



House of Commons
International Development
Committee

**Private Sector
Development:
Government Response
to the Committee's
Fourth Report of
Session 2005–06**

**Fourth Special Report of Session
2005–06**

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International Development Committee

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Fourth Special Report

On 23 July 2006 the International Development Committee published its Fourth Report of Session 2005-06, *Private Sector Development*, HC 921-I. On 5 October 2006 we received the Government's response to the Report. It is reproduced as an Appendix to this Special Report.

In the Government Response, the Select Committee's conclusions and recommendations are in bold text. The Government's response is in plain text.

Appendix: Government response

DFID's Approach to Private Sector Development

[Paragraph 27] We consider that DFID should retain its focus on both market development and investment climate approaches to PSD. Indeed, this balanced approach is the only logical one: generating and sustaining growth, through improvements to the investment climate, and then using this growth to provide opportunities for poor people to participate in markets. To increase the role of budget support in PSD would risk neglecting the systemic development of the private sector and markets. DFID has a real opportunity to provide intellectual leadership on a hybrid approach incorporating both market development and investment climate work. DFID should be aware of changing donor 'fashions' within PSD and attempt to carve out a sustainable, long-term model for its PSD policies.

We agree. While improvements in the investment climate will underpin growth, a complementary focus on making markets work for the poor is also needed. DFID's lead role in promoting the Investment Climate Facility for Africa and the Africa Enterprise Challenge Fund — which is being designed to accelerate the benefits of inclusive markets for the poor — demonstrates that belief. DFID was a pioneer of the 'making markets work' framework, launching a framework paper in 2000 and then applying that through programmes in over 8 countries. We continue to apply the 'making markets work' in new countries and markets, with initiatives in land and labour markets launched in South Africa in 2006.

Poverty Reduction Budget Support (PRBS) is one of the many aid modalities that DFID uses, and it can provide important support for private sector development. The 2006 Joint Evaluation of PRBS found that dialogue on PRBS complements work on sector and cross cutting issues such as PSD. For example, in Tanzania, where DFID is providing PRBS the investment climate has been the subject of an expanding public-private sector policy dialogue, and the investment climate for the private sector has been improving as a direct result of government policy changes. Progress has been made in addressing labour regulation, business licensing, the tax regime and land regulation.

Infrastructure

[Paragraph 36] It is crucial that the mistakes of the 1990s — assuming that the private sector will shoulder the burden of responsibility for infrastructure investments — are not repeated. Donors and governments should help mitigate risks that the private sector cannot afford to take. The current priority must be to emulate Asia’s successes in building infrastructure in Africa, with a particular focus on agriculture-supporting infrastructure. To support this, DFID must engage with other donors to ensure that the Commission for Africa-recommended increase in donor funding of US\$10 billion a year up to 2010 (and, subject to review, a further increase to US\$20 billion a year in the following five years) is secured.

We agree that bilateral and multilateral donors must learn from the infrastructure lessons of the 1990s, and earlier decades. We recognise useful recent work by the World Bank in highlighting many of these lessons. The Infrastructure Consortium is clear on the need for donors to be more realistic about the capacity of the private sector to fill the infrastructure funding gap, and the conditions that are required to enable the private sector to provide infrastructure finance. Many infrastructure projects will continue to rely on substantial public financing. The Consortium is working to facilitate the clearer prioritisation of investment, better and quicker project preparation, and sustainability of infrastructure service delivery throughout the design life of the asset. We are encouraged by the trend in increasing infrastructure investment in Africa from various donor sources which is on track to meet the US\$10 billion target by 2010.

[Paragraph 38] DFID has shown leadership in establishing the Africa Infrastructure Consortium. DFID now needs to use its authority amongst the Consortium donors to build on initial momentum and swiftly generate extra investment for African infrastructure. Efforts should be made, however, to balance big loans to governments with smaller, locally sensitive grants reflecting regional and national infrastructure priorities. Consultation mechanisms should be put in place to ensure that investments by the Consortium reflect the needs of poor people and the local private sector.

We agree with the need for a balanced approach to meeting infrastructure needs. It is important to recognise the distinction between ‘economic infrastructure’ and ‘basic services infrastructure’. Economic infrastructure is essential for regional integration, increased trade and economic growth and development. Smaller scale basic services infrastructure is essential for access at the local level to water and sanitation, electricity and transport services to enable access to schools, medical facilities and markets. The role of the Infrastructure Consortium is mainly to reinvigorate investment in large economic infrastructure to stimulate much needed trade and economic development. The Consortium emphasises the importance of ensuring that large infrastructure investments will benefit poor people, and that projects are fully assessed to ensure compliance with social and environmental safeguards. The Consortium also promotes the identification of gaps in infrastructure provision and performance at all levels.

Work on responsive basic services provision is and will continue to be through national and sub-national planning and budgeting processes, supported where necessary by sector reforms and capacity building. This work is implemented through government agencies, UN agencies such as UNICEF, NGOs and the local private sector, with harmonised support from donors.

Property Rights

[Paragraph 43] DFID is becoming more engaged in the property rights agenda but capacity and activity remains limited. There appears to be no specific staff expertise in this area within DFID and capacity needs to be stepped up. The need for flexibility across varying country contexts and sensitivity around a politically charged issue should not prevent DFID from increasing and broadening its property rights programmes, as long as this expansion is underpinned by a coherent strategy and in-house expertise.

[Paragraph 70] DFID should expand its resources for property rights work to ensure programmes and projects are prioritised for fragile and conflict-affected states.

We agree that property rights are an important development issue. DFID was actively involved in the development of the EU Land Policy Guidelines which provide a broad policy framework for DFID engagement. Appropriate responses to land and property rights are very specific to the political, historic and economic context of the country concerned and need to be led from within that country. Livelihoods advisers — for whom an understanding of property rights is a core competence — are working on property rights in 10 countries in Africa and 5 in Asia. For example, in Rwanda we have supported the cross-Africa LandNet network and the development and implementation of national land policy and the 2005 Land Law. In India, a new project in Orissa will develop a new state land policy and land administration system (land titling and registration) to improve land use efficiency, reduce the cost of land transactions, protect the rights of the poor and improve livelihoods.

In addition to our continuing country-level work we are working closely on property rights with the UN High Level Commission on the Legal Empowerment of the Poor, and their work over the next few years should assist us in developing our understanding and so improve operational activity on property rights.

We agree that property rights are potentially an important cause of fragility and conflict. Property rights reforms are highly politically sensitive, and reforms in conflict-affected states will probably only be feasible as part of a wider political settlement of the causes of conflict. In fragile states we need to be careful how contested property rights relate to the causes of fragility before promoting any reform agenda in this area. Formalisation of property rights can be generally only one element of a broader package of reforms, the nature of which will vary according to the particular context. We will encourage the UN High Level Commission on the Legal Empowerment of the Poor to address these issues, including the extent to which unequal distribution of land and property rights legal systems, by discriminating against poor people and minorities may be both a cause and an indicator of broader state fragility.

Regulation, Taxation and Competition Policies

[Paragraph 46] DFID must continue to support capacity building and technical assistance on regulation, taxation and competition policies, at all levels of government. DFID's support for business environment surveys is valued and should be extended, where possible.

We agree. Better regulation, fair taxation and effective competition policy are central elements of a good overall investment climate — for both domestic and foreign businesses. Over the last few years DFID has expanded its work in each of these areas and intends to continue to do so.

Investment Climate Facility

[Paragraph 49] DFID has led the way amongst donors with its support for the ICF, an innovative policy representing an impressive, business-supported, African-‘owned’ partnership. The Facility has the potential to be a powerful vehicle in making Africa an easier and more attractive place to invest. However, now that initial phase funding is secured, the challenge is to ensure that the ICF focuses on bringing about sufficient, tangible changes in Africa’s business environment. The ICF’s role and the existing need have been well thought-out; time spent hiring consultants and carrying out more analysis must be avoided in preference to actively supporting programmes and technical assistance as efficiently as possible (without compromising on quality).

[Paragraph 50] Whilst in many ways ‘starting small’ is beneficial to assessing national and regional needs and building momentum from the bottom up, the ICF’s operations should be conducted with a view to potential increases in scale, to ensure that technical and other forms of assistance are sufficient to meet the huge need for investment climate improvements.

We agree that investment climate reform is key to growth and poverty reduction and that the ICF is an innovative initiative that will help bring about important reforms and progress in this area. We also agree that whilst the process of forming the ICF partnership has been very successful in raising the profile of this agenda in Africa, the ICF must now focus on implementation and delivering results. DFID, African countries and institutions, and our other ICF partners share this determination. DFID will continue to work with and assist the ICF as necessary through, for example, participation in the ICF Technical Advisory Committee (TAC) meetings. We also recognise that reforming the investment climate will require significant resources and political commitment. The ICF has been designed to enable it to scale-up operations over time. It is also important that the ICF coordinates with, and complements other reform efforts. Niall FitzGerald and the Trustees are fully aware of this, and the ICF’s initial activities are being carefully designed to ensure they are consistent with the principles the IDC has highlighted.

Investment Climate, PSD and Governance

[Paragraph 53] Good investment climates hinge on strong economic and political governance. We hope to see the symbiotic relationship between good governance and private sector development emphasised across the Department's PSD policies.

We agree that governance is central to the PSD work on the investment climate. This is underpinned by interdisciplinary collaboration to incorporate governance perspectives. We are considering how to develop better indicators on how governance affects the investment climate, including what latest evidence indicates may be particular areas of significance. We are now applying political economy analysis to underpin the sustainability and impact of key investment climate reforms, and to help country offices to prioritise and sequence investment climate work on the basis of political feasibility and sustainability. We are developing the evidence base for our broader understanding on governance and growth, including the 'Institutions and Pro-Poor Growth' Research Centre formed at the London School of Economics in 2005.

Anti-Corruption

[Paragraph 56] DFID should continue to place the eradication of corruption high on the donor agenda and lobby at the global level for commitment to anti-corruption measures. Specifically, DFID should actively encourage developed country ECAs to enhance transparency — internally and in the projects that they support — by implementing improved procedures on bribery and corruption; should seek to fulfil as swiftly as possible the Commission for Africa's recommendation regarding the implementation of "all necessary legal and administrative measures to repatriate illicitly acquired state funds and assets" and should lobby for the ratification of the UN Convention Against Corruption and the implementation of supporting legislation by all signatory countries.

We agree. The Prime Minister has asked the Secretary of State for International Development to tackle international corruption wherever it threatens to undermine the fight against poverty. The UK Anti-Corruption Action Plan was agreed in July and is now being implemented. The UK has ratified UNCAC and committed to press our G8 partners to ratify UNCAC by March 2007. The return of assets is a fundamental principle of this Convention; HMG will work with the UN Office on Drugs and Crime and other partners to ensure that it is implemented. The UK has fully implemented the OECD 'action statement' on bribery that reduces the risk of export credit agencies providing financial support to companies that bribe overseas.

UK Banks and resource-backed loans

[Paragraph 59] DFID and the UK Government should engage with UK banks to encourage a review of the use of resource-backed loans to developing countries, especially those with a history of corruption and economic mis-management. UK banks should take advice from the international financial institutions on adopting appropriate conditions for loans relating to levels of disclosure and oversight requirements.

The UK has taken the lead in ensuring that debt burdens in developing countries are reduced to sustainable levels. The Government strongly believes that prudent debt management by developing countries is essential for economic stability and growth. We have a direct interest in ensuring that countries in receipt of debt relief from the UK and international financial institutions do not amass new unsustainable debt. To this end the UK is working with the International Monetary Fund and World Bank to develop a "debt sustainability framework", which should include advice to partner countries and financial institutions on commodity backed loans.

We will explore with the IFC the extent to which global standards such as the Equator principles can be extended to cover resource-backed loans. Ministers have already initiated a dialogue with banks at a senior level with the joint aim of banks playing a stronger development role. More broadly we are working to promote responsible business practices through the Extractive Industries Transparency Initiative, the UN Global Compact and the Ethical Trading Initiative, and have recently strengthened our implementation of the OECD Guidelines for Multinational Enterprises by setting up a revamped National Contact Point.

China and resource-backed loans

[Paragraph 61] China's growing interest in African investments requires donors and governments to find mutual interests that will encourage the Chinese authorities to regulate resource-backed loans and other provision of capital more tightly, to ensure that lending does not contribute to corruption and negative developmental outcomes.

We agree that it is important to engage China on development policy, and DFID's Permanent Secretary visited Beijing in September to do this. It is of the utmost importance to encourage the Chinese authorities to ensure that resource-backed lending does not contribute to corruption and bad developmental outcomes. China has a shared interest with the UK and other OECD countries in ensuring that resource rich countries are well governed — to ensure the security of supply of energy and minerals.

The Extractive Industries Transparency Initiative

[Paragraph 64] DFID has spearheaded and hosted the EITI process over the past four years. DFID's leadership has secured buy-in to the process from companies and countries alike.

We agree. The Extractive Industries Transparency Initiative (EITI) brought together a global coalition of governments, companies and NGOs. EITI is being implemented in some twenty resource-rich countries around the world. Eight of these countries have already or will shortly produce their first EITI reports. More countries are joining the Initiative all the time — both as implementers and as supporters.

EITI & Emerging Markets

[Paragraph 65] The EITI implementation process needs to be expedited within signatory countries. Under-represented oil and gas producing regions, such as North Africa, the Middle East and Latin America, need to be brought on board.

We agree. Bringing non-OECD emerging markets into the Initiative will be of critical importance to ensuring that the EITI approach becomes the global standard for the oil, gas and mining sectors. We will remain closely involved in engaging emerging markets.

EITI & Civil Society

[Paragraph 66] Parallel measures to build capacity and open the political space available to civil society will greatly enhance EITI's potential to improve transparency and accountability.

We agree. It is a principle of EITI that civil society is actively engaged as a participant in the design, monitoring and evaluation of this process and contributes towards public debate. Participating countries need to meet the Criteria, or if possible, exceed them, to be considered as successfully implementing EITI.

EITI & Future Direction

[Paragraph 68] DFID should keep an open mind as to potential strategies for underpinning the EITI with mandatory disclosure requirements and should, at the very least, actively consider transferring from a voluntary to a mandatory approach in 2008–9, when further international implementation and political will has been secured. DFID must energetically explore when, how and to whom EITI's Secretariat should be transferred, with the ultimate aim of international 'ownership' the driving decision making factor. Securing and consolidating further 'buy-in' from other donors will be particularly important to achieving this. DFID needs to move ahead with extending the EITI framework to other sectors such as procurement, construction and arms.

We agree. The voluntary approach is currently working with more and more countries and companies joining the initiative but DFID will keep an open mind about the benefits of mandatory disclosure requirements for companies in the future. DFID is energetically exploring when, how and to whom the EITI Secretariat will be transferred. The current ad hoc arrangements, with the Secretariat hosted in DFID, have served us well but more formal arrangements are needed now that implementation is taking place in twenty countries. As outlined in the White Paper 'Making Governance Work for the Poor', DFID is committed to developing new transparency initiatives to increase the scrutiny of public spending in the defence, construction and health sectors as well as improving transparency and value for money in public procurement in developing countries.

Investment Climates in Difficult Environments and the Poorest countries

[Paragraph 72] For states that are no longer in the throes of out-and-out-war, DFID needs a clearer strategy for improving nascent, disabled and damaged investment climates. DFID's emerging work-stream in this area must be strengthened to develop a specific PSD strategy for fragile and conflict-affected states, with strong links to complementary policy areas such as transparency in natural resources industry and conflict reduction. This is particularly important given DFID's increasing profile in such countries.

We agree that investment climate work is a priority in post conflict situations. DFID is building its understanding of how best to help build investment climates in post conflict situations through case studies, workshops, country engagement, and sharing experiences. A working group to facilitate this lesson-learning has been set-up across DFID divisions and country offices, the Post Conflict Reconstruction Unit (PCRUC) and the World Bank and IFC. Strategic themes include the need to integrate private sector into early post conflict reconstruction planning, and public private dialogue to identify and prioritise investment climate reforms.

[Paragraph 73] It is clear that in very poor countries, where there is very little capital or purchasing power, donors and governments have a particular obligation to step in and 'fill the gap' between private sector reach and the poorest of the poor.

We agree. Donors are well placed to work with governments and NGOs to use their funds both directly in the provision of services for the poorest and also to extend the reach of the private sector in providing services to the poor in the more risky and less attractive sectors. The thirteen multi-donor private sector infrastructure facilities pioneered by DFID provide good examples of where different facilities have been developed to build the investment climate and mitigate the risks in private sector investment in infrastructure associated with project development, weaknesses in capital and credit markets and delivering services to the poor. These initiatives have stimulated the involvement of other donors and successfully leveraged in private sector investments representing overall a donor/private sector ratio of 1:10. One example of extending the reach of the private sector is the Global Programme for Output Based Aid which can provide targeted subsidies to increase the distribution of services such as water, sanitation and energy to poor communities.

[Paragraph 76] DFID had no clear answers to this inquiry on specific PSD strategies for the poorest countries, beyond work on the enabling environment and regional integration. A specific work-stream on improving the investment climate of the poorest countries would help identify a coherent strategy and more creative approaches towards this end.

DFID is increasingly focused on the poorest countries, and has a clearly set out approach to investment climate that is already tailored to very poor countries. Key areas of focus for very poor countries include rural investment climate studies to identify the main obstacles to rural enterprise development and develop the evidence base to inform PSD strategies; the informal economy, including property rights; and sub regional investment climate studies to tackle investment climate problems in the poorest regions. DFID collaborates closely with several agencies in the area of investment climate diagnostics, including World Bank agencies and the Commonwealth Business Council, and will explore with them the possibilities for expanding the scope of this work to focus even more on the poorest countries and the poorest regions within countries.

Making Markets Work for the Poor

[Paragraph 83] We recommend that DFID continues its leading role in demonstrating the value of the MMWP approach adequately supported with sufficient funding and other resourcing, The Department must build on the successes of the FinMark and ComMark initiatives and scale up these innovative programmes. The technical assistance and creative thinking that underpins these MMWP programme must not be sidelined by the increasing profile of either investment climate work or budget support.

We agree. DFID has a series of activities planned which will help demonstrate the value of the MMWP approach, share lessons on operationalising MMWP initiatives, and identify how the Department can best take forward work on MMWP. These activities will also help identify the appropriate level of funding and other resources needed for future work. DFID will continue to ensure that its support to investment climate reform and market development is complementary, and that the increased profile of investment climate work and budget support is not at the expense of MMWP work.

DFID has already enabled elements of the FinMark and ComMark initiatives to be replicated by other DFID country programmes. We have similar financial deepening projects under way, or being set up, in eight countries (Nigeria, Ghana, Kenya, Uganda, Tanzania, South Africa, Pakistan and Bangladesh). DFID is also currently exploring options for a wider regional role for FinMark. The ComMark Trust model has been adopted in several other large country programmes including Nigeria and Bangladesh. However it is also important to understand which specific areas of ComMark have been successful and where efforts to date have been less successful. We are currently in discussions over our involvement in the ComMark programme with an aim of focusing future efforts on key success areas.

DFID has sought, and will continue to seek to mainstream the MMWP approach to other market level initiatives, including work which is under way with the World Bank on increasing access to land for poor people in Kenya, Uganda, Rwanda, India and Cambodia.

Job Creation and Youth Employment

[Paragraph 87] In the absence of global targets on employment, a key priority for donors is achieving a more explicit focus on creating and sustaining jobs, especially within African countries. This should include increased support for improving the technical skills of those at the lowest end of the job markets. Consideration should be given to developing international targets on employment, with a particular focus on young people. DFID’s current reliance on investment climate reforms as a means to create jobs is insufficient to reach the groups who are most in need, especially young people. The Department should seek to build partnerships with governments and companies that closely link education with job creation.

Creating and sustaining jobs is a priority for all partner governments and we agree donors must respond better. Meaningful international targets for employment would be extremely difficult to set. Employment levels fluctuate within each individual economy, not only over the business cycle but also as a result of variable regional and international demand conditions, trends in the technically determined capital:labour ratio of the economy’s leading sector and demographics. We agree, however, that the demographic transition now facing most developing countries — in particular the “youth bulge” that is hitting labour forces — is challenging countries’ and donors’ existing approaches. Hence our support for the attention the World Bank is giving this issue in this year’s World Development Report¹.

Solutions with the greatest impact on youth (and overall) unemployment are likely to involve: reducing the costs of doing business in Africa for SMEs; providing outlets for surplus labour through migration; reforming social protection systems so that they support incentives to invest in education and training and, most importantly of all, improving basic technical skills by tackling rising secondary school drop-out rates. In this last respect, DFID will work with international partners including ILO and UNIVOC to promote new ideas and initiatives. This could include promoting partnerships between governments, educational and training institutions and the business sector to ensure that the supply of skills is better tailored to specific employment needs.

[Paragraph 89] Bringing the millions of informal workers in developing countries under international labour law protection is a major priority and DFID needs to seek active dialogue with the private sector, governments, multilateral organisations and other donors on how to ensure that investment climate improvements and other PSD strategies prioritise minimum labour standards enforcement.

We agree. Our support for the ILO is an indication of the UK’s commitment to promoting decent work. We want to ensure that the ILO’s core labour standards are respected internationally — and that they are applicable to all people. For this reason, the White Paper on International Development commits the UK to promote good labour standards and work to eliminate child labour. It also commits the UK to encourage developing country government, the private sector, trade unions and civil society to work together to promote growth and employment, and the promotion of decent work will be part of this.

¹ World Bank World Development Report 2007, “Development and the Next Generation”

Financial Sector Development

[Paragraph 94] The FinMark Trust has deepened understanding and co-operation around financial sector development in southern Africa in a highly cost-effective and sustainable fashion. Negotiations with the World Bank regarding the FinMark methodology need to be taken up at a high political level to ensure that this important tool for financial sector development is successfully replicated and scaled-up.

We agree that the FinMark approach of generating financial sector information to influence financial sector policy is effective and have been working to influence the World Bank and the UNDP to also adopt and mainstream this approach. DFID is piloting the 'FinScope' access to finance survey tool (that was developed by FinMark) jointly with the World Bank in Ghana and Pakistan. DFID has provisionally agreed financial inclusion indicators with the World Bank and the UNDP, which were developed with FinMark, and a World Bank technical note has been produced to promote the agreed indicators. Discussions with the World Bank are in process to determine the nature of DFID support to an initiative to roll-out access to finance surveys and financial indicators in a larger number of developing countries.

DFID helped secure a high level commitment by developing country finance ministers to promoting financial inclusion, including through the use of access to finance data generated by surveys such as FinScope, at the Commonwealth Finance Ministers meeting in mid-September this year.

Agriculture

[Paragraph 97] If a series of key constraints can be addressed, there is no reason that Africa cannot emulate Asia's successes in achieving agricultural growth. A lack of agriculture-supporting infrastructure is the primary barrier, and increases in infrastructure funding must be targeted towards this sector. Irrigation is a particular concern. DFID must work with other donors to achieve the Commission for Africa-recommended 50% increase in funding for irrigation before 2010. Another priority is re-building the seed industry within Africa. This package of measures should be closely linked into other investment climate improvements such as addressing property rights and land tenure.

We agree that improving agricultural productivity in Africa is essential to unlock growth and reduce poverty. However, while significant gains are possible, these are unlikely to be equivalent in scale or have the same poverty impact as observed in the Asian green revolution of the 1960s and '70s, not least due to radically different supply, demand and policy conditions.

We agree that improving Africa's infrastructure is vital for improving agricultural productivity. DFID supports country-led sector wide reform and programmes in countries like Ethiopia and Mozambique to help prioritise infrastructure investments and promote aid effectiveness. The Infrastructure Consortium is facilitating the scaling up of investment, notably for NEPAD-identified projects. It is also conducting a diagnostic study, with World Bank and DFID funding, to identify infrastructure gaps and performance measures.

Increasing the area under sustainable, well managed and accessible irrigation in Africa will be an important part of our strategy to increase agricultural productivity. DFID's involvement will be through AU/NEPAD's Comprehensive Africa Agriculture Programme (CAADP), working closely with the World Bank, African Development Bank, FAO and others.

We agree that African farmers need better access to high quality seed and other useful technologies. This is why, in addition to providing nearly £20 million a year to the Consultative Group on International Agricultural Research (CGIAR), DFID also supports a number of initiatives to improve access to high quality seed for small farmers.

We agree that measures to develop agriculture must be accompanied by investment climate improvements such as improved land rights and tenure security. DFID has active land programmes in 7 countries in Africa and 3 in Asia, and with the World Bank is working to strengthen evidence and support national policy dialogue on land policy and administration for agricultural growth.

[Paragraph 99] The MMWP approach must underpin DFID's interventions in agriculture to ensure that market distortions are avoided.

We agree that the MMWP approach is useful for assessing constraints to the development of particular commodities and their associated markets. Building on market opportunities and tackling market distortions are central priorities of DFID's Agriculture Policy Paper, and a pillar of CAADP which we support.

Our policy dialogue and programmes with African governments help make the environment for private investment more attractive. DFID has designed a three year policy learning programme with the World Bank, and involving six African countries, to strengthen evidence and support national policy dialogue on building input and output markets. We are working to make agricultural commodity markets work for the poor in Nigeria, Kenya and Zimbabwe. Our work on deepening financial markets, for example through the Financial Sector Deepening Trust in Kenya, is helping address the credit constraints of small-scale agricultural enterprises, traders and producers.

DFID is working with the Malawi government to ensure that fertilizer subsidies are 'market smart' and contribute to the long-term development of a reliable private sector input supply market. DFID is piloting effective and market-friendly social protection schemes such as cash transfers (e.g. Zambia) and funding a national safety nets programme using a mix of food and cash transfers in Ethiopia. A new policy learning programme will investigate how to improve potential synergies between social protection and agricultural growth in Malawi, Zambia and Ethiopia.

[Paragraph 100] In order to stimulate private sector investment in African agriculture, donors and governments must take the investment risks that companies cannot.

We partly agree. Donors like DFID can share risk with the private sector in the early stages of investment and testing new business models that may be commercially viable and bring

benefits to the poor. For example, DFID's Business Linkages Challenge Fund has been instrumental in leveraging investment in agriculture, particularly in Africa, through sharing the risks faced by the private sector investor. Examples include citrus production in Mozambique, cotton in Malawi and smallholder tea in Kenya. The Commission for Africa picked up on these experiences and recommended a multi-donor Africa Enterprise Challenge Fund (AECF). DFID has committed \$20 million to the AECF, to be launched in 2007. The Fund will share risk with the private sector and drive innovation in agriculture and rural business.

Agricultural Finance

[Paragraph 102] Donors need to target funding in an intelligent way that mitigates private sector risk by providing early bursts of finance, supports the role of SMEs, co-operatives and small-holders (rather than creates a greater market role for government or donors) and allows projects to be run on business lines. Successful multi-donor initiatives of this kind already exist (for instance, Infraco). DFID should show leadership by pursuing the replication of such models. Partnerships are key to ensuring that the necessary linkages are built within the market that will bring the benefits of growth to small and large farmers alike.

We agree that both small and large farmers need financial services in order to improve productivity and hence contribute to growth and poverty reduction. We also agree that agriculture may require specific approaches and instruments to mitigate risks and to build the necessary partnerships that enable the supply chain to function. Filling the financing gap is one of the priorities in DFID's Agriculture Policy Paper. We will continue to encourage InfraCo (of which DFID is a founding member) to look for opportunities in this area. We will continue to work to extend access to finance, including agricultural finance, through our support to the IFI's, CGAP, the Financial Sector Reform and Strengthening Initiative (FIRST), our remittances programmes and our country-based financial sector programmes.

DFID is also committed to replicating and scaling up the challenge fund instrument in this sector, and the African Enterprise Challenge Fund will focus on rural areas targeting agriculture and the financial sector. Through funding 21 of its 55 projects in agriculture, the Business Linkages Challenge Fund demonstrated the relevance of this risk-reducing mechanism in this sector.

Investments in Skills Programmes

[Paragraph 106] In its ongoing dialogue with the private sector (through groups such as Business Action for Africa), DFID needs to press for investments in developing countries to incorporate training, skills and technology transfer. The AfricaRecruit initiative should continue to receive support as a successful strategy for boosting human capital within Africa and addressing the 'brain drain'. This and other country-level skills programmes should receive longer-term donor support, in partnership with the private sector where possible.

We agree. We acknowledge the central role played by the private sector in increasing training opportunities and the skills base, and the contribution that diaspora communities and organisations such as AfricaRecruit can make to reducing poverty and promoting development. Although universal primary education remains our priority, there is a growing need to invest in secondary, tertiary and vocational education, lifelong learning and skills in order to increase the ability of governments and the private sector to deliver basic services and to promote sustainable growth. The White Paper on International Development commits the UK to provide £8.5 billion in support of education over the next 10 years. This includes providing new support for higher education and vocational skills training to train the professional staff needed by health and education services. 20 African countries have agreed to develop 10 year plans for which they will seek long-term funding. We hope to see more evidence of public/private partnerships in education plans and will be encouraging partner governments to do this.

[Paragraph 109] We agree that there is great scope for increased private sector involvement in healthcare provision. Private sector growth will only gain momentum in developing countries if basic services such as education and health are improved. Donors need to recognise the role of private sector providers of education and healthcare and strengthen partnerships with these bodies.

We agree. The White Paper *Eliminating World Poverty: Making Governance Work for the Poor* notes that ‘investing in people — their skills, health and security — boosts economic growth and increases incomes’. DFID’s forthcoming health strategy (still in preparation) will set out how DFID plans to help partner governments tackle barriers to access to healthcare, including that provided by the private sector.

Growth and inequalities

[Paragraph 112] We consider assigning total responsibility to national governments for the equitable distribution of the benefits of growth to be an inadequate response by DFID. Achieving DFID’s ultimate aim of poverty reduction requires not just triggering growth but assisting partner governments in finding the right strategies to ensure that poor people benefit from growth. DFID needs to build a coherent strategy for PSD in middle income countries with large inequalities. This strategy should involve dialogue with the Governments of China and India, in particular, about how to include the poorest sectors of their countries in economic growth.

We agree that DFID should assist partner governments in finding the right strategies to ensure that poor people participate in and benefit from growth. This is best achieved through the development of partnerships that support national governments to meet their broad-based growth goals, as set out in their poverty reduction strategies.

Many of our partner countries are paying more attention to how to generate higher levels of broad-based growth. DFID is in the process of developing a number of new programmes that are aimed at supporting this country-led process. Such programmes are aimed specifically at identifying the key constraints to growth. DFID will also support and

undertake operational research that is aimed at giving practical guidance on issues such as generating employment-intensive growth.

This process builds on the support that DFID has already provided to over 14 countries to undertake pro-poor growth analysis. Some of this analysis has already been included in the next generation of Poverty Reduction Strategies (e.g. Zambia).

With regard to a stand alone DFID PSD strategy for Middle Income Countries (MIC), we are already working through the multilateral agencies to "build commitment with MIC governments by making the case for poverty reduction, for example by highlighting the links between inequality and growth" (MIC Strategy 2005). The World Bank Development Committee approved a new Bank-wide MIC Strategy at the Annual Meetings in Singapore, and the other Regional Development Banks have worked with the Bank to examine how to enhance their programmes in MICs, including through private sector initiatives.

For *China*, DFID produced its last Country Assistance Plan (CAP) in May this year. It covers the last five years before graduation from a bilateral programme in China. In preparing the CAP we had to make key choices about where our programme would have most impact, and decided that the most effective use of DFID's resources would be to focus on a selected number of MDGs and work alongside government programmes in these areas. As a result, our main programme is focused towards basic education, TB, HIV and AIDS and water and sanitation.

However we have a range of important projects focused on private sector development from our previous CAP that are still in implementation and do address the issues of growth and inequality. These projects stem from quite a long history of pro-poor Private Sector Development supported by DFID in China.

India is a fast growing, emerging economy, but is not yet a middle income one: current projections are that India will not cross that threshold before 2012, and could still have 250 million absolutely poor people by 2015. A third of the total people in the world living on under \$1/ day live in India. Growth in the 1990s has been relatively pro-poor in India compared to other Asian countries, but there is a danger of India's poor being left further behind in the decades ahead. We are already engaging with the central Government of India and with the governments of the four states that DFID partners currently (Andhra Pradesh, Madhya Pradesh, West Bengal and Orissa) about how to include the poorest people in India in sustainable economic growth. DFID's current India CAP (2004-7) includes growth as one of three pillars. DFID currently supports work on investment climate, microfinance, business support services, and adding social measures to the large investment loans of the Asian Development Bank and the World Bank (for example in infrastructure). A specific new strategy on PSD is not a priority at this time.

CDC

[Paragraph 117] We agree that there is a continuing role for CDC as an investment pioneer and provider of risk finance. The 2004 restructuring seems to have been successful in reinforcing CDC's 'demonstration effect' and its ability to mobilise other money alongside its own.

[Paragraph 118] Whilst accepting the UK Government target of a 5% market return should be met wherever possible, we consider that returns should be balanced with directing finance where it is most needed to reduce poverty.

[Paragraph 119] CDC's portfolio of investments must continue to be carefully scrutinised for their overall contribution to poverty reduction. CDC's social and environmental record is patchy and we recommend close monitoring by DFID on where and how CDC invests. Acting as an investment catalyst is a necessary but not sufficient contribution to poverty reduction: CDC must ensure that its 'development footprint', is a wholly positive one.

We agree that CDC should be ready to invest in sectors and activities in poorer developing countries even if the expected rates of return are not so immediately attractive. However, CDC also have to ensure that their investments are sustainable in the longer term if their mission of stimulating private sector activity, encouraging growth and attracting third party investment in poorer countries is to be achieved. It is inevitable that some private sector investments will be unsuccessful and CDC should only invest when they judge there is a reasonable chance of recouping their capital and leaving the investee company in a stronger position than before.

We agree that CDC's investments are socially responsible and their impact developmentally beneficial. CDC is committed to ensuring that both factors are fully considered when deciding whether to invest. We have discussed with CDC the need for systems to measure both impact and adherence to the business principles and to provide quantifiable evidence to demonstrate this. We understand that this is in hand.

Microfinance

[Paragraph 123] DFID's annual expenditure on microfinance work remains limited and part of DFID's increasing budget could be usefully spent in expanding microfinance projects beyond their currently very limited range, embedded in a broader strategy of deepening financial markets. This could include partnership with the banking sector in providing business case evaluated unsecured loans to small businesses whose principals have few assets of land or other security.

We agree that the challenge for the microfinance sector is to expand and significantly increase the number of poor people benefiting from microfinance products. The banking sector has much greater financial resources than DFID and has the systems and branch infrastructure to potentially provide microfinance on a large scale. By combining the strengths of microfinance NGOs and those of banks, massive increases can be made in providing microfinance to the poor. A recently approved £73 million multi-donor microfinance programme in Bangladesh commits 20% of its resources for working with extreme poor households through NGOs.

DFID supports partnerships with the banking sector by, for example, helping developing country regulators introduce legal reforms to make microfinance a more attractive financial sector activity and by providing grant funding through challenge funds to financial institutions that wish to innovate and expand. DFID provides about £30 million

annually to microfinance and financial sector development. In a number of countries DFID has joint financial sector programmes with the World Bank, which further leverage our support to microfinance.

[Paragraph 124] Microfinance institutions have to operate in a regulated environment, otherwise poor people are liable to be exploited. In parallel with its support to microfinance, DFID must seek to build policy environments that provide appropriate levels of regulations and competition.

We agree that the regulatory environment is an important contributing element in the success of microfinance institutions. DFID-supported programmes work directly with central banks, policy makers and national advocacy groups in Nigeria, Bangladesh, Kenya, South Africa, Uganda, Ghana, Tanzania, India and Zambia to improve information on access to finance and to determine national priorities and support national programmes on access to finance. For example, the Shared Growth Framework is working to assist the Central Bank of Nigeria to introduce risk-based supervision and the Financial Sector Deepening Trust in Kenya has worked with the central bank and other key stakeholders to introduce deposit-taking microfinance institutions. Furthermore, DFID along with other donors, supports the global Financial Sector Reform and Strengthening Initiative (FIRST) which has provided technical assistance on regulatory policy in 22 African countries.

Support to SMEs

[Paragraph 129] An idealised notion that ‘the market will provide’ must not stand in the way of SMEs in undeveloped or missing markets receiving urgently needed basic assistance, which can be supplied and funded, to an extent, by donors and governments. Support to SMEs in the form of free business development advice and technical assistance is largely absent from transition and developing countries. Whilst any return to large-scale market intervention must be avoided by donors, DFID should not proceed to the other extreme and focus exclusively on investment climate work where SME growth is concerned.

DFID believes that developing a more business friendly policy, legal and regulatory environment is the most effective entry point for donors and governments to promote SME development. However, we recognise that SMEs frequently lack access to key business support services. While there may be a case for some degree of subsidy to increase access by SMEs to business services, particularly smaller SMEs, our main approach to promote the development of these services is (a) to encourage private sector supply by expanding our activities to improve the working of business services markets, particularly those markets serving the poor (an approach to private sector development commended by the Committee elsewhere in the report), and (b) through instruments such as challenge funds, to stimulate business and market linkages between SMEs, micro enterprises and larger corporations.

[Paragraph 130] DFID and other donors must be sure to include and prioritise SMEs in their dialogue with the private sector about social and environmental impacts. In their efforts to address SME growth, donors must concurrently pursue routes to improved adherence to international labour standards and codes on social and environmental abuses.

We agree that more needs to be done to enhance SME labour standards and to upgrade environmental regulation of SMEs. These issues are now being given increased attention by our country programmes, such as Bangladesh, where poor labour standards and environmental pollution are particularly severe. There may also be scope to promote greater adherence by SMEs (both foreign and domestic) to international codes on environmental and labour standards by encouraging governments to incorporate reference to these in country investment codes. We will also work with private sector and standard setting agencies/bodies to encourage regulation that is appropriate to SME capacities and resources and also protects the public interest.

Challenge Funds

[Paragraph 135] Challenge funds are a useful tool for direct engagement with the private sector and can help to catalyse market activity where it is slow or non-existent. For reasons of sustainability and coherence, however, it is vital that DFID embeds challenge funds in wider PSD programmes — not least to prevent gaps in funding. The linkage of the African Enterprise Challenge Fund with the ICF is a promising sign that DFID is aware of this need to integrate grant funding with systemic enabling environment improvements.

We agree. The current generation of DFID challenge funds pioneered the usage of this instrument for development purposes. Clear lessons have been learnt that we are incorporating into the African Enterprise Challenge Fund (AECF). These lessons include ensuring that the challenge fund is aligned and coordinated with enabling environment programmes such as the ICF. We see the AECF as an instrument that catalyses pioneering ventures — this will both highlight regulatory issues in frontier markets whilst also serving as a catalyst to ensure business responds when reforms are implemented. The AECF will also adopt a sector specific approach with strong operational and governance linkages with other donor programmes. This will ensure the AECF is embedded within the broader PSD agenda and policy lessons are fed back more effectively than in the past.

We have included challenge funds as a key component of the ‘remittance country partnerships’ being implemented with Nigeria, Ghana and Bangladesh.

Public Private Partnerships

[Paragraph 140] Numerous successful examples support the use of PPPs as a means to finance and implement PSD. The UK Government has shown innovation in spearheading the International Finance Facility for Immunisation and should explore

other creative funding models for PPPs such as the self-financing Global Alliance for Improved Nutrition. In addition, the UK Government should engage with governments and donors to address the funding problems experienced by the growing body of PPPs working on healthcare R&D, especially those working on neglected diseases.

We agree with the benefits of PPPs for some important developments in health. DFID funds a number of such partnerships to develop new generations of health commodities including drugs, vaccines and microbicides. As of September 2006 these are: the Drugs for Neglected Diseases Initiative, International Partnership on Microbicides, Medicines for Malaria Venture, International AIDS Vaccine Initiative and Aereas (drugs for Tuberculosis). DFID also funds a number of PPPs that focus on implementation. These include: the Global Fund to fight AIDS TB and Malaria, the global Alliance on Vaccines and Immunisation, the Lymphatic Filariasis Partnership and the Onchocerciasis Control Programme.

DFID plays an active role with governments and donors to increase support for a wide range of health related PPPs. Support for product development PPPs follows a competitive process and other PPPs may receive funding as additional research funds come on line. We are working to ensure such PPPs benefit the poorest people.

Remittances

[Paragraph 143] Encouraging commercial banks to better facilitate remittance flows is a key example of how DFID can influence the private sector in contributing to development outcomes. To help increase remittance flows, banks must reduce transactions costs. The UK Government should engage with banks to encourage cheaper and more competitive services.

We agree. In 2004 we started engaging with the financial sector to encourage banks and money transfer companies to provide cheaper, more secure and more easily accessible remittance services to developing countries. The Secretary of State held a consultation with the private sector and diaspora that led to the creation of a DFID-chaired Remittances Working Group, and then in early 2006 this graduated to a private sector-led UK Remittances Task Force.

The innovative ‘Sending Money Home?’ initiative has been effective in reducing costs and improving the accessibility of remittances from the UK. The website www.sendmoneyhome.org has resulted in much clearer information being accessible to remittance senders, and there is evidence of remittance costs falling significantly in those countries profiled on this website. DFID has also sponsored surveys to provide much-needed information for policymakers and the private sector on remittances to countries such as Bangladesh and Nigeria. The significant press interest in DFID’s remittance initiatives has further increased the profile of remittances to developing countries with senders and the private sector.

[Paragraph 145] We consider that, as part of its dialogue with diaspora organisations, DFID should explore existing diaspora practices regarding remittances and other inward investment schemes and help engage the private sector to find additional ways — beyond remittances — to channel investment into home countries

We agree. We plan to encourage diaspora networks and goodwill through the remittance country partnership programmes we have with Nigeria, Ghana and Bangladesh. DFID has already supported the development of links between Sierra Leone diaspora and businesses in Sierra Leone. In addition to talking to UK diaspora on ways to encourage diaspora investment more broadly, we have commissioned research and lesson-learning by UK diaspora representatives on the Sierra Leone case to inform future DFID work in this area.

Ethics and Labour Standards

[Paragraph 154] DFID should seek to embed its support for ethical trading in a package of wider measures, including improvements to the enabling environment; the widespread implementation of labour standards; a more coherent approach to ethical trading across government and the development of an ethical code to govern government procurement policies. In addition, DFID needs to build up a more sustainable approach to supporting fair trade, with long-term, predictable funding a priority. Adequate consideration must be given to scaling-up pilot programmes and disseminating learning. As part of the increased focus on youth employment that we recommended in Chapter 4, DFID should seek to expand its work in supporting young entrepreneurs. DFID must engage with companies to ensure that fair trade schemes do not push costs back to suppliers and the poorest in the supply chain.

Our support for ethical trade is already — and will continue to be — closely linked to our commitment to labour standards, a commitment that was reinforced in the recent White Paper (please refer to paragraph 89 for more information).

The Government's policy on procurement is that all public procurement of goods, works and services should be based on value for money, having due regard for propriety and regularity. In addition, the EC Treaty principles of non-discrimination, transparency and equal treatment apply to all public contracts. The EC procurement directives, which are based on the Treaty principles, set out detailed procedures and criteria for the award of public contracts above £93,738.

The Office of Government Commerce has produced guidance on how HMG social priorities such as core labour standards can be incorporated into the purchasing cycle. We plan to build on this framework for action through a scoping study to identify ways to develop greater awareness and understanding of how labour standards issues can be addressed.

The financial sustainability of fairtrade is a key concern of DFID's and is a focus of our current grant to the Fairtrade Foundation: 'Investing in the Future of Fairtrade'. Fairtrade has expanded rapidly in recent years and there appears to be strong support from retailers, particularly in the UK, for developing more own-brand fairtrade products. However the bigger challenge is to integrate fairness into the retailers' mainstream value chains in a

sustainable way as this will have a much wider impact for poor producers in developing countries. This is an important focus of our work with supermarkets.

[Paragraph 155] The ETI has demonstrated that securing commitment from companies to a basic ethical code is possible. However, the ETI currently has no ability to monitor ethical trade and there is a global gap in formal scrutiny. We suggest that the ETI could be usefully expanded into a monitoring mechanism that ensures more independent scrutiny of company operations. To enable this, sufficient funding arrangements should be put in place, which will need to include increases to DFID's current contribution of £0.5million per year, in conjunction with seeking further funding from corporate members of ETI.

We disagree. The ETI is a learning network established to further understanding of how to ensure labour rights are promoted and respected throughout a company's supply chain. It has made a very significant contribution to global good practice in this field over the last decade. ETI does not provide assurance of corporate ethical performance and is not set up to undertake the necessary monitoring to perform this role. Other initiatives do seek to provide such assurance of either suppliers or retailers including Social Accountability International and the Fair Labor Association. ETI is an independent, voluntary initiative and ultimately the Committee's recommendation is a matter for consideration by the Board of ETI.

Corporate Social Responsibility and beyond

[Paragraph 160] Whilst a number of companies are 'going beyond' PR-driven CSR policies to implement responsible behaviour in their core business operations, many policies remain superficial, 'tick box' corporate gestures, rather than meaningful attempts to grapple with social and environmental impacts. Furthermore, the CSR focus is concentrated in the multinational business sector, rather than on SMEs, which are often over-represented in industries with high social and environmental impacts. DFID must seek to re-dress this balance. We urge the Department to support improved implementation of international codes for multinational companies such as the OECD Guidelines for Multinational Enterprises. This will entail lobbying for far greater collaboration and coordination across Whitehall and introducing Government initiatives to push companies into CSR policies.

We agree. DFID can do more to support effective implementation of international codes for multinational enterprises and to encourage business alliances that support sustainable development. We work closely with companies on a wide range of development issues, including labour rights (Ethical Trading Initiative), transparency in oil, gas and mining (Extractive Industries Transparency Initiative) and access to medicines (good practice in the pharmaceutical industry). The success of many of these initiatives depends on working in partnership with non-governmental organisations.

We agree that there has been less progress in promoting CSR with small and medium sized enterprises. DFID, through its own offices and with FCO posts, supports business in associations in a wide range of countries and this work includes the promotion of CSR to small and medium sized as well as larger companies.

In the White Paper the UK Government committed to revamp the UK's National Contact Point (NCP) for the OECD Guidelines for Multinational Enterprises by September 2006, 'with the involvement of DFID, the Foreign and Commonwealth Office (FCO) and independent experts as well as the Department for Trade and Industry to strengthen our implementation of the OECD Guidelines for Multinational Enterprises.' The tri-department NCP has now been established, as have new procedures for the handling of complaints brought to the NCP. A communications strategy will detail how the departments will promote the guidelines to multinational enterprises. DFID's new role in the NCP, alongside FCO and DTI, will help to enhance its capacity.

We work to improve coordination across Whitehall, particularly by working closely with DTI and FCO. For further detail see DFID response to paragraph 194.

Impact of Business on Poverty Reduction

[Paragraph 162] The Oxfam-Unilever project exploring the links between business and poverty reduction in Indonesia is an exciting new model for assessing corporate behaviour and ensuring that growth benefits 'the base of the pyramid'. DFID should, in its ongoing dialogue with business and civil society organisations, support similar projects, where they are likely to assist poverty reduction through private sector growth.

We agree. The Oxfam-Unilever project was of great value and provided interesting and practical insights into the impact of Unilever's operations in Indonesia which can and should be replicated elsewhere. We also recognise that the 'base of the pyramid' concept is an important one that can inform business strategy in developing countries. We have, for instance, worked closely with the pharmaceutical industry to promote differential pricing to make medicines more affordable for people at the base of the pyramid. We have good relations with a wide range of companies involved in this area (including Unilever) and where appropriate would consider providing direct support to such projects.

Cooperative Enterprises

[Paragraph 166] Co-operatives — when performing efficiently — represent a private sector model that provides many benefits and opportunities to poor people. We hope that the resurgence of interest in co-operatives is not a passing fashion: co-operatives represent a cost-effective and sustainable way to support PSD. DFID's Strategic Grant Agreement (SGA) with the Co-operative College has been mutually beneficial, helping both partners to raise the profile of co-operatives as key contributors to PSD. We support the need to put in place a new SGA with the Co-operative College when the current Agreement expires in March 2007.

The SGA initiative was set up to help DFID engage with organisations whose core business was not related to international development but who, with support, could develop in this area. SGAs are transitional instruments and it was envisaged that at the end of the agreement (2007) the organisations supported would mainstream the activities or access other traditional funding sources.

We agree that the SGA with the Co-operative College has been beneficial to both parties. The College has successfully achieved the overall aim of the SGA and discussions will take place to consider their future relationship with DFID beyond March 2007.

[Paragraph 168] The co-operative movement has a particular role in public sector delivery and in making trade work for poor people. Co-operatives can provide an effective vehicle for the large-scale provision of public utilities, and governments planning public sector reform and privatisation projects should include co-operative enterprises amongst the private sector options. DFID's 2005 grant of £50 million to rural electricity co-operatives in Bangladesh is a positive indication of the Department's renewed commitment to the co-operative sector, and we anticipate similar expressions of support from DFID in the short term future. The important role of co-operatives in PSD should be adequately communicated to all DFID country programmes to ensure a coherent approach to this under-recognised PSD model.

Following on from the DFID policy paper 'How to leverage the co-operative movement for poverty reduction', the Co-operative College is preparing a pack promoting the role of co-operatives, which will be publicised and distributed to all DFID overseas offices. In addition, DFID will organise an internal seminar based on the findings of extensive research — commissioned by ILO with DFID funding — on the contribution and potential of cooperatives to create decent employment, to support economic activities, to offer basic social protection and voice and to provide representation in the rural and informal sector of African economies. This will contribute to further dissemination of the research findings within DFID and ensure developments in the cooperative movement in Africa are better known by DFID overseas offices.

The ILO has a new *Cooperative Facility for Africa* (which DFID may help fund). The Facility is seen as a means of facilitating networking among cooperative apex organizations and cooperative support structures throughout the continent and beyond, to enable the exchange and sharing of knowledge, expertise and resources.

Business Forums

[Paragraph 172] Business forums act as a vital conduit for public-private dialogue and private sector action on poverty reduction. Business Action for Africa (BAA) is a highly promising outcome from 2005 and it is crucial that DFID continues its support for the forum. In conjunction with support from BAA's growing corporate membership, DFID should assess current funding levels with regard to ensuring that BAA can continue to expand as a crucial partnership for PSD.

We agree. Business forums are of great importance, and BAA offers an excellent forum to generate and promote best practice, and to help to coordinate business support for development friendly policies. DFID joined the BAA board (the Oversight Group) at the outset and has provided financial support. We recently committed to extend this support, alongside other members of the Oversight Group, and will continue to contribute to BAA's work areas and support its efforts to promote the role of business in Africa's development.

Private Sector Development in practice: DFID's organisational design and ways of working

[Paragraph 181] DFID officials acknowledged that PSD is a relatively new area for the Department. However, we observe a number of indications that DFID's administration and organisational design have not 'caught up' with the Department's growing prioritisation of PSD within its thinking and policy-making. For a start, somewhat of a cultural divide seems to exist between DFID and the private sector — their ways of working and organisational cultures are very different, and bridging this gap represents a challenge that DFID has not yet fully addressed.

[Paragraph 183] Involving the private sector in policy-making — an integral part of building PSD policies — will require DFID to accommodate the different working styles in public and private sector bodies, otherwise the capacity of companies to contribute to PSD approaches may be compromised. One aspect of overcoming the cultural gulf is slimming down the time and opportunity costs associated with participation in policy consultation, which are evidently perceived by the private sector as a barrier to their engagement with DFID.

DFID uses a number of mechanisms to work with the private sector, and to give the private sector a lead, where appropriate, in achieving development goals. The private sector plays a leading role in the Investment Climate Facility for Africa, which has been set up to improve the conditions for businesses to operate in Africa. DFID works alongside UK supermarkets on product standards, with banks on remittances and microfinance and with international pharmaceutical companies on improving access to medicines. The UK Remittances Task Force, which evolved out of a DFID-chaired Remittances Working Group, has now graduated to a fully private sector-led initiative. This Task Force has set its own goals that bring together commercial priorities with development priorities, and it receives DFID support in achieving those. We have referred earlier to our support of the ETI and EITI.

DFID is exploring ways to work more closely with the arm of the World Bank Group that deals directly with the private sector, the IFC. We see the IFC as effective in promoting public private dialogue both at country level — for example in poverty reduction strategy discussions — and global level — for example through the Equator Principles for social and environmental standards in project finance.

We are considering new ways of engaging with the private sector on strategic policy issues, in tandem with a review of our existing Policy Advisory Group.

[Paragraph 184] Adopting a streamlined approach should not require radical or costly changes to DFID’s approach, merely an adapted style. Time will not permit DFID staff to visit every individual company involved in a particular aspect of PSD. This is why we recommend that DFID makes better use of business forums networks such as Business Action for Africa, and industry groups in the UK and across countries of operation, as a means to link with a number of private sector actors simultaneously in a time- and cost-effective way.

We agree. DFID increasingly engages with industry groups such as Business Action for Africa in order to more effectively communicate with and influence the private sector. Business networks and industry groups can also be highly effective in promoting development goals, for example financial inclusion through voluntary banking codes. In the financial sector DFID engages with the Remittances Task Force, the UK Microfinance Club, the UK money transfer association, and a number of country-level banking associations. In agriculture DFID works with Eurepgap, a retail standards setting body which most of the major supermarkets are members of. DFID maintains good working relations with the Commonwealth Business Council, which can be an effective convenor of the private sector for events and dialogue. The Investment Climate Facility is a valuable mechanism for working with the private sector in Africa.

[Paragraph 185] In our view, not only does the limited number of PSD specialist staff affect DFID’s ability to engage more effectively with the private sector, it is also an insufficient number to cover DFID’s 36 country offices plus its two UK-based headquarters. We believe that DFID should set a minimum target of one PSD advisor for each of its 36 country offices in addition to the current Growth and Investment Group within DFID headquarters.

As the Report notes, PSD expertise is often well integrated into DFID country teams, such as the Growth teams in Ghana, Nigeria and elsewhere. PSD advisors are already located in many of DFID’s most strategically important countries, with two each in Bangladesh and Nigeria. DFID staff take a multi-disciplinary approach to development, and expertise on private sector development may come from livelihoods, infrastructure, and economic advisers, among others, in addition to DFID Private Sector Advisers. Recruiting more Private Sector Development expertise is subject to the human resource constraints that apply right across DFID. DFID’s Policy Division includes a Growth and Investment Group which plays an important role in policy development and supporting policy implementation by DFID country offices. The roles of Head of Profession Private Sector Development and the Chief Economist are also vital for joining-up the country-led approaches pursued by DFID offices.

We would note that in line with the Paris Declaration, DFID seeks to leverage the expertise and capacity of other agencies where relevant. The IFC has a significant role in PSD and in some cases support to IFC activities will be an effective way for a country office to support PSD.

[Paragraph 188] The development of multidisciplinary teams in country offices, which integrate PSD expertise with other policy specialisms, should be emulated across all 36 DFID country offices.

Multidisciplinary teams that integrate private sector and growth with other policy areas are developing in a number of DFID offices. For example in Uganda a ‘services and growth’ team brings together advisers from the livelihoods, private sector, economics, governance and health professions. There is a growth team in Nigeria that includes two private sector advisers. In other countries, such as Kenya and Zimbabwe, private sector development is covered by other disciplines, often within a multi-disciplinary team approach. In some cases DFID support to private sector development is provided through a secondment to another agency which has a wider PSD programme, for example the Asian Development Bank in the case of Vietnam.

[Paragraph 189] We believe that greater integration should also be sought within DFID’s Policy Division. Deploying a PSD advisor to every team — for instance, in the way a Social Development Advisor currently sits within most teams — would involve too large-scale an increase in staff to be cost-efficient. But, following the Department’s restructuring in 2002 — which aimed for enhanced fluidity of staff deployment — DFID should have a staff structure in place to ensure that PSD Advisers can work flexibly across different teams according to work priorities. We advise DFID to use the flexibility and fluidity of its post-restructuring arrangements to maximum effect, and move PSD Advisers in and out of Policy Division teams to support changing priorities and the cross-cutting nature of different policy areas.

We agree that private sector expertise is relevant to a range of DFID policy areas, and we already have a structure that enables private sector advisers in PD teams to work with other groups, teams and professional disciplines. For example, PSD advisers in the current Growth and Investment Group are involved in policy areas beyond the direct remit of that group, including climate change, migration and social protection. In a number of cases this is formalised through joint initiatives by teams across Policy Division groups. PSD advisers are also located in the trade group. The Head of Profession for Private Sector Development helps ensure that this expertise is available for policy development more broadly.

DFID’s Policy Division is realigning some staff and financial resources in response to the recent White Paper, and this will include a review of the skills base.

[Paragraph 190] We recommend that if, as we have recommended, the numbers of PSD Advisers are expanded, a minimum target should be set to recruit advisers who have both business qualifications and business experience.

Private sector advisers in DFID must meet a set of core competencies which will have been developed through experience in private sector development or directly in the private sector. A number of DFID staff, including those outside the private sector advisor cadre, have private sector experience prior to joining DFID. We will be recruiting a new Head of

Profession for Private Sector Development to further deepen our expertise in PSD. DFID staff take a multi-disciplinary approach to achieving development, and expertise on private sector development may come from agriculture, infrastructure and economic advisers, among others, in addition to private sector advisers. Recruiting more private sector development expertise will be subject to the human resource constraints that apply right across DFID.

[Paragraph 191] We advise that the increased use of secondments into and from the private sector will assist the development of common understanding between DFID and the private sector.

We agree. DFID's 'Secondment and Interchange Strategy' of November 2002 noted the value of secondments to 'bridge the 'culture gap' with the private sector, local authorities and even the voluntary sector' and resulted in the establishment of a dedicated Secondments Team responsible for oversight of secondment activity. DFID has had 1 secondment into the private sector (at BP) and 6 secondments from the private sector into DFID in the last 3 years, in addition to 2 secondments into private sector support institutions (Africap and the Investment Climate Facility for Africa). We recognise that we need to increase the number of outward secondments to the private sector where possible, and we will continue to do this.

[Paragraph 193] We support DFID's current outsourcing of challenge funds to consultancies and risk finance to the CDC Group. Not all DFID policies will benefit from being outsourced to the private sector and we do not recommend expanding the use of outsourcing beyond its current usage, which is focused on policies which involve the most direct engagement with the private sector.

We agree that the approach of outsourcing the management of challenge funds and risk finance facilities has been effective. Outsourcing project management can also be a cost effective option that taps into private sector management capacity and expertise. This does not take away the strategic and oversight role that DFID still needs to play when outsourcing is used. For example the financial sector deepening projects supported by DFID in several African countries are managed by consultants or as trusts (not least FinMark Trust), with good results that build on their expertise and perceived neutrality. Outsourcing will continue to need to be one option under review for delivering better support to partner governments.

Using Resources outside DFID

[Paragraph 194]. DFID will also strengthen its resources for PSD by ensuring that it utilises the strengths of other UK Government Departments through effective co-ordination of policies linked to PSD. A particular area where improved co-ordination would be beneficial is the implementation of international regulatory codes on the private sector's social and environmental impacts.

[Paragraph 195] DFID will strengthen its resources for PSD by ensuring that it utilises the strengths of other UK Government departments. This will involve more efficient co-ordination with other departments, where appropriate, to ensure a shared vision for achieving the development promises for 2005 and the role of PSD in meeting global targets. A particular area where greater co-ordination would be beneficial is the implementation of international regulatory codes on the private sector's social and environmental impacts.

DFID works closely with other government departments on a wide range of corporate codes of conduct, including with FCO (Global Compact, Voluntary Principles on Energy and Security, business and human rights), DTI (OECD Guidelines for MNEs, CSR Draft International Strategic Framework) and DEFRA (Forest Law Enforcement, Governance and Trade Legislation and Licensing Scheme, FAO Code of Conduct for Responsible Fisheries). DFID is a member of the Interdepartmental Group on Corporate Social Responsibility (CSR), which is managed by the DTI and which provides a forum for government departments to discuss CSR issues, including codes of conduct.

DFID also works with other government departments to shape and ensure the effective implementation of the environmental and social safeguards of the International Financial Institutions, such as the World Bank. These are employed by International Financial Institutions (IFIs) in their support to private sector projects to ensure negative impacts are avoided or appropriately managed and positive impacts enhanced. Commercial banks are increasingly adopting those standards, for example through the Equator Principles for project finance. We will explore with the IFC and other IFIs how such standards can be extended to other areas of commercial bank activity in developing countries.

[Paragraph 197] Donor co-ordination is particularly important within PSD due to the wide-ranging nature of the private sector's potential engagement with poverty reduction. DFID should ensure that it co-ordinates effectively with other donors over PSD, and continue its active participation in international co-ordination initiatives such as the Donor Committee for Donor Agencies for Enterprise Development and the OECD PovNet.

We agree. Donor coordination is particularly important within PSD due to the wide-ranging nature of the private sector's potential engagement with poverty reduction. DFID promotes better coordination through its participation in international co-ordination initiatives such as the Donor Committee for Enterprise Development, the OECD PovNet, and the multi-donor microfinance trust fund CGAP. DFID is also a leading member (and chair) of the Financial Sector Reform and Strengthening Initiative (FIRST), that includes four other bilateral donors, the IMF and the World Bank. Moreover DFID participates in many donor forums at country level (for example acting as Chair of the Bangladesh Local Consultative Group on Private Sector Development).

Innovation

[Paragraph 202] The sustainability of policies is clearly a concern within any development sector. But we feel that in its approach to PSD — a new and disparate area — DFID is at particular risk of innovating at the expense of following up and sustaining existing policies. New ideas and pilot schemes are not a panacea for sustainable, long-term PSD policies, especially in the case of bilateral projects, where DFID cannot rely on other donors to step in after initial phases. DFID should focus on ‘implementing as well as innovating’ with regard to PSD. Existing policies should be carefully assessed for scalability and sustainability before new policies are launched.

We agree that sustainable and long-term PSD policies are needed. The investment climate focus within a ‘making markets work’ framework provides a sustainable framework within which approaches that may at times be innovative and opportunistic can be implemented to promote private sector development. The role of the private sector in developing countries is often a rapidly evolving one and DFID needs to be able to respond to changing opportunities. The recent positive changes in the perception of the corporate private sector towards social, environmental and other developmental concerns also imply a need for continued flexibility from DFID.

We believe that innovative thinking is often the key to working better with the private sector and understanding how it can contribute to poverty eradication. Experience shows that DFID’s innovations do bring in funds and other resources from other partners, as has happened in DFID’s work in investment climate, private sector infrastructure, and financial sector development. For example, private sector infrastructure programmes supported by DFID and other donors have generated some US\$1.5 billion in private investment, representing a donor/private sector ratio of 1:10. Our role in many cases is to demonstrate through pilot programmes that private sector investment can be viable without the need for long-run public subsidy. We aim to develop replicable business models which do not depend on continuing donor subvention.

The Growth and Investment Group in Policy Division plays a significant role in learning lessons and supporting innovations in private sector development throughout DFID. Policy and practice papers are used as instruments to extend existing policies across the Department. The role of Head of Profession, Private Sector Development, is also vital for ensuring the coherence and sustainability of DFID’s PSD work.

Approach to PSD

[Paragraph 206] We advise that DFID should take pro-active steps to integrate PSD as a ‘way of doing things’ across the full range of policy areas, from agriculture to health and education. Integrating PSD approaches within other policy areas will transform PSD’s current status as somewhat of an ‘add-on’ — a stand-alone channel of work — to a mainstreamed development approach that is assimilated into policy-making throughout the Department.

We agree that the private sector is a key actor in a range of policy areas. DFID is already engaged with the private sector in areas as diverse as infrastructure, healthcare provision, access to medicines, the use of mineral resources and food production. Much of DFID's work in this area is leading edge, including exploring how the financial sector can act as a conduit for cash transfers, how the private sector can take a lead in tackling corruption, and how financial markets can be used to help respond to natural disasters. DFID will continue to produce guidance material, including 'how to' notes, to assist country offices in adopting these and other approaches for working with the private sector.

[Paragraph 208] It is imperative that DFID's PSD policies are underpinned by a clear strategic plan. Without this long-term vision and coherent strategy, DFID's capacity for innovation could result in a scatter-gun approach to PSD — an incoherent mix of policies that will undermine the private sector's potential to contribute to poverty reduction. We anticipate DFID's PSD strategy being spelt out as soon as possible, together with deliverable, practical and time-bound plans for the full implementation of existing PSD policies.

We agree that DFID's approach to PSD needs to be set out more clearly. We will do so through revisiting the DFID Private Sector Development statement (published in December 2005) that presents our strategic approach, in order to ensure an up-to-date and coherent framework in support of country-led approaches. This will be supplemented by practical guidance (for example 'how to' notes) on engaging with the private sector.

We recognise that DFID's activities in private sector development, as in other areas, need to be country-specific, and reflect partner countries' own priorities, their Poverty Reduction Strategies, and other plans and policies. We also recognise that other donors and agencies play an important role in private sector development. Within this context, we will work to ensure that private sector development policies and programmes are well coordinated and based on sound international practice.

Department for International Development

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