development initiatives

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the enabling environment for private sector development

donor support and implications for the blended finance agenda

key messages

- To achieve sustainable development, the enabling environment for private sector development must continue to be strengthened. Donor support in this area can be considered a form of 'catalytic' aid, as is 'blended finance' (which, in contrast, directly engages the private sector).
- International commitments have been made to support developing countries to improve their enabling environments, particularly least developed countries (LDCs). A wide range of actors together provided US$9.9 billion of aid for the enabling environment in 2015.
- Yet most enabling environment official development assistance (ODA) targets middle income countries, or is not allocated to specific countries. LDCs receive comparatively less support, despite the commitments made. This presents a risk to achieving the Sustainable Development Goals (SDGs).
- Blended finance initiatives also (currently) mostly benefit middle income countries. The increase in blended finance may present an opportunity for donors to increase 'enabling environment' ODA to LDCs, where stable, international public finance is needed and where blended finance may have relatively fewer opportunities.
- The OECD Blended Finance Principles and policy guidance should encourage dialogue on effective coordination of different donor approaches to private sector development, including sequencing of approaches, which could enhance results and country ownership.
- Clear, agreed definitions and shared methodologies could help develop the evidence base and would allow for more meaningful analysis of whether support to the enabling environment is meeting needs.

introduction

Global policy dialogue on financing needs for the 2030 Agenda for Sustainable Development has focused on the significant gap between these needs and the resources currently available to developing countries. This has generated increased interest from donors in how existing forms of international public support, particularly ODA, can be used to 'catalyse' additional resources, particularly from the private sector. Catalytic aid can take various forms: 'blended finance' mechanisms have perhaps attracted the most attention in recent global debates on financing for development.[1] But the importance of supporting developing countries (particularly LDCs) to strengthen the underlying 'enabling environment' for private sector development is also an important focus for donor support, as well as a priority area for developing countries,[2] and has a long history in aid policy and practice.

Efforts to build a sound enabling environment can be characterised as a catalytic approach to private sector development with a wider national, regional and international impact, compared with the more direct, 'deal/investment'-level catalytic approach of blended finance. It can therefore be seen as, if not an important prerequisite, at least complementary to scaling up investments in blended finance. The complementarity of these two approaches is emphasised in the Addis Ababa Action Agenda[3] and, more recently, the OECD Principles for Blended Finance (adopted by the OECD Development Assistance Committee (DAC)).[4]

Specific commitments to support LDCs to improve their enabling environments for private sector development appear in the Istanbul Programme of Action.[5]

Despite its importance, there are significant gaps in the knowledge base about the landscape of donor support for the enabling environment for private sector development, and no standard definition of what this type of support comprises. Development Initiatives (DI)'s discussion paper on this topic (forthcoming) presents a framework that considers this type of support in the wider context of catalytic aid and a methodology that aims to facilitate assessment of how it is targeted. The aim is to stimulate conversation on these important issues and seek feedback on this analytical approach. This briefing summarises key points from the discussion paper.

What is donor support for the enabling environment for private sector development?

Partly because the 'enabling environment' is context dependent (barriers to private sector growth differ from country to country), there is no established definition of the 'enabling environment for private sector development'. The working definition used here is **the conditions necessary for domestic business and entrepreneurs to operate and the conditions that facilitate international trade and private investment into a country.**

Table 1 illustrates the range of activities that fall within this definition.

Table 1
Categories of donor support to the enabling environment for private sector development

Category	Description	Examples of projects
Policy/ institutional reform	Activities related to improving the 'business enabling environment' or 'investment climate', including strengthening the policy, institutional or regulatory environment for domestic and international enterprise	*Implementing government reforms to improve the investment climate in the energy sector* – project funded by Germany in Indonesia reported under the energy policy sector
Market functioning	Activities related to improving production and distribution, addressing market failures and imperfections and integrating all actors into markets. Includes infrastructure for private sector development, access to finance and activities to strengthen the labour force	*Increasing competitiveness of the maize, rice and soybean value chains through 1) increased productivity in targeted commodities, 2) increased market access and trade, and 3) strengthened local capacity* – project funded by the USA in Ghana reported under the agriculture sector

key findings

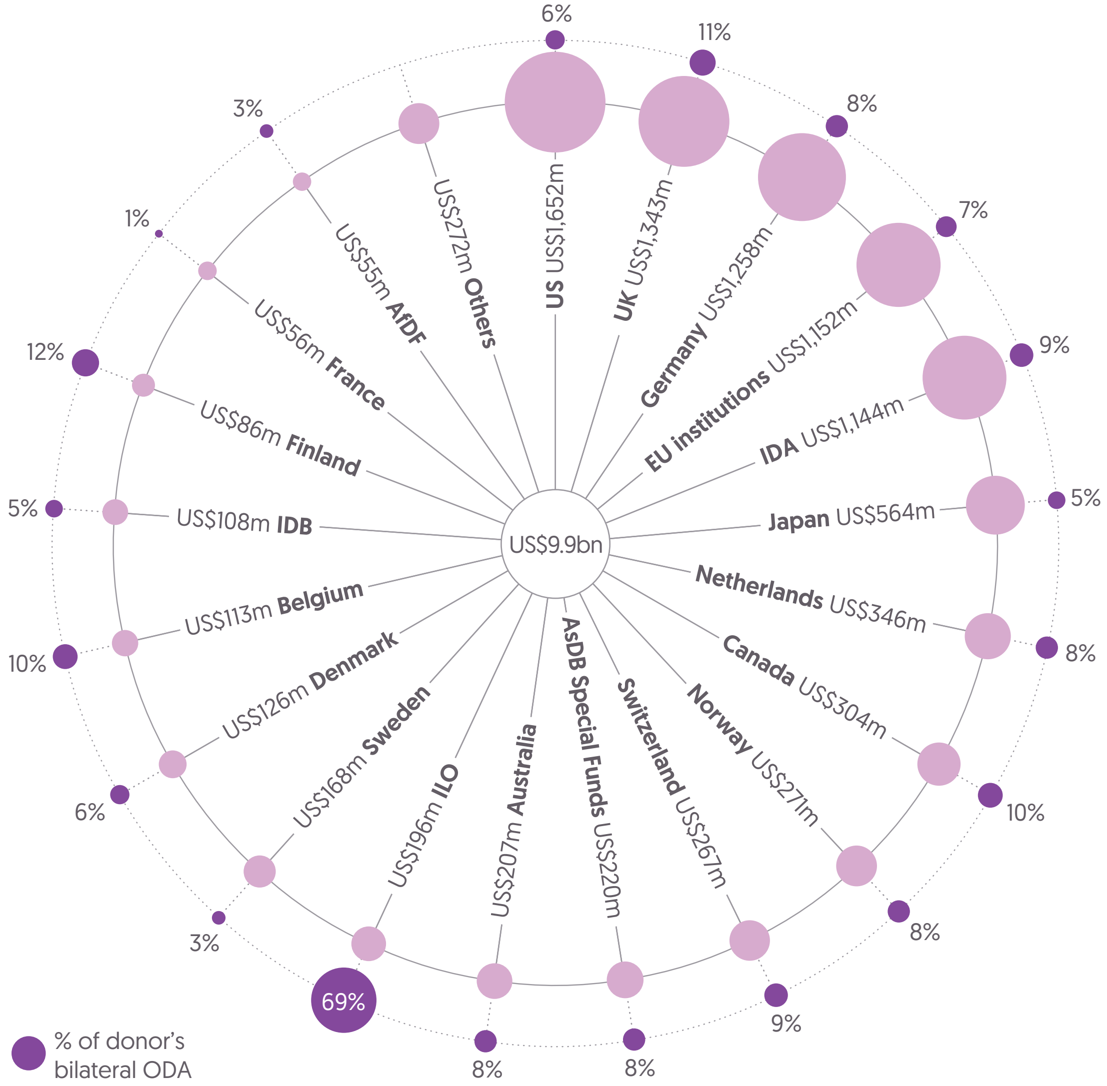
In 2015, US$9.9 billion was spent in ODA on activities targeted at supporting the enabling environment for private sector development (termed 'enabling environment ODA' in this report). This is comparable in volume to spending on education (US$10.8 billion), and is larger than spending on water and sanitation (US$6.6 billion).[6]

A wide range of actors provide enabling environment ODA

A wide range of donors provide enabling environment ODA, but it plays a bigger role in some donors' portfolios than others (Figure 1). The US's share (US$1.65 billion) accounted for 6% of its total bilateral ODA in 2015; meanwhile, the International Labour Organization (ILO), although thirteenth in terms of volumes provided, targets the majority of its ODA at supporting the enabling environment for private sector development (69%).

Figure 1

The US, UK and Germany are the largest donors of ODA to the enabling environment for private sector development



Source: Development Initiatives based on OECD Creditor Reporting System (CRS)

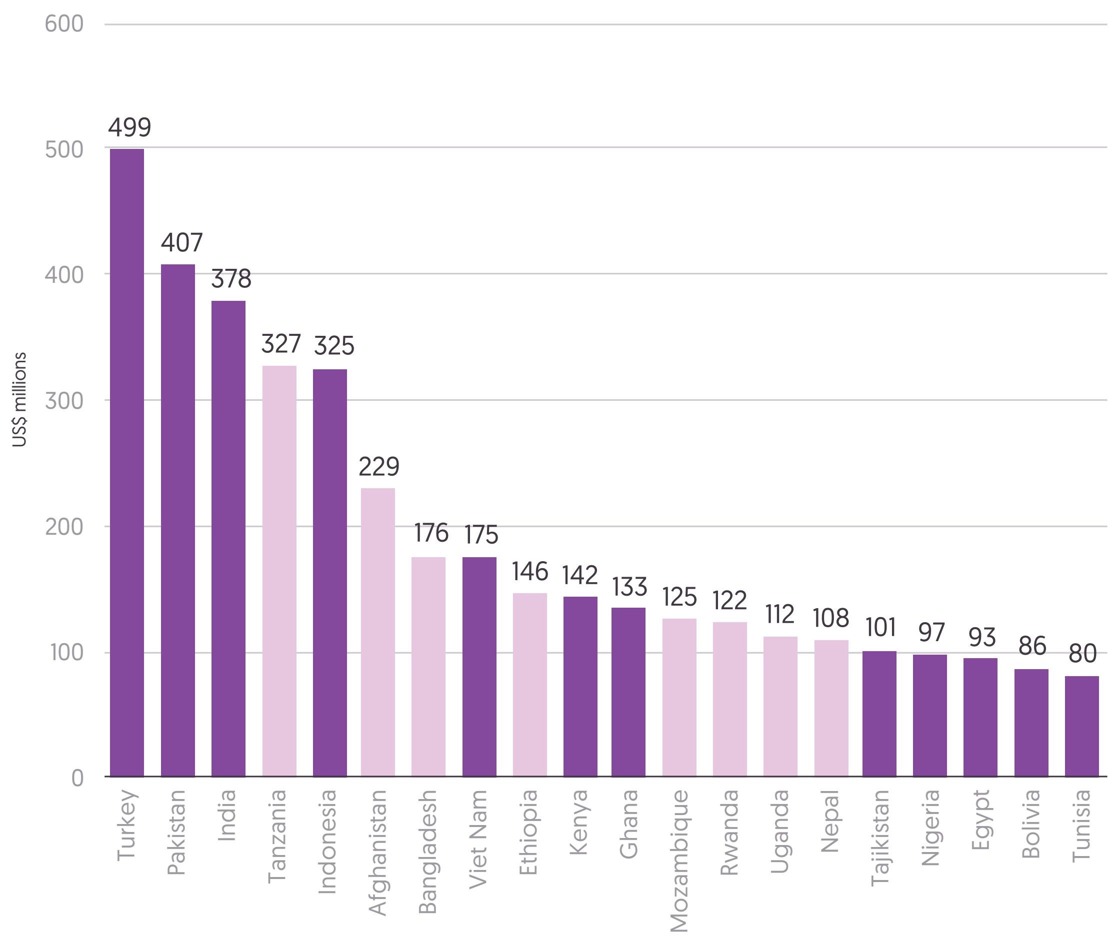
Notes: AfDF: African Development Fund; AsDB: Asian Development Bank; IDA: International Development Association; IDB: Inter-American Development Bank; ILO: International Labour Organization.

A third of enabling environment ODA is not spent directly in countries

One-third of enabling environment ODA goes to projects that are regional in scope or not transferred to specific countries, including in-donor research and support to institutions based in donor countries[7] as well as projects such as the ILO's activities to improve global employment policies. Thus individual countries receive less support directly than aggregate figures might suggest: US$6.4 billion of the total US$9.9 billion. Of the country-allocable amount (US$6.4 billion), Turkey, Pakistan and India received the most in 2015 (Figure 2).

Figure 2

Middle income countries (MICs) Turkey, Pakistan and India received the most enabling environment ODA in 2015, followed by Tanzania (an LDC)



Source: Development Initiatives based on OECD CRS

Note: Lighter shading indicates LDC status.

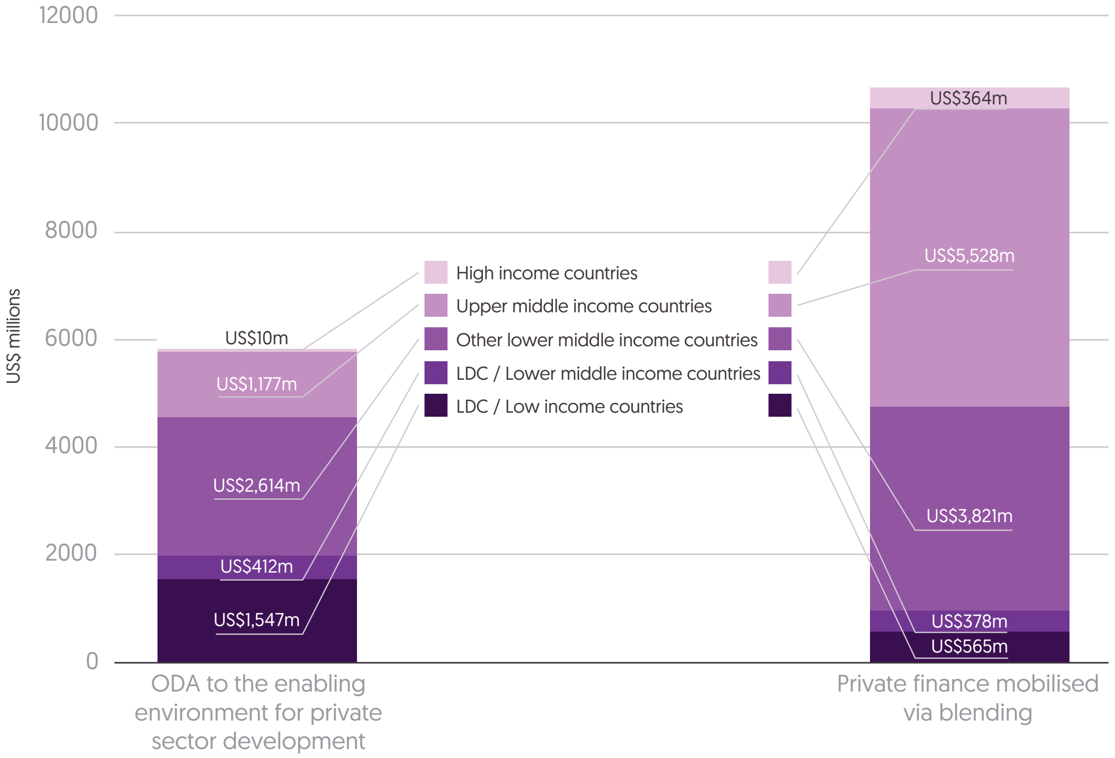
As for blended finance, MICs receive the most enabling environment ODA

The distribution of enabling environment ODA is fairly similar to what is known about blended finance, though there are some key differences.[8] Turkey, Pakistan and India, the largest country recipients for enabling environment ODA, also appeared among the largest recipients of 'amounts mobilised from the private sector' according to the 2016 OECD survey.

However, when compared with volumes of private finance mobilised via blending, enabling environment ODA appears to target LDCs (especially low income LDCs) proportionately more (Figure 3). This said, non-LDC middle income countries still receive the largest amount of enabling environment ODA, despite international commitments to provide 'enhanced financial and technical support' to LDCs.[9] The increase in blended finance, which will likely benefit MICs, may present an opportunity for donors to increase enabling environment ODA to LDCs, where stable, international public finance is needed and where blended finance may have relatively fewer opportunities.

Figure 3

Non-LDC MICS receive most enabling environment ODA, as well as benefiting most from blended finance



Source: Development Initiatives based on OECD CRS, World Bank and 2016 OECD survey 'Amounts Mobilised from the Private Sector by Official Development Finance Interventions'.[10]

The OECD Blended Finance Principles and policy guidance could encourage dialogue on effective coordination of different donor approaches to private sector development. Support to the enabling environment in LDCs may be a prerequisite for blended finance projects that have sustainable long-term development impacts. A sequenced, coordinated and country-focused approach could lead to enhanced 'pipelines' of blended finance opportunities in LDCs, with greater country ownership.

Enabling environment ODA takes a variety of forms

Enabling environment ODA is delivered through a range of channels. Recipient governments are the largest single channel of delivery accounting for 31% of enabling environment ODA; however, the majority is disbursed through other channels, including multilateral organisations, donor government agencies and NGOs.

There is no typical project; enabling environment ODA projects are funded across a wide range of sectors and tend to deliver multiple objectives. For technical reasons, it is also difficult to take a systematic analytical approach to unbundling the totals. By interrogating the data using CRS purpose codes, however, it can be seen that different country groups tend to receive enabling environment ODA that targets different aspects of the enabling environment. For example, in low income countries, activities aimed at agricultural development account for 18% of enabling environment ODA, while in lower and upper middle income countries respectively, it is mostly spent on business support services and institutions, and formal financial intermediaries.

questions and implications

Overall, this analysis highlights the wide scope and the complex nature of this type of donor support as well as the difficulties in painting a clear picture of volumes and breakdowns. As a preliminary exercise, it throws up questions particularly pertinent for policymakers interested in a strategic approach to catalytic uses of ODA in developing countries. These include:

- How can we better assess the extent to which enabling environment ODA is being targeted at the countries, places, people and sectors that need it most? What kind of proxies could be used to assess need for enabling environment ODA?
- What is the role for developing country stakeholders in identifying these needs, and appropriate forms of support for addressing them, taking into account issues of policy coherence? Are current channels of delivery used for enabling environment ODA likely to ensure that these needs are met?
- What are the implications of these findings for the trend towards using ODA for blended finance, particularly in LDCs? Should the OECD encourage knowledge-sharing on the potential benefits of sequencing or coordinating different types of enabling environment ODA?
- What are the implications of these findings for the OECD Blended Finance Principles and the associated policy guidance?
- How can monitoring of spending in this area be enhanced? What are the barriers to doing so? Is the definition and methodology used here a helpful starting point?
- What information would be needed to analyse critical factors for success in enabling environment ODA, both at country and project level? Is this information available?

Please contact us to receive our discussion paper, or look out for publication on our website. DI will build on this work to produce more detailed analysis of this area through our Investments to End Poverty project in 2018. We welcome your thoughts, feedback and comments.

notes

1 DI, 2016. Blended Finance: Understanding its potential for Agenda 2030. Available at: http://devinit.org/post/blended-finance-understanding-its-potential/

2 It should be noted that developing countries emphasise the need for improving the international and domestic enabling environments, and for policy coherence, as well as direct donor support. See for example the Statement on behalf of the Group of 77 and China by H.E. Ambassador Mamabolo, at the Round Table on Ensuring Policy Coherence and an Enabling Environment at all Levels for Sustainable Development at the Third International Conference on Financing for Development (Ethiopia, Addis Ababa, 14 July 2015). Available at: http://www.un.org/esa/ffd/ffd3/wp-content/uploads/sites/2/2015/07/G77-AND-CHINA-Round-Table-2.pdf

3 The Addis Ababa Action Agenda points to different catalytic uses of international public finance, including strengthening domestic enabling environments, and investing in blending and pooled financing mechanisms (paragraph 54). It also points to the need 'to create the enabling environment at all levels and a regulatory framework necessary to encourage entrepreneurship and a vibrant domestic business sector' (paragraph 36) and for LDCs to 'continue to improve their enabling environments' (paragraph 46). Available at: http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf

4 Principle 3C: "Tailor blended finance to local context: Use blended finance alongside efforts to promote a sound enabling environment." OECD Blended Finance Principles. Available at: http://www.oecd.org/dac/financing-sustainable-development/development-finance-topics/blended-finance.htm

5 Istanbul Programme of Action, paragraph 56. Available at: http://ldc4istanbul.org/uploads/ipoa.pdf

6 All findings relate to ODA gross disbursements in the year 2015. Projects included in our estimate of ODA to the enabling environment for private sector development may be captured in other sectors – overlaps are difficult to account for given the methodology, which is based on data reported by donors to relevant purpose codes within the OECD DAC CRS and on a key word search to capture relevant activities reported against purpose codes not considered to be fully relevant to this area.

7 The bilateral unspecified figure also includes capital contributions of donors to their development finance institutions (DFIs) which have been reported against relevant purpose codes or whose descriptions included words in the list of key words used here to capture relevant projects beyond fully relevant purpose codes. Capital contributions to DFIs amounted to US$918 million (including BIO (Belgium), CDC Group (UK) and Norfund (Norway)).

8 Data in the 2016 OECD survey captures 'amounts mobilised from the private sector' but not the amounts invested by donors. For the purposes of this analysis, and in the absence of data on the latter, the former is used as a proxy for the scale and distribution of blended finance.

9 Istanbul Programme of Action Paragraph 56. Available at: http://ldc4istanbul.org/uploads/ipoa.pdf

10 Data on 'private finance mobilised via blending' refers to 2014 data reported in the 2016 OECD DAC survey 'Amounts Mobilised from the Private Sector by Official Development Finance Interventions'. Figures include amounts mobilised through the use of three instruments: guarantees, syndicated loans and shares in collective investment vehicles. Analysis is limited to 85 developing countries for which data on both ODA to the enabling environment for private sector development and 'amounts mobilised through blending' is available.

Development Initiatives (DI) is an independent international development organisation working on the use of data to drive poverty eradication and sustainable development. Our vision is a world without poverty that invests in human security and where everyone shares the benefits of opportunity and growth.

We work to ensure that decisions about the allocation of finance and resources result in an end to poverty, increase the resilience of the world's most vulnerable people, and ensure no one is left behind.

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