take more than five years in some cases for the requisite levels of profitability to be achieved.

63. The tool most appropriate for supporting PPPs for enterprise development is the **enterprise challenge fund**. Such funds have proliferated over the past decade or more. Australia has established one, the Enterprise Challenge Fund for the Pacific and Southeast Asia[34], and supported another, the African Enterprise Challenge Fund. Such funds, of which there are now many around the world, have not yet managed to establish a strong track record but have registered some notable successes. Their main weakness has been a tendency to use the same tool for enterprise development and business transformation ends, despite the fact that these different ends involve working with quite different partners and deploying resources in quite different ways. Enterprise challenge funds are best used to support the development of local business ventures, and less suitable for supporting efforts to make established firms more inclusive in their business processes. Established firms do not need the funds, and will rarely bother bidding for them.

Recommendation 3: The government should develop a successor to the Enterprise Challenge Fund for the Pacific and Southeast Asia, taking account of lessons learned from the recently-closed pilot program. A successor program should focus on local enterprise development and be integrated into relevant country programs.

6.2 Business transformation

64. Here the aim is to make an established business more inclusive of the poor through changes in its operations. The benefits of such changes are confined to a specific group of poor people, and are intended to spread to similar groups through replication or scaling-up. Thus the benefits are not of the public-good type. More inclusive business models are already being adopted by multinational corporations without much or any donor agency involvement, most notably in relation to international trade in commodities such as coffee and cocoa. This responds to a level of consumer demand for 'fair-trade' products, a subcategory of ethically-sourced products.

65. It is reasonable to ask why donor agencies should have any role to play in promoting inclusive business. We would argue that donor agencies do have a role, principally because there are situations in which a company would be willing to change corporate strategy but the costs associated with training and organizing poor people to participate in their supply chain are a major disincentive. In such situations, it is reasonable for a donor agency to step in and help, usually through a third-party with

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[34] The Project Completion Report for this fund has recently been released (http://aid.dfat.gov.au/aidissues/foodsecurity/Documents/ecf-2013-project-completion-report.pdf). It finds that by 2015, two years after project closure, the full cost of the program will have been offset by benefits for the poor in terms of increased incomes or reduced costs. This does not read as resounding success, but several of the specific activities supported have performed very well.

community organization and small-business advisory capacity. In some cases a donor agency might also share with the firm its preliminary analysis of the feasibility of a new business model. However, in general it would be difficult to justify providing funds directly to the firm for community organization purposes, since the communities concerned need independent advice. It would also be difficult to justify undertaking detailed feasibility work for the benefit of a large commercial operation.

66. An appropriate tool for supporting inclusive business partnerships is a donor-funded brokering agency which acts as an intermediary between businesses and the organisations—mostly civil society organisations—that are best placed to ready communities for engagement with them. Beyond connecting companies to civil society organisations, a brokering agency should also have funding capacity. This should be used judiciously, with funds provided only where there is a clear risk that the costs of a strategy change might exceed the returns, and only where the firm is willing to share the costs. For the reason given in the previous paragraph, funds should in general be allocated not to firms but rather to linked civil society organisations. It should be noted that this would constitute cost-sharing with the firm, rather than risk-sharing; the firm is risking a minor loss at most, and it does not need to share this risk. What firms do need, in some situations, is a change in the external environment which makes it much easier for them to shift strategy. One example of such a broker is Fair Trade Australia and New Zealand. Another example, in conception at least, is Business for Millennium Development—though this organization now appears to operate as a consulting firm for businesses, in part because its funding agreement with the former AusAID required it to strive for self-sufficiency in funding.

67. A second tool for supporting inclusive business partnerships is technical training. Technical and vocational education has fallen out of favour with aid agencies over the last decade or so, but the Australia-Pacific Technical College is in principle an example of a mechanism that seeks to develop local skills matched to the needs of regional employers.[35]

Recommendation 4: The government should consider establishing an inclusive business broker with funding capacity, independent of business, to develop a small number of potentially high-impact inclusive business partnerships with companies operating in aid program partner countries.

[35] 'In principle' because questions have been raised about the cost-effectiveness of the training provided.

6.3 Restricted public goods

68. Here the objective is to take what a firm is doing, or has the capacity to do, for its own business reasons, and render it publicly beneficial. This is not the same as making it beneficial to a specific group of people who are part of a firm's supply chain; the aim is to achieve more generalized benefits for a population, even if in a limited geographic area. In that sense, the aim is to produce a public good.

69. One example of this idea would see a firm with its own education and training capacity open its doors to a wider population, or a firm implementing a preventive health program expanding that program beyond its immediate business interests (which might include its own workers and their immediate families). There is a good case for donor support for such expansions in particular contexts, particularly where government service delivery is chronically weak, resulting in major welfare loss.

6.4 Global public goods

70. The best exemplar of a PPP for the provision of global public goods is the health-sector production development partnership, of which more than 25 have been established since the late 1990s. Such partnerships see pharmaceutical companies using their core research capacity to contribute to the production of vaccines, drugs and diagnostics for neglected diseases—where 'production' might encompass discovery, development and distribution. Here public resources are used to establish production platforms which engage the capacities of multiple private research laboratories and drug manufacturing firms, with some of the private inputs provided pro bono and some under contract.

71. No special mechanisms are required to support partnerships of the above kind. Partnerships that open up firms' own health or education programs can be supported through country sector programs or in some case NGO funding allocations. Product development partnerships are multilateral mechanisms appropriately supported from global health allocations.

Recommendation 5: The government should undertake a systematic examination of the relevance and performance of the major health-sector product development partnerships with a view to allocating multi-year support to several of the most effective. Funding of around $10 million per annum for such mechanisms would meet minimum burden-sharing expectations, but more would yield high returns.

6.5 Collaboration for enhanced development impact

72. This is an area where one would not actually expect to see, and one does not see, a lot of activity. Here we are looking at partnerships that engage private development

actors on the same basis as official donor agencies. The private actors in question might be philanthropists wishing to invest in good development programs, or corporations wishing to contribute far beyond their core business to the development of a country or countries where they operate.

73. Australia is not replete with philanthropists wishing to invest in international development programs, though there are some, including the Harold Mitchell Foundation, a major benefactor of the Development Policy Centre. There have been occasional examples of philanthropic organizations co-investing with the Australian aid program in specific projects—the Myer Foundation co-funded the Australia-Indonesia BRIDGE School Partnership Project[36] and more recently the Harold Mitchell Foundation has co-funded the Papua New Guinea Family and Sexual Violence Case Management Centre. If there were greater will on the part of philanthropic organisations or individuals to invest in international development, there would clearly be scope for DFAT to provide advice on options for such investment, including advice on the capabilities of Australian NGOs.

74. There are even fewer firms in Australia, or in Australia's vicinity, that operate substantial corporate aid programs. The establishment by BHP Billiton of the Papua New Guinea Sustainable Development Program, which became over time the second largest donor to Papua New Guinea after the Australian government, is something of a special case, and perhaps now a historical curiosity.[37] Nevertheless, BHP Billiton is a substantial donor through its corporate social responsibility programs—its 2013 Sustainability Report indicates 'community investment' of somewhere near $250 million in 2013 of which around 45 per cent is spent overseas. Many other resource extraction companies also have substantial community programs in the countries where they have business interests. What is rarer is the establishment of a separate foundation for national development by a private corporation. There is a striking instance of this in Papua New Guinea, where the Oil Search Health Foundation is operating not merely in areas where Oil Search Limited has mining operations but also in other areas across Papua New Guinea with funding provided from the Australian aid program and the Global Fund to Fight AIDS, Tuberculosis and Malaria.

75. While it is worth looking out for opportunities to use private actors for service delivery in fragile states, the main priority under the present heading should be to encourage large-scale private giving to development programs, particularly the

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[36] For details, see http://www.asiaeducation.edu.au/teachers/bridge_school_partnerships/indonesia_bridge.html.

[37] Papua New Guinea's Prime Minister moved in 2013 to wrest ownership of the Ok Tedi mine from the PNG Sustainable Development Program, and also to take control of the Program's assets.

programs of non-government organisations that might tackle problems not easily discussed between the Australian government and its development partners. This might include, among other things, regular dialogue with major philanthropic foundations, and the creation of a corporate and philanthropic relations function within DFAT, with a more focused mandate than the business engagement function that existed in the former AusAID. Such a function, which would be much as recommended in 2011 by the Independent Review of Aid Effectiveness, could manage consultative engagement with private actors where that is thought likely to be productive.

76. A corporate and philanthropic relations function could also in principle oversee the formation of company-specific alliances, such as the one that currently exists with Carnival Australia, so as to ensure consistency of approach, fairness and centralized progress monitoring. However, umbrella partnerships should be approached with caution: they could be resource-intensive and ultimately disappointing if not constructed around a clearly-specified core activity falling under one of the categories of practical cooperation above—most probably inclusive business, public good production or delivery partnerships.

Recommendation 6: A corporate and philanthropic relations function should be established within DFAT to manage consultative engagement with business and philanthropic organisations, oversee the selective formation of alliances and manage an external inclusive business brokering agency.

7 Aid tying

77. This topic deserves short shrift but cannot entirely be ignored owing to the lingering ambiguity mentioned earlier in this submission about the present government's interpretation of the notion of economic diplomacy. Canadian economic diplomacy involves making aid allocation decisions with an eye to potential benefits for Canadian investors and traders. Australian economic diplomacy, on the interpretation of the Secretary of DFAT, involves making aid allocation decisions with an eye to potential benefits for developing countries' international trading capacity and for the functioning of the international trading system generally. It is to be hoped this interpretation is borne out. However, it is worth briefly discussing what might happen if it is not.

78. There are two ways in which the aid program can be used to confer advantage on Australian businesses wishing to operate in developing countries. One is to tie the procurement of goods and services under the aid program to Australian suppliers. This was done until 2001, when most forms of aid to the least-developed countries were

untied pursuant to an agreement reached by the OECD's Development Assistance Committee. Australian food aid was partially untied in 2004.[38] Later, in 2006, all Australian aid was fully untied, with the exception of aid modalities that are considered to be inherently tied, including scholarships and subsidy funding for Australian NGOs. There is ample research to indicate that the tying of aid is wasteful, increasing costs by anywhere between five and 30 per cent, or even more in the case of food aid.[39] And in the Australian context the beneficiaries of tying were primarily a handful of generic project management firms, much of whose work was ultimately subcontracted to local suppliers.

79. The second way in which the aid program can be used to advantage Australian businesses is to create tied business assistance mechanisms within the aid program. Such mechanisms might help businesses identify and develop joint venture opportunities, or soften the terms of official or private export credits so as to make Australian goods and services more competitive. Australia has previously operated mechanisms like this, namely the Private Sector Linkages Program and the Development Import Finance Facility.

80. The Private Sector Linkages Program was a 'matchmaking' program, quite small, which funded feasibility studies and visits aimed at building the groundwork for joint ventures in developing countries. Lip service was paid to development objectives, as in similar schemes in other countries, but the program in fact allocated resources against very loose criteria and is not known to have led to any significant, poverty-reducing or growth-enhancing investments. Some other donors still maintain such matchmaking programs, sometimes run by their trade ministries. Like the defunct Australian program, they tend to be small with fuzzy objectives and vague funding criteria.

81. The Development Import Finance Facility (DIFF), now a little notorious owing to the circumstances surrounding its demise[40], was a standard 'mixed credits' scheme which provided grants to developing countries (mainly China, India and Indonesia) to soften the terms of official export credits offered for specific transactions by the Export Finance and Insurance Corporation. It operated under the OECD's Helsinki Disciplines, which seek to reduce trade distortion by ruling out the use of tied aid credits, including

[38] 'Partially untied' is here a technical term meaning that a donor allows procurement either from its own suppliers or from developing country suppliers.

[39] Stephen Knack and Lodewijk Smets, 'Aid Tying and Donor Fragmentation', World Bank Policy Research Working Paper 5934, January 2012. Available here: http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-5934.

[40] Recounted here: http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/Publications_Archive/CIB/cib9596/96cib20.

mixed credits, for commercially viable activities and by setting minimum levels of concessionality. However, it was at bottom a mechanism to help Australian firms compete for contracts against foreign firms receiving similar subsidies. It financed some perfectly reasonable projects, as well as some that drew criticism—such as the Piparwar coal project. The problem with it was not so much the projects that it financed, which improved in quality up to the point of its demise, but simply the fact that it was supply-driven and tied for the benefit of a rather small pool of companies.

82. Both the Private Sector Linkages Program and DIFF were closed by the Howard government on taking office in 1996. The full untying of the aid program ten years later, still under the Howard government, completed the removal of subsidies for Australian business from the aid program. Labor expressed an intention to reinstate a DIFF-like mechanism, a 'Green Development Project Scheme', in the lead-up to the 1998 election, which it lost, but neither major party is known to have considered reviving a mixed credits mechanism since that time. If there were any consideration of reinstating an aid credits program (i.e. a soft loan program), there would be no more case for tying it than there is for tying grant aid. Competitive Australian firms will win contracts; uncompetitive ones assisted by aid subsidies will only waste public resources.

83. While tying procurement to Australian suppliers does nobody any favours, a case can be made for focusing on Australian firms in seeking to form certain types of PPP for development. Inclusive business partnerships and service delivery partnerships, in particular, are most sensibly pursed with firms headquartered in Australia or in our neighbouring countries. It would be difficult to engage in effective dialogue with more far-flung companies, and those in other donor countries are likely to be in dialogue with their own governments in any case. Product development partnerships, however, are a different matter. There is no good case for tying medical research funds to Australian research institutions. Many of them will already be engaged by product development partnerships, without any need of tied funding to support that engagement.

Recommendation 7: The government should state definitively that its policy of economic diplomacy seeks benefits for Australian business by building the economies and strengthening the trading capacity of developing countries, not by providing privileged access to aid contracts or subsidies.

8 Recommendations

Following are the recommendations of this submission in consolidated form.

- **Recommendation 1**: In light of the low level of activity in support of private sector development in the Australian aid program, DFAT should systematically survey opportunities to transfer resources from under-performing projects to projects aimed at building productive capacity, enhancing economic infrastructure and improving the enabling environment for private sector activity. A central financing capacity should also be created.

- **Recommendation 2**: The government should clearly articulate, by means of a policy statement, what are the main objectives of its engagement with business, encompassing both consultative and practical engagement.
- **Recommendation 3**: The government should develop a successor to the Enterprise Challenge Fund for the Pacific and Southeast Asia, taking account of lessons learned from the recently-closed pilot program. A successor program should focus on local enterprise development and be integrated into relevant country programs.
- **Recommendation 4**: The government should consider establishing an inclusive business broker with funding capacity, independent of business, to develop a small number of potentially high-impact inclusive business partnerships with companies operating in aid program partner countries.
- **Recommendation 5**: The government should undertake a systematic examination of the relevance and performance of the major health-sector product development partnerships with a view to allocating multi-year support to several of the most effective. Funding of around $10 million per annum for such mechanisms would meet minimum burden-sharing expectations, but more would yield high returns.
- **Recommendation 6**: A corporate and philanthropic relations function should be established within DFAT to manage consultative engagement with business and philanthropic organisations, oversee the selective formation of alliances and manage an external inclusive business brokering agency.
- **Recommendation 7**: The government should state definitively that its policy of economic diplomacy seeks benefits for Australian business by building the economies and strengthening the trading capacity of developing countries, not by providing privileged access to aid contracts or subsidies.

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