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MOBILISING INVESTMENT FOR DEVELOPMENT

REVIEW OF ODA USES AND EXPERIENCES

This report on ODA/Investment synergies is work-in-progress. It was prepared by the OECD's Development Co-operation Directorate based on work by an external consultant, Ms Maria Unterrainer.

TABLE OF CONTENTS

EXECUTIVE SUMMARY

Investment, both domestic and foreign, is critical for sustained economic growth and poverty reduction. The Monterrey Consensus on Financing for Development highlighted the need to build stronger synergies between ODA and investment to help meet the financing needs for the MDGs. This theme was taken up at the OECD 2003 Ministerial Council Meeting and the OECD is now engaged in preparing an Initiative on Investment for Development. One component of this Initiative is the ODA/investment synergies project. Details of the Initiative and the ODA/investment synergies work are available on the internet at: *http://www.oecd.org/daf/investment*.

These issues are by no means new. The importance of the "meso" level enabling environment for investment (e.g. regulatory framework, infrastructure) has long been understood and donors, both bilateral and multilateral, have long been involved in supporting it, through a considerable array of actions. There has been noticeable improvement in many developing countries, but it is evident that we still need to do more on the enabling environment, and to do it better and for longer periods. Getting the enabling environment right is thus critical, but in itself is not enough to maximise the investment potential of developing countries. We also need to work at the "micro" level (e.g. investment promotion and facilitation) so as to strengthen the ability of the enterprise sector to respond to the lowered barriers and new opportunities arising from a better business climate. Support to the business sector (not subsidies to individual enterprises) is a more recent direction for donor efforts.

So why this renewed attention at this juncture? One important reason is evidently the growing realisation that there will be considerable shortfalls in meeting the MDGs, shortfalls that can be limited by effective, scaled-up actions, now.

This report is a preliminary step towards the initial output of the Initiative on Investment for Development – providing guidance to donors on using ODA to support developing countries' efforts to mobilise investment for development. Proposals emerging from this work can be flagged in the DAC/OECD report to the Millennium Summit in September 2005, to get feedback and support.

In order to develop that guidance, we first need to understand better i) what bilateral donors in the DAC are doing to support investment (activities and instruments); ii) how much ODA they are spending on this area; and iii) how effective these efforts have been in promoting sustainable investment. This report focuses particularly on the first of these three issues, but makes some preliminary remarks concerning the others.

So far, some of the main messages coming out from this work-in-progress are:

- DAC member countries' support for investment covers a very wide range of activities at both "meso" and "micro" levels. Collectively, they probably cover each and every single factor that could conceivably be relevant for stimulating investment. There is a fairly clear implicit/explicit rational for every type of intervention, so "relevance" is not an issue, but strategic focus and prioritisation may be. Not all of the areas supported by bilateral donors are equally important for investment, though. We cannot say whether donors are basically all working from the same implicit conceptual framework (i.e. determinants of investment and importance for growth, development, poverty reduction, etc.), but they do seem to have quite different views on what are the major barriers to investment to address (if that is the approach they take to targeting) and the areas that can be effectively actioned by ODA (as opposed to some other instrument) – even after taking account of the particularities of different partner countries. It is presently unclear whether donors connect up to what partner countries and/or businesses have identified as clear priorities and/or main impediments.

- DAC member countries' support for investment is not only undertaken through development agencies/foreign ministries but also via a variety of other actors including development finance institutions as well as other ministries such as treasury, trade, etc. Again, it is not clear from the information at hand that these different actors are as well co-ordinated as they could be and that they link up in the most effective ways with partner countries, the private sector and other stakeholder objectives and priorities.

- It is by no means a straightforward task to identify how much ODA is spent on "mobilising investment". A definition of "ODA for investment" for statistical purposes does not exist in the DAC system. In addition, support for investment, as indicated above, is very multidimensional and thus there are difficulties in both delineating the area and identifying how much ODA in a given category is primarily directed at investment support. For example, how much of the USD 5.2 billion of ODA spent on infrastructure (transport, communications and energy) on average over the 2000-2002 period can/should be directly allocated to investment support? The same question arises for the USD 5.4 billion of ODA going to the "productive sectors" and the USD 1.7 billion of ODA going to the banking, financial and business sectors on average over the same period. Nevertheless, based on these indications, as well as examples of some of the ODA amounts spent on individual projects (see chapter 2), it is quite evident that DAC member countries spend a sizeable amount and share of their ODA promoting investment. Consequently, it is important to know how effectively that ODA is spent.

- Unfortunately, at this juncture, we are unable to say much about aid effectiveness in this area. We need to look much more into "micro"/project-level evaluations. For example, some initiatives have the explicit goal of increasing income levels and employment in partner countries, but there is little published information on the extent to which income and employment have indeed increased, the extent to which increases were the result of the initiative and whether the result represents good value for money. More evaluation (or more information on evaluation results) is needed to assess whether, overall, investment support represents good value for money, as well as to assess the relative effectiveness of support for different types of investment support (e.g. as between enabling environment and supply-side support, as well as initiatives within each of these groups, e.g. corporate governance, risk mitigation, etc.).

Comments and reactions on this work-in-progress would be welcome. Of particular importance is to gain views and insights from DAC Members and other stakeholders as to the main areas and messages we should start to develop in preparing guidance to donors. On the basis of the work already undertaken, the following examples (illustrative and not exhaustive) are offered to promote discussion:

- Should donors seek to have more focus in their support by limiting interventions to a much smaller range of areas? If so, how do we identify these - through evaluation reports, business surveys, investment scoreboards, etc?

- Does the range of activities and the variety of actors involved hinder better co-ordination, particularly around developing country-led and PRSP processes?

- Do donors connect up as well as they should with other stakeholders, both at home (e.g. other ministries and government agencies involved) as well as in partner countries (e.g. with multilateral agencies, the business sector and civil society)?

- Do we know enough about evaluation or should we take steps to strengthen the evaluation culture and methodology for comparing and assessing different types of interventions?

- So far, we have said little about the instruments used to pursue investment support (loans, grants, technical co-operation, business partnerships, trade fairs, etc.). Should we look in more depth at this issue to be sure we have the right armoury of instruments, best adapted to promoting investment via development co-operation?

CHAPTER 1

INTRODUCTION

Without major and sustained efforts to promote more and better investment (both domestic and foreign) in developing countries, meeting the Millennium Development Goals (MDGs) will be even more difficult than presently envisaged.[1] In the Philippines, for example, a cornerstone of the government's plan to halve poverty in six years is to attract more investment in order to create 10 million new jobs. In Afghanistan, several billion dollars of official development assistance (ODA) have been pledged in recent years but foreign companies have so far only invested around USD 100 million, mainly in telecommunications and hotels. The Afghan Minister of Finance estimates that some USD 15 billion in private investment will be needed to boost legitimate enterprise and to transform Afghanistan into a modern state.[2] For firms, there are substantial business opportunities in providing goods and services to the world's 4 billion poorest people - who represent a multi-trillion dollar market - although some radical innovations in technology and business models may be required to do so.[3]

A range of factors affect the capacity of developing countries to stimulate and attract the investment they need. These include the degree of political, social and macro-economic stability, the policies that make up the regulatory framework, the way financial and labour markets function, the quality of governance, the extent of corruption, the condition of relevant physical and technological infrastructure, the educational and health standards of the population, the size of national and regional markets and the effectiveness of activities designed to promote investments or support local businesses.

When heads of state and government met at the United Nations International Conference on Financing for Development in Monterrey in 2002, they acknowledged that achieving the MDGs will require substantial increases in ODA as well as in domestic and other international resources. Leaders consequently urged donors, developing countries and international development institutions to intensify efforts to promote the use of ODA to leverage foreign investment and domestic resources, as additional sources of financing for development.[4]

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1 . For every goal and target included in the United Nations Millennium Declaration, there are encouraging signs of progress in some parts of the world as well as worrying evidence of stagnation and even reversal in others. See: OECD (2004), "Progress Towards the Millennium Development Goals", *The DAC Journal, Vol. 5, No. 1,* OECD, Paris, pp. 51-70. The *Global Monitoring Report 2004,* prepared by the World Bank and the International Monetary Fund, also warns that most developing countries will, on current trends, fail to meet most of the MDGs.

2 . Interview with *The Financial Times* published on 13 August 2004.

3 . For a discussion on doing business with the "bottom of the pyramid", see: Prahalad, C. K. and Hart, S. L. (2000), "Strategies for the Bottom of the Pyramid", World Resources Institute, July. or Prahalad, C. K. (2004), "The Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits", Wharton School Publishing, Philadelphia.

4 . United Nations (2002), "Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002." A/CONF 198/1.

Synergies between ODA and investment can arise when aid fosters more or better investment so that sustainable benefits flow to the partner country that exceed what would have been achieved through either development co-operation or investment alone. Mobilising investment for development may not be an explicit objective of member countries of the OECD's Development Assistance Committee (DAC), but bilateral donors spend a significant share of their ODA financing a variety of activities that - without subsidising private sector activity - have a positive impact in terms of stimulating investment.[5] It is less clear, however, whether these activities are sufficiently strategic in their overall effect. This is a missed opportunity given the challenge ahead to achieve the MDGs and the benefits that could be derived from a more strategic and co-ordinated approach by donors.

In order to draw lessons on how ODA can be used effectively to promote investment in developing countries, this paper reviews a selection of relevant activities supported by bilateral donors in the DAC at the "meso" and "micro" levels, *i.e.* the enabling environment for investment (e.g. regulatory frameworks, infrastructure) and support targeted to the business sector (e.g. investment promotion and facilitation). It does not cover an array of areas at the more "macro" level (e.g. macroeconomic stability, debt sustainability, etc.), nor other areas obviously of broader relevance, including for investment and investors (e.g. peace and security, market access, health, education, etc.). The scope of this study does not include the activities of multilateral agencies.

The aim of this review is not to compile a comprehensive list of "who does what" in terms of which donors support which activities. Rather, it looks across the range of activities that bilateral donors are collectively doing to provide specific examples of the types of activities they undertake and to identify the main targets for their support and the underlying rational for their interventions in those areas.

The specific areas addressed in this paper, many of which build on other work being undertaken as part of the broader OECD Initiative on Investment for Development, are:

- *At the meso level:* the regulatory framework (in such areas as trade policies, tax policies, competition policies and financial markets), governance, including anti-corruption efforts, and infrastructure (chapter 2).
- *At the micro level:* investment promotion and facilitation and the development of local businesses (chapter 3).

These activities may be supported through technical assistance, grants, consessional loans, equity stakes or investment guarantees and may be implemented by development agencies, ministries of foreign affairs, other government ministries or agencies, development finance institutions or investment guarantee agencies in DAC member countries. Information has been drawn from a range of sources including published material, DAC member countries' websites, DAC peer review reports and information provided directly by DAC member countries.

This paper also presents, in chapter 4, some emerging reflections on policy implications for donors on using ODA to support developing countries' efforts to mobilise investment. The drawing of such lessons is a substantive contribution to the Initiative on Investment for Development, the results of which will be presented to the OECD Ministerial Council Meeting in 2006.

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5 . For its 2005 World Development Report, the World Bank commissioned a study which produced estimates of how much bilateral and multilateral donors together spend in developing and transition countries to improve the investment climate: an average of USD21.1 billion per year between 1998 and 2002, or about 26% of all foreign assistance (broadly defined). See: Migliorisi, S. and M. Galmarini (2004), "Donor assistance for investment climate reforms and for direct support to firms: An overview of available data".

CHAPTER 2

IMPROVING THE ENABLING ENVIRONMENT - ACTIVITIES AT THE MESO LEVEL

As the private sector is the primary actor with regards to investment, DAC member countries tend to promote investment indirectly by working to make the enabling environment more supportive of efforts by the private sector to conduct economic activities. The enabling environment encompasses a variety of areas, principally the regulatory framework, governance issues and relevant infrastructure.

I. Legal and regulatory framework

The legal and regulatory framework – which codifies the various incorporation, contracts, competition, tax, trade and financial market policies adopted by a country – is a significant factor shaping the enabling environment. Developing countries commonly often face two kinds of problems related to domestic regulation: the uncritical emulation of other countries' regulatory systems which can be inappropriate, given local conditions and capacities, and regulatory systems are vulnerable to rent seeking (a problem not limited to developing countries).

Appropriate reforms to the legal and regulatory framework can produce significant economic and social benefits. These include fostering non-inflationary growth, boosting consumer benefits, improving the competitiveness of export and upstream sectors, enhancing flexibility and innovation in the supply-side of the economy, reducing vulnerability to economic shocks, creating jobs and strengthening regulatory protection for health and safety, the environment and consumers. However, economy-wide benefits from reform processes occur over the medium term and may be a challenge to introduce because they often entail a threat to vested interests and a re-allocation of capital and labour resources in the short term. In countries where the core rules underpinning functioning markets – such as property rights, judicial institutions, commercial codes and bankruptcy laws – are absent, these challenges are even more critical.

Reform of the regulatory framework can take place at three levels: revising a single regulation, rebuilding an entire regulatory framework and its institutions or improving processes for designing regulations and managing reform. DAC member countries actively support efforts by developing countries to reform their regulatory framework by providing assistance with policy, legal and regulatory changes as well as services that improve the enabling environment.

a) Legal framework

The development of basic legal systems for company incorporation, contracts, immigration of foreign nationals and other areas related to economic activities is an important aspect of the enabling environment for private sector activities. Developing a domestic legal system in which individual laws are consistent, rights can be defended and disputes settled is important for a country's internal stability and external credibility.

Activities pursued by DAC member countries to support developing countries' as they reform their legal systems include assistance to legal reform of the most fundamental kind (e.g. for countries undergoing transition from a centrally planned economy), support for the revision of national constitutions, commercial codes, contract law and omnibus commercial law projects. Donor assistance also includes the training of judges and lawyers in improved legal procedures, helping to introduce new practices, such as alternative dispute resolution, into national judicial systems and legal curricula and streamlining administrative and management systems in courts. Policy dialogue with ministries of justice, holding workshops and seminars and hosting technical training programmes are other activities supported by donors.

In Viet Nam, the Ministry of Justice currently co-ordinates over fifteen separate DAC members that fund almost one hundred separate legal projects in the field of legal and judicial development. Japan and the United States are actively engaged, channeling technical assistance through long-term advisors. Large numbers of Vietnamese judges and procurers have also been sent to Japan and the United States for one-to-three month training programmes.

Canada and France are helping to strengthen the legal framework covering private sector activities in sub-Saharan Africa by providing financial support to the Organisation for the Harmonisation of Commercial Law (OHADA). The organisation, which aims to harmonise the legal framework for businesses in Africa, has indicated its intention to adopt a single legal framework for co-operatives in its 16 member countries. In response to concerns from credit unions that proposed modifications would compromise the functioning of existing institutions, the Canadian International Development Agency (CIDA) also provided funds to allow credit union networks to consult each other, agree on a common position and formulate their agreement in clear legal terms. These funds allowed African and international legal experts to prepare a solid consensus position to be presented to OHADA and resulted in the development of greater private-sector capacity in policy formulation and lobbying.

b) Trade policies

Although barriers to international trade and investment have been falling in recent years, developing countries still tend to have higher barriers to free trade than industrial countries (13% for developing countries compared to only 4% for industrialised countries).[6] Greater openness to international trade can enable developing country economies to grow faster. Unleashing exports expands access to foreign exchange and allows firms to exploit economies of scale better. At the same time, reducing barriers to imported goods lowers the cost of imported inputs, facilitates the diffusion of technology and enhances incentives for local firms to innovate and improve their productivity. Both channels can have a positive impact on investment flows to the country.

Through their ODA programmes, DAC member countries are helping developing countries to strengthen domestic institutions so as to enjoy the benefits of economic liberalisation and to build their capacity to fulfil obligations and exercise privileges as part of the multilateral trading system. Frequently, donors' support enables developing countries to improve their positions in bilateral and multilateral trade negotiations, translate commitments made into national legislation and design and implement trade and investment promotion strategies.

As an example, Canada supplies substantial trade-related technical assistance in Central and South America and the Caribbean. A programme on food safety, animal and plant health, as well as customs administration channels is provided through the Canadian Food Inspection Agency and the Canada Customs and Revenue Agency. CIDA also provides other government departments with resources to assist them deliver co-operation activities in these areas, under the framework of Labour and Environment side agreements associated with Canadian bilateral free-trade agreements and the Free-Trade Area of the Americas.

6 . World Bank (2004), "World Development Report 2005: A Better Investment Climate for Everyone", World Bank, Washington.

Similarly, the United States Agency for International Development (USAID) funds a scheme that aims to increase Central American readiness to join multilateral, regional and bilateral trade agreements and to meet related commitments. The Regional Trade and Investment Program for Central America (PROALCA) has contributed to lowering tariffs, simplifying customs procedures and strengthening regional economic integration and thereby expanding intra-regional trade. In 2001, almost 2 000 people from Central America received training on trade and related issues. In its latest phase, the programme is supporting implementation of the Central America Free-Trade Agreement (CAFTA) while continuing the promotion of open trade and investment policies and work on compliance with World Trade Organisation (WTO) requirements, intellectual property rights, trade barrier elimination, regional dispute settlement, customs reform and labour issues.

c) Tax policies

Governments face a challenge in developing tax policies and setting tax rates in ways and at levels that do not hold back economic growth, by acting as a disincentive for firms to invest and create employment. At the same time, tax revenues are needed to finance the delivery of public services that help improve the enabling environment for private sector activities as well as contribute to achieving other societal objectives including the reduction of poverty.

Developing countries' statutory tax rates do not differ considerably from those of industrial countries but their tax revenues are reduced by high levels of informality coupled with poor administration and corruption.[7] This puts a disproportionate burden on those who do comply and results in a distortion of competition. Simplifying tax structures and strengthening tax administrations are avenues pursued to increase tax revenues in developing countries. DAC member countries' assistance in this area centres on providing technical assistance and training to assist partner countries to reform tax regimes and to strengthen tax authorities.

In Fiji, for example, the Australian Agency for International Development (AusAID) is helping the government to reform its revenue collecting agencies by substantially changing their skills, organisational structure and methods of operation. These changes are expected to result in increased compliance and an improved quality of service for taxpayers.

The United States Department of the Treasury's Office of Technical Assistance provides support to developing and transition countries through its tax advisory programme. The focus of this programme is on three areas: i) tax policy (legal and economic advice in structuring tax legislation and regulation to eliminate complicating and inefficient tax preferences and reduce unreasonably tax high rates); ii) forecasting and revenue estimation (the structuring of models and the generation of statistical data to feed such models); and iii) tax administration (system organisation and operation, taxpayer education and service, effective audit and collection functions, training and creation of host country management and training capacities). Among other countries, assistance has been provided to Bosnia and Herzegovina, Bulgaria, Estonia, Latvia, Poland, Russia, the Slovak Republic and Ukraine.[8]

d) Competition policies

Well functioning markets are crucial for private sector development. Competition policies are essential for well functioning factor and product markets, for fostering firm entry and exit and for

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7 . World Bank (2004), "World Development Report 2005: A Better Investment Climate for Everyone", World Bank, Washington.

8 . Of these countries, only Bosnia and Herzegovina is on Part 1 of the *DAC List of Aid Recipients* and therefore eligible to receive ODA. Aid to the other countries mentioned is classified as "official aid".

promoting and rewarding innovation and diversification. Regulation can provide the means for dealing with market failures that inhibit productive investment while, at the same time, reconciling the interests of firms with broader societal goals.

Development co-operation provided by DAC member countries in this field includes technical assistance, for institution and capacity building and the development of appropriate regulatory frameworks, as well as financial assistance.

As an example, the United Kingdom's Department for International Development (DFID) is providing co-funding for the development and introduction of a regional competition policy and law covering the 20 member states of the Common Market for Eastern and Southern Africa (COMESA). By removing barriers to trade between member states, the development of a regional law to counter anti-competitive business practices is expected to foster trade and boost growth.

Japan has dispatched experts on a long-term basis to Indonesia with the aim of assisting with deregulation and competition policy. As competition policy is a new undertaking for Indonesia, Japan's assistance aims to raise awareness in government of the significance of business competition law in the context of economic reconstruction. Advice has also been given on institutional development in order to strengthen the government's capacity to enforce competition law.

e) Financial markets

Financial markets and systems are important in the growth process due to their role in mobilising and allocating capital. Particular problems faced in developing countries include structural problems (e.g. state intervention and monopolies), institutional shortcomings (e.g. with insolvency, with collateral, title and property rights and dealing with the informal sector and micro loans) and discretionary policies (e.g. directed lending and subsidised credits). As a result, financial sector development, firm-level productivity and economic growth have been held back.

DAC member countries assist developing countries in strengthening local financial markets through grants and technical assistance. Financial sector regulation, supervision and development are major areas where donors provide support. Microcredit is another field where some donors are active.

An example of a multi-donor programme in this area is the Financial Sector Reform and Strengthening (FIRST) Initiative. This USD 53 million programme is co-financed by Canada, the Netherlands, Sweden, Switzerland and the United Kingdom, together with the World Bank and the International Monetary Fund (IMF). FIRST supports capacity building and policy development projects in the financial sectors in developing countries by providing technical assistance grants for short and medium-term projects related to financial sector regulation, supervision and development.

The Financial Deepening Challenge Fund is one of a series of competitive schemes launched by DFID in recent years. It is a cost-sharing mechanism that provides grants of between GBP 50 000 and GBP 1 000 000 to private sector financial institutions that are committed to increasing access to commercially sustainable financial services for the poor and businesses that employ the poor. The Fund was designed to support projects involving the development and piloting of a broad range of financial products and services including credit, savings, insurance, health cover, housing finance, pensions, leasing working capital and remittances. It was also intended to support projects that lead to improvements in the regulatory and supervisory environment for financial services delivery.

Institutional twinning is another approach adopted by donors. For instance, the Bank of Sweden and the Bank of Sri Lanka have established a collaborative arrangement. By exchanging ideas and experience in various areas such as monetary policy, staff knowledge is consolidated and extended at both banks. As part of this programme, staff from each bank corresponds with each other, including through visits and staff exchanges. The project is supported financially by the Swedish International Development Co-operation Agency (Sida) which also acts as a sounding board and catalyst.

Spain has established a fund, managed by the Spanish Agency for International Cooperation (AECI) that supports microcredit institutions, particularly in Latin America. The objective is to provide low-income micro-entrepreneurs with access to market-driven financing and to develop the financial sector. Support comprises both loans to financial institutions to fund microcredit operations as well as technical assistance for institution building. In 2003, lending activities were under way in Colombia, the Dominican Republic, Ecuador and Peru.

II. Governance and anti-corruption

Good governance is an essential pre-requisite for well functioning markets and hence attractive investment conditions and a sustainable allocation of investment capital. The OECD's Public Management Committee has identified the following as the principle elements of good governance[9]:

- *Accountability:* the government is able and willing to show the extent to which its actions and decisions are consistent with clearly defined and agreed-upon objectives.

- *Transparency:* government actions, decisions and decision-making processes are open to an appropriate level of scrutiny by other parts of the government, civil society and, in some instances, outside institutions and governments.

- *Efficiency and effectiveness:* the government strives to produce quality public outputs, including services delivered to citizens, at the best cost, and ensures that outputs meet the original intentions of policymakers.

- *Responsiveness:* the government has the capacity and flexibility to respond rapidly to societal changes, takes into account the expectations of civil society in identifying the general public interest and is willing to critically re-examine the role of government.

- *Forward vision:* the government is able to anticipate future problems and issues based on current data and trends and develop policies that take into account future costs and anticipated changes.

- *Rule of law:* the government enforces equally transparent laws, regulations and codes.

Many DAC members promote better governance in developing countries by actively promoting change processes and political reform. Actions are spread across the main public governance areas and cover all levels of government. Important issues addressed include reform of legal and judicial systems, decentralisation and municipal development and public institution building, as well as increasing transparency and the fight against corruption.

In Indonesia, for instance, a dozen DAC members[10] are supporting the Partnership for Governance Reform programme. The Partnership brings together the Indonesian government, legislature, judiciary,

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9. OECD, Directorate for Public Governance and Territorial Development, Public Management Committee: Principle Elements of Good Governance.

10 . Australia, Canada, the European Commission, Finland, France, New Zealand, the Netherlands, Norway, Spain, Sweden and the United Kingdom, along with Korea, the Asian Development Bank and the World Bank.

civil society, the corporate sector and the international community and fosters policy dialogue and analysis on governance issues. The key areas of this initiative include anti-corruption, decentralisation, legal and judicial reform, dispute settlement, police reform and civil service reform.

In Kenya, Germany is promoting good governance through the Open Fund for Good Governance managed by the German Agency for Technical Co-operation (GTZ). The fund supports endeavours by stakeholders in government, civil society and the corporate sector to strengthen good governance. The fund provides technical and financial support to individual initiatives mainly in three areas: preventing and combating corruption, constitutional reform and co-operation between the state and civil society. A high-level steering committee, comprising eminent persons from government, civil society and the private business sector, guides the activities of the fund.

a) Institution building

The importance of well functioning public institutions for economic development is widely recognised. Many DAC member countries have established partnerships between their own national utilities and regulatory agencies and counterparts in developing countries to support public institution building.

For example, USAID provides support to the United States Energy Association for the development of utility and regulatory partnerships between practitioners in the United States and developing country agencies in this field. Countries receiving assistance include Brazil, India, Indonesia, the Philippines and Senegal. In Brazil, USAID instituted a regulatory partnership between the Brazilian National Agency for Electric Power and three American state-level public utility commissions. The aim is to exchange experiences in the areas of energy production, planning and market regulation.

Under the Philippines-Australia Governance Facility, an AUD 25 million project launched by AusAID, support is being provided for governance initiatives at national, regional and local levels. Assistance is often provided in the form of short-term advisors, training, study tours and attachments with relevant Australian public or private organisations for a broad range of governance activities. Following a recent redesign of the project, the Facility is expected to put greater emphasis on public sector financial management.

b) Decentralisation

The development of democratic local governance and the corresponding decentralisation of authority from national to local levels are a means of making governing institutions more responsive and more effective. Facilitating and supporting moves in developing countries towards greater decentralisation is consequently a goal pursued by many DAC member countries. Activities include creating a favourable environment for decentralisation, primarily through support for related legal reforms, promoting democratic local governance and strengthening capacity in local governments.

Spain's approach in this field focuses on institutional strengthening of municipalities and local governments. Municipalities are seen as the proper and autonomous form of government and the most democratic and representative entities for managing community interests and aspirations. The Foundation for Local Development and Municipal and Institutional Reinforcement in Central America and the Caribbean (FUNDEMUCA) serves as an implementing agency for Spain's support and puts institutional capacity building at the centre of its projects, initiatives and issues.

Another example of activities in this area is the Netherlands' LOGIC programme. Its overall goal is to contribute to poverty reduction by stimulating social and economic development at the local level. Specific objectives are strengthening municipal management and governance practices through strengthening administrative and political capacity, strengthening capacity for planning and implementation of services, contributing to more adequate participation of stakeholders in local government operations and increasing the dissemination of expertise and experience between municipalities in participating countries, in other developing countries and in the Netherlands. The programme provides opportunities for municipal administrators and civil servants to share experiences, work together, train each other and apply their knowledge in practical situations. Partner countries include Ghana, Tanzania, Uganda and Zimbabwe.

c) Transparency and anti-corruption

Increasing transparency has a central place among the factors influencing the enabling environment for private sector activity but it is also a domain where government policies and actions can have a substantial impact. Transparency should be promoted both with regards to the actions taken by authorities as well as the broader business community.

Promoting greater transparency is at the core of many DAC members countries' efforts to improve public governance. Donors have been active in capacity building of offices of the Auditor General by providing training and expertise and promoting the exchange of experience. Increasing awareness of the importance of transparency and pointing out strategies to promote it are other avenues pursued.

Increasing transparency is also one means of tackling corruption. Corruption can manifest itself in a variety of ways, such as bribery, extortion, fraud, trafficking and embezzlement, but also nepotism and cronyism. Even the most straightforward acts of corruption need not always involve money. Other gifts or advantages, such as membership of an exclusive club, are used as "sweeteners" to clinch deals. Understanding the multifaceted dimension of corruption is essential in order to identify workable ways of coping with it.

Efforts to stamp out corruption figure prominently in many donors' development co-operation programmes. It may be pursued as a cross-cutting issue or pursued in its own right, through support for anti-corruption bodies or by supporting advocacy work by non-governmental organisations (NGOs). More than a dozen DAC member countries provide funding to Transparency International, a prominent international advocacy group in the area.

In Zambia, donor activity to fight corruption takes place under a joint Memorandum of Understanding signed by the Zambian government with Denmark, Ireland, the Netherlands, Norway, Sweden and the United Kingdom. An Anti-Corruption Fund has been established that channels assistance to a Task Force on Corruption, amongst others. This task force is chaired by the Director of Public Prosecutions and consists of staff from the Drug Enforcement Commission, the Zambian Police, the Anti-Corruption Commission and the Office of the President. The task force's main aim is finding and retrieving illegally gotten funds and assets.

At the cross-country level the Extractive Industries Transparency Initiative (EITI) seeks to increase transparency in the reporting of revenues derived from mineral resource extraction. Launched by the United Kingdom in 2002, the initiative involves businesses, governments, international agencies and NGOs. The initiative is based on the conviction that revenues from oil, gas and mining companies should be an important engine for economic growth and social development in developing and transition countries but the lack of accountability and transparency in these revenues can exacerbate poor governance and lead to corruption, conflict and poverty.

d) Corporate governance and corporate responsibility

The system by which business corporations are directed and controlled has a direct impact on market confidence as well as on company performance. Therefore, good corporate governance plays a crucial role for companies seeking access to capital as well as for countries that aim to encourage private sector investment. *Corporate governance* involves the formal rights and responsibilities of a company's management, its board, shareholders and various stakeholders. *Corporate responsibility*, on the other hand, refers to a debate on the relationship between business and society with the aim of minimising negative impacts while enhancing the positive contribution of business to such societal goals as sustainable development and poverty reduction. The focus is often on voluntary efforts by businesses.

DAC member countries have underscored the importance of sound management practices in the private sector for a country's development. For instance, USAID and DFID support partnerships between investors and local communities in Indonesia, where both agencies formed a partnership with BP in the Tangguh LNG project, a high-tech gas facility, in order to involve local communities and allocate effectively the wealth generated. Donors also support corporate governance reform in Indonesia through the Partnership for Governance Reform programme mentioned previously. This work has included conducting Research for a Corporate Governance Perception Index.

The importance of corporate responsibility in promoting development is its role in acting as a precondition for investment in developing countries, its contribution to overcoming market inefficiencies and gaps in governance and its ability to provide a means for public and private sectors to co-operate in order to address social challenges. Several DAC member countries have been bringing together governments, the private sector and civil society groups in order to increase awareness of and promote dialogue about corporate responsibility.

As an example, CIDA has been co-operating with the Association of Latin American State-Owned Companies (Arpel) in order to foster the capacity of its members to develop and implement environmental protection practices and to promote a standardised approach to environmental management. The Netherlands has also launched an initiative in Angola on fiscal transparency, corporate responsibility and corruption related to diamonds and oil. An objective is to place controls on diamonds from conflict areas, including a requirement for transparency in definitions of corporate accountability.

III. Infrastructure

The availability of relevant infrastructure has a major impact on the enabling environment for private sector activities. For most firms, power, water supplies and telecommunications are vital while transport infrastructure allows companies to move beyond local markets to buy from and sell to other countries in the region or throughout the world. At the same time, incentives for providers of infrastructure to invest in developing countries are affected by the enabling environment. Activities that promote infrastructure investments can consequently have a potentially large impact if they help create a virtuous circle of improvements in the enabling environment which leads to new infrastructure investments that in turn improve the enabling environment and encourage further investment.

Although public financing will remain important for new infrastructure investments in developing countries, the scope for private participation remains substantial. During the 1990s, some 22% of financing was private. Public-private partnerships that generate adequate cash flows for investors continue to flourish in sectors such as telecommunications, ports, airports, freight railways and natural gas pipelines where user fees are imposed on large wholesale customers rather than retail customers. However, in such sectors as roads and water supply and sanitation, the public sector is likely to remain dominant.

A significant share of DAC member countries' bilateral ODA finances activities related to infrastructure. In 2002, the share was nearly 13%.[11] Specific priority areas vary across DAC members - while some focus on transportation, others channel aid to water or energy. Information and communications technology (ICT) is receiving greater attention from several donors as well. Some ODA for infrastructure activities is provided as grants but ODA loans[12] are also often extended in this sector. In addition, many DAC members have set up funds to provide risk capital for the implementation of infrastructure and other projects and have mechanisms for providing insurance to mitigate certain political and other non-commercial risks (this is discussed further in Chapter 3).

The Public-Private Infrastructure Advisory Facility (PPIAF) is an example of a multi-donor technical assistance facility aimed at helping developing countries improve the quality of their infrastructure. PPIAF assistance can facilitate private involvement in the financing, ownership, operation, rehabilitation, maintenance or management of infrastructure services, with eligible projects including roads, ports, airports, railways, electricity, telecommunications, solid waste, water and sewerage and gas transmission and distribution. PPIAF pursues its mission through two main mechanisms: i) channelling technical assistance on strategies and measures to tap the full potential of private involvement in infrastructure; and ii) identifying, disseminating and promoting best practices on matters related to private involvement in infrastructure in developing countries. At the end of March 2004, the PPIAF portfolio covered 310 activities in more than 80 countries for a total value of USD 70 million. PPIAF was developed by Japan and the United Kingdom working closely with the World Bank.

a) Transportation

An example of donor support for transportation is provided in Ghana, where transportation is one of five priority sectors for Denmark's development programme. By supporting Ghana's National Road Sector Development Programme, Denmark aims to revitalise the economy and reduce poverty by lowering transport costs and improving rural development. To date, some 28 km of the trunk road between Accra and neighbouring Côte d'Ivoire have been renovated and over 1 000 km of secondary roads have been built or renovated.

Japan is an active donor in the transportation sector. In Viet Nam, for instance, it has financed several projects to improve Highway No. 5, a trunk road connecting Hanoi and the gateway port city of Haiphong. Japan's assistance has included the construction of a four-lane road, the construction of new road bridges and engineering works. Moreover, Haiphong Port was rehabilitated in order to expand its capacity.

b) Water supply and sanitation

Water and sanitation is an important area of intervention of several DAC member countries, including the French Development Agency (AFD). An example of French assistance in this field is a programme to supply drinking water in Mali via support for activities to improve distribution networks in Senegal, help to expand treatment plants in Niger and reforms to water infrastructure maintenance practices in Burkina Faso.

Belgium is also active in Senegal, supporting a EUR 15 million project to rehabilitate and reinforce the water facilities in the peanut basin of Senegal. The undertaking is designed in accordance with a

11. Source: OECD. Includes ODA commitments in the following sectors: water and sanitation, transport and storage, communications and energy. For comparison, DAC member countries spent nearly 9% of their bilateral ODA in the education sector and almost 5% in the health sector.

12. To qualify for recording as ODA, a loan must have a grant element of at least 25%, calculated against a fixed 10% discount rate.

previous pilot project that developed a water strategy in rural areas of the regions of Fatick and Kaokack. Belgium also assists Benin in the implementation of new water supply network in the departments of Atacora and Donga and has signed agreements with Ecuador, for the provision of drinking water in Sierra Norte, and with Laos, to support the formulation of a national policy on water supply and sanitation.

c) Energy generation and supply

Sweden provides an example of donor support in the energy sector. In Uganda, where very few households outside of towns have electricity, Sida is supporting expansion of the electricity network in the Kabale District and preparing to expand into five other districts. The target groups for these projects are households, businesses and institutions. In addition, Sweden has stationed an advisor at the Ministry of Energy, extended an ODA loan for the expansion of the Owen Falls hydroelectric power station and supported a regional programme for trading energy between Nilotic countries.

In Latin America, Spain has provided ODA loans to Bolivia, to extend the electrification system in Cobija-Porvenir, and to Honduras after Hurricane Mitch, for the reconstruction of the hydroelectric power station in Nacaome. The electricity sector is also a priority area for Spain's development co-operation programme in the Dominican Republic.

d) Telecommunications

Promoting telecommunications is a long-standing objective of some DAC member countries including Germany's Bank for Reconstruction (KfW) which now focuses on the provision of related infrastructure and the use of modern ICT systems and applications. So far, KfW has funded more than 150 projects in telecommunication and radio communication including projects in public broadcasting (in Burkina Faso, Indonesia, Mali, Niger and Rwanda), the provision of public switching and transmission network as basic ICT infrastructure (in Afghanistan, Cambodia, China, Egypt, El Salvador, Lesotho and Nicaragua) and rural telephony (in Laos, Mongolia, Namibia and Zimbabwe). The usage and promotion of ICTs to promote private business has received increased attention recently, with projects funded including information systems for the management of patents in China and payment transaction systems in Uganda.

As part of its comprehensive co-operation package for bridging the digital divide, Japan provides grants and ODA loans for ICT projects. In its ODA loan operations, a strong emphasis is put on the telecommunications sector in support of building infrastructure for the more prevalent use of ICT. In Afghanistan, for example, the Japan International Co-operation Agency (JICA) is working on rebuilding Kabul's telecommunications system in collaboration with the Japan Broadcasting Corporation (NHK). Other examples of Japanese assistance include the North-South Submarine Fibre Optic Cable Link Project in Vietnam and the New Delhi Mass Rapid Transport System Project, which includes ICT components such as communication and traffic systems. Japan also provided grants for a pilot study on the formulation of an ICT master plan in El Salvador.

Similarly, through its Private Sector Development Programme, Denmark has supported the establishment of a partnership between the Danish ICT business Metrocomia and the Ugandan company Mail-Net Communication. This joint venture serves both as a supplier of ICT solutions to the Ugandan market as well as a sub-supplier for the Danish company.

CHAPTER 3

DEVELOPING SUPPLY-SIDE RESPONSES - ACTIVITIES AT THE MICRO LEVEL

As well as making the enabling environment in developing countries more supportive of efforts by the private sector to conduct economic activities, DAC member countries promote investment more directly through a range of activities focussed on investment promotion or private sector development. Such activities range from strengthening national investment promotion strategies to supporting the development of local businesses.

I. Investment promotion and facilitation

In the area of investment promotion and facilitation, DAC member countries' involvement includes providing assistance to investment promotion agencies, supporting the formulation of investment promotion strategies and supplying risk capital and investment guarantees.

a) Developing investment promotion strategies and agencies

An important component of any country's efforts to promote and facilitate investment is a comprehensive investment promotion policy which is consistent with domestic industrial policies and export promotion policies. In developing countries, strengthening relevant institutions may be equally important and it may be necessary to reform any policies or institutions that tend to restrict competition or investment.

Support by DAC member countries in this area includes technical assistance to transfer knowledge, training programmes, institution twinning and assistance with the formulation of master plans and feasibility studies relating to the establishment of export processing zones. On occasions, projects related to standards and conformity assessments have been implemented.

As an example, the Germany Investment and Development Corporation (DEG) has been directly involved in setting up and providing effective management for investment promotion in Lesotho since 1985 through its 10% ownership of the Lesotho National Development Corporation. This Corporation's mandate is to initiate, promote and facilitate the development of manufacturing and processing industries, mining and commerce in a manner calculated to raise the level of income and employment in Lesotho. Promoting Lesotho as an attractive investment location for both foreign and domestic investors is the central goal of the Corporation. Lesotho has been notably successful in attracting foreign direct investment, which amounted to more than 15% of its gross domestic product during the period 1992-2001.[13]

Japan's involvement in this area includes organising a Trade and Investment Promotion Seminar for Latin American, Asian, African and Middle Eastern countries. The seminar was primarily targeted at middle managers in charge of investment promotion in government and para-statal organisation. Its aim was to contribute to economic development and industrial promotion in the participating countries through

13. OECD (2004), "Trends and recent development in foreign direct investment", OECD, Paris.

investment flows and export promotion. Japanese assistance has also been fundamental in the creation of export processing zones on Thailand's western seaboard.

b) Risk capital and risk mitigation

Many DAC member countries have set up mechanisms to provide risk capital for private investment in developing and transition countries through some form of development finance institution. These schemes are important for financing projects that otherwise may be hampered by perceptions by other investors of excessive risk. Many DAC members can also insure investors for such political risks as losses due to war or civil war, expropriation and nationalisation and inconvertibility of profits and dividends.[14]

The Emerging Africa Infrastructure Fund is an example of a multi-donor initiative to help make long-term debt financing available for private sector infrastructure companies in sub-Saharan Africa. Launched in 2002, its initial financing of USD 305 million was provided by a combination of development agencies/ministries, development finance institutions and private banks, including USD 100 million of committed equity capital underwritten by the four development agencies/ministries in the Private Infrastructure Development Group (PIDG)[15] that also initiated the Fund.[16] This financing structure enables the Fund to reduce lending risks to levels where it can offer competitive loans within a 15 year period. The Fund's first transaction was a USD 30 million term debt facility for MSI Cellular of the Netherlands, to help enable the company to meet its expansion needs in sub-Saharan Africa where it already had operations in 12 countries. PIDG is also exploring the establishment of a Development Guarantee Company (GuarantCo), to provide partial risk guarantees for local currency bonds issued by municipalities and utilities, and has proposed the establishment of a Project Development Company (DevCo), to work with developing country governments and utilities to structure financeable infrastructure opportunities.

The Canada Investment Fund for Africa is another new initiative that provides an example of the contribution of CIDA to stimulating domestic and foreign investment in Africa. The Fund is a joint public-private sector initiative designed to provide risk capital for private investments that generate growth. Its aim is to channel at least CAD 200 million in additional investments in Africa. The Canada Fund for Africa, launched as part of the follow up to the 2002 G8 Summit in Kananaskis, is contributing CAD 100 million and the remainder will be raised from private sector partners. The Fund will operate in a commercially viable manner, demonstrating good corporate responsibility practices in all its operations.

Similarly, the Norwegian Investment Fund for Developing Countries (Norfund) was set up in 1996 to help establish sustainable, viable private ventures in developing countries that perceptions of risk would otherwise prevent from taking place. The Fund's main areas of operation are direct investments, investments in funds, investments in fund management companies and investments in a private Norwegian-based investment company for the energy sector. Norfund appears to be a conducive mechanism to channel development funds to promote private sector development with investments generally being accompanied by know how transfer and adherence to high social and environmental standards. However, like several other development finance institutions, it has had less success in promoting investment in least-developed countries and in sub-Saharan Africa.

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14. In DAC statistics, which record cross-border *flows* for development, the extension of a guarantee cannot be recorded as ODA. However, disbursements that occur when a guarantee is exercised are ODA.

15. PIDG comprises the Dutch Ministry of Foreign Affairs, Sida, the Swiss State Secretariat for Economic Affairs (seco) and DFID.

16. In addition, a tranche of USD 85 million of development finance debt was provided by the Netherlands Development Finance Company (FMO), DEG and the Development Bank of Southern Africa (DBSA), together with USD 120 million of commercial debt from Standard Bank Group and Barclays Bank.

Export Development Canada (EDC) is an example of a DAC member countries investment insurance institution. It is a crown corporation and reports to the Canadian Parliament through the Minister of International Trade. EDC can provide Canadian firms with political risk insurance covering up to 90% of eligible losses incurred in developing and transition countries. Specific risks covered are losses due to transfer and inconvertibility of funds, political violence and expropriation. A variety of investments can be insured - including equity, shareholder loans, assets, service agreements and production sharing contracts - and risks can be insured for up to 15 years. Eligible investments must demonstrate benefits to Canada and the partner country and all projects are reviewed in the light of EDC's *Code of Business Ethics*, which includes a commitment to protecting the environment and prohibits corruption.

II. Developing local businesses

Businesses require a wide range of services to support their operations including accounting, audit, quality assurance, telecommunications, internet, business planning, legal advice, training, production engineering, market research, packaging and design services. The importance of these services for investment derives from the fact that they can increase productivity, improve market access and accelerate enterprise growth.

Several DAC member countries have set up facilities to establish or promote business partnerships between companies in industrialised and developing countries. These may provide information on foreign markets or match firms with related needs or interests. Some DAC member countries have also established agencies to promote imports from developing countries.

a) Business services

Through their ODA programmes, DAC member countries have supported business services with the aim of improving productivity, profitability and firm growth. Business centres providing such services to micro, small and medium-sized enterprises have been established by many donors but concerns about sustainability have led many DAC member countries to move away from direct service delivery in favour of brokering services through local consulting firms and business associations. Such support now covers a wide range of services including marketing, product design, market research, quality assurance, production involvement, Web design, Internet services, business plans, feasibility studies, technology upgrades and management restructuring.

For example, USAID provides business development services with the focus on connecting micro and small enterprises into global, regional and local markets through linkages with larger firms. Access to the business-linkages and business and financial services is understood as a precondition for these enterprises to become competitive domestically as well as globally. Activities undertaken include a Small and Medium Enterprise Exposition which showcases small and medium enterprise products, a microfinance refresher course as well as savings mobilization workshops.

b) Business partnerships

The Italian Institute for Foreign Trade, for instance, provides assistance in establishing partnerships between Italian enterprises and counterparts in developing countries. Support is supplied through a wide network of field offices, which are separate from the local Italian Embassy or the local Italian Development Co-operation Office, and includes information, technical assistance on legal and financial issues and assistance in liaising with the local business community.

A Match-making service is another way business partnerships are promoted. Germany's Advisory Service for Private Business provides such a service for countries in the Southern African Development Community (SADC). The Norwegian Agency for Development Co-operation (NORAD) has a match-making programme for India, Sri Lanka and South Africa that aims to establish sustainable and profitable joint ventures between Norwegian and local companies through the development of business partnerships that foster transfer of technology and the exchange of management and business skills.

Denmark provides an example of how a DAC member country can promote imports from developing countries. The Danish Import Promotion Office for Products from Developing Countries (DIPO) is financed by the Danish development co-operation programme but is integrated into the Danish Chamber of Commerce. DIPO assists exporters from developing countries in their efforts to penetrate the Danish market by mediating contacts with Danish importers and providing information about the Danish market. All services are free of charge.

CHAPTER 4

EMERGING IMPLICATIONS AND LESSONS FOR DONORS

As this review shows, DAC member countries, through a variety of government entities, are supporting a large and diverse set of activities that contribute to stimulating investment in developing countries. It is less clear, however, whether these activities are sufficiently strategic in their overall effect. More co-ordination appears necessary, both within DAC member countries' administrations and among bilateral and multilateral donors, particularly at the field level, behind a clearer strategic objective to help enable more developing countries to achieve the MDGs by increasing the quantity and improving the quality of investment.

As well as situating investment as a vital tool for development, established good practices for the management and implementation of development co-operation programmes could be applied more systematically. As in other areas addressed through development co-operation, tailoring activities to partner countries' needs and ensuring the participation of stakeholders on the basis of ownership by the developing countries themselves are important guiding principles. The emergence of Poverty Reductions Strategy Papers (PRSPs) and similar national development plans facilitates a more co-ordinated and comprehensive approach at the field level and enables donors to bring development co-operation programmes more easily into line with partner countries' development objectives.

More information concerning evaluations of the impact of donors' activities on mobilising investment is needed, to understand better what works, what doesn't work and why. While some individual evaluations have been conducted of DAC member countries' programmes that encourage FDI or support private sector development in developing countries, joint evaluations at a more aggregate level would be especially appropriate as they could gauge how the various and collective actions of donors are impacting on critical factors for more and better investment. A rise in income levels in the partner country or an expansion in employment could be used as indicators of increased investment.

It would also be useful to analyse further whether particular types of intervention are more appropriately carried out by bilateral or multilateral donors. A recent report found that governments of many partner countries are more comfortable working with multilateral donors in the field of the business environment because these agencies are considered to be more neutral.[17]

As the private sector is the primary actor with regards to investment, greater awareness of the potential role that the private sector can play in achieving the MDGs is crucial. Approaching private sector development as a crosscutting issue and integrating a private sector development perspective into country strategies consequently appears desirable. In the past, donors' support for private sector development has exhibited some shortcomings. Interventions have led to market distortions and market deepening slow down, with interventions becoming unsustainable. New approaches have attempted to deal with these

17 . White, S and J. Chacaltana (2002), "Enabling small enterprise development through a better business environment: Donor experiences in supporting reforms in the business environment", Report prepared for the Working Group on Enabling Environment of the Committee of Donor Agencies for Small Enterprise Development, Washington.

deficiencies by emphasising the paramount role of market deepening and internally driven institutional change, with donors playing an enabling role. While many donors pay considerable attention to the significance of high quality institutions and the role of macro factors for private sector development, micro-level interventions have often predominated.

As a recent thematic study commissioned by Sida stresses, a comprehensive approach to supporting private sector development is essential. The private business sector may fail to develop despite massive support because there may be several binding constraints but not all of them are targeted. Consequently, multi-faceted, multi-sectorial approaches are likely to succeed better than single-factor, focussed interventions, particularly if the former are designed with an understanding of the cultural context in mind.[18]

There are a variety of activities that donors can undertake to make markets more competitive. Insights into the most pressing deficiencies can be gained through furthering the systematic analysis of constraints for market development. Examples of scoreboards that assess the investment and business environment include the United Nations Conference on Trade and Development's (UNCTAD's) Investment Compass and Investment Policy Reviews, the World Bank's Doing Business, World Business Environment Survey and Investment Climate Assessments, and the World Economic Forum's Global Competitiveness Report. These tools provide guidance on those areas where actions are most required and where ODA can best be used. However, for some developing countries, useful assessments can currently not be made due to a lack of reliable data. And where reliable data does exist, analyses, such as the Investment Climate Assessments, can be costly and only a limited number can be conducted because the World Bank is unable to find the funds from within its own resources to undertake these studies alone. Bilateral donors can help developing countries to develop their national statistical systems and to fund the preparation of investment scoreboards, but they can also follow through by using the findings from these tools to design appropriate interventions. A recent study of donor practices found that very few donors are currently using the findings of investment scoreboards to design new programs.[19]

This report presents a wide range of activities that contribute to mobilising investment in developing countries and where donors are active. The following paragraphs present some suggestions on how these activities could be developed further, better targeted or brought more squarely into line with an objective of promoting investment. These suggestions are presented as a basis for reflection and discussion. They should not be considered complete and no priorities should be implied.

As part of a comprehensive approach, development co-operation programmes should pay attention to "behind-the-border" issues. Specifically, donors could be more concerned about helping developing countries to strengthen their domestic policies and institutions consistent with international rules, as represented by the various agreements under the WTO, while, at the same time, paying attention to potentially negative repercussions that economic liberalisation might entail for the domestic economy, including appropriate social safety nets. One avenue that donors can pursue is to assist developing countries to put regulations in place that bring their frameworks for public-private partnerships into line with international standards. The "Model Legislative Provisions on Privately Financed Infrastructure Projects", produced by the United Nations Commission on International Trade Law (UNCITRAL), have been designed for this purpose and can be promoted.

18. Danielson, A (2003), "Support for Private Sector Development: Summary and Synthesis of three Sida Evaluations", *Sida Studies in Evaluation 03/05*.

19 . White, S (2004), "Donor approaches to improving the business environment for small enterprises", Report prepared for the Working Group on Enabling Environment of the Committee of Donor Agencies for Small Enterprise Development, Washington.

DAC member countries are increasingly devoting resources to trade-related technical assistance and capacity building, with almost all placing trade in the context of poverty reduction and economic development. There appears to be growing awareness among donors regarding the importance of capacity building that allows developing countries to establish their trade-related policies and institutions and to implement them on their own - as opposed to industrialised countries applying their policies and institutions to developing countries. While Export Processing Zones received high attention in the past, interest appears to have waned in recent years. Evaluations show a need for a longer-term effort with regards to trade-related technical assistance and capacity building, with a necessity for long-term financing and sustainability of the results. Furthermore – as in other areas – strong ownership and co-operation between all parties are indispensable, if assistance is to be successful, and an integrated and comprehensive approach is needed.[20]

The performance of customs administrations has an important impact on trade performance and hence on potential investment. Poor performance and excessive bureaucracy can constitute a considerable burden on firms and foreign investors. This applies not only to firms involved in import and export but also to firms supplying exporters or that depend on imports. In addition, corruption can impose additional costs on firms through delays in processing imports, a problem particularly relevant for importers of perishable goods. Significant benefits should consequently be possible by improving customs administrations. Computerisation can play a major role in speeding up processes and increasing transparency. Contracting out functions to private firms is another option that could produce efficiency gains.

In the area of legal and judicial reform, there is growing recognition among several donors that effective interventions must be sensitive to and take account of differences between donor and partner countries in their ideological, institutional and cultural compositions. Approaches that limit themselves to improving laws, strengthening legal institutions and modernising law schools risk being ineffective in the long run. On the other hand, carefully constructed interventions, that draw on a deep knowledge of local law and social practices, can be effective in guiding responses within predetermined directions but even these comparatively modest results may not become apparent for a decade.[21] From this perspective, the tying of technical assistance to the provision of services by nationals of the donor country becomes problematic if it results in interventions that are insufficiently adapted to conditions in partner countries.

Ineffective or unpredictable dispute settlement mechanisms are frequently cited as an obstacle to increased investment in developing countries. This review has identified little activity by DAC member countries related to improving dispute settlement mechanisms. This area may consequently merit increased attention from donors. Similarly, support towards increasing the private sector's capacity to lobby and participate in policy formulation mechanisms also appears relatively rare.

Creating a favourable environment for domestic savings in developing countries is necessary to help poor people reduce their vulnerability to negative shocks but also for mobilising the capital that can be used for productive domestic investments. Donors' approach to micro finance has shifted in recent years. While in the past the cost of borrowing was subsidised through specialist micro finance organisations which remained apart from the rest of the financial system, there has been a trend towards integrating micro finance into the mainstream financial system, thus triggering systemic change in micro finance institutions which need to adopt commercial principles.

20. OECD and WTO (2003), "Second Joint WTO/OECD Report on Trade-related Technical Assistance and Capacity Building", July 2003, OECD, Paris and WTO, Geneva.

21 . See the discussion of various donors' approaches in AusAID (2000), "Viet Nam. Legal and Judicial Development", Working Paper 3, April 2000.

With regards to anti-corruption, emerging lessons include a necessity to focus on the needs of partner practitioners and a stronger awareness of the area as a development issue. To ensure credibility, donors must tackle supply-side issues. There is a need for synthesising experiences as well as strengthening evaluation by making them more transparent. Moreover, research results could be more targeted and more practitioner friendly. Better co-ordination and collaboration between DAC member countries in the area of anti-corruption – as in other areas – would seems desirable and this is already occurring among Utstein Group members (see box 1).

Box 1. Utstein Group's Action Plan on Anti-Corruption

The Utstein Group partnership - Germany, the Netherlands, Norway and the United Kingdom - committed themselves in 2000 to collaborate with each other and all other relevant parties to combat corruption in development. The action plan drawn up and endorsed by the group has the following four components:

- Strengthen the international anti-corruption framework, principally the OECD Convention to Combat Bribery and the Inter-Governmental Financial Action Task Force.
- Provide co-ordinated support to developing countries committed to fighting corruption.
- Improve capacity in the development assistance administration of the Utstein partners to assist developing country efforts to combat corruption, and to protect development assistance co-operation from corruption.
- Learn from the experience of others and develop resources for anti-corruption activities.

The increased attention that corporate governance has received in industrialised countries in recent years has, so far, not extended to developing countries where a number of specific challenges have been identified by the World Bank and others. These include inadequate protection of minority investors, costly reforms of corporate or securities laws being deemed unjustified, few firms being publicly listed and many lacking liquidity and corporate governance not being seen as applying to non-listed companies. To ensure they are effective, corporate governance standards need to be tailored to the requirements of developing countries. Special attention should be given to ensure that rules are simple and transparent, thus greatly facilitating enforcement. The World Bank assists its client countries in the assessment of their corporate governance institutional frameworks and practices by preparing country corporate governance assessments using the OECD Principles of Corporate Governance as a benchmark. However, many other donors have so far been hesitant to include necessary corporate governance reforms in their development co-operation programmes.

In developing countries, infrastructure development has often been undermined by governments' use of state ownership or regulation to pursue objectives unrelated to efficient service provision. There is a newly emerging understanding that merits encouraging, that the role of governments lies in creating a sound enabling environment for commercial providers of infrastructure facilities. A specific obstacle that businesses encounter when contemplating infrastructure investments in developing countries, notably in the water and sanitation and energy sectors, is insufficient access to investment guarantees, especially for projects that generate cash flows in local currencies. Conducting a comprehensive assessment of businesses' requirements in terms of investment guarantees could be timely to help identify where available coverage is currently inadequate. Areas where there may be a need for additional coverage could include currency risk, regulatory risk and guarantees for sub-sovereign entities.

With regards to risk capital and risk mitigation, an important question to consider concerns difficulties encountered in investing in least-developed countries and sub-Saharan Africa, despite a strong commitment to do so. An evaluation of NORFUND[22] shows that an obligation to invest a certain percentage in these countries needs to be coupled with an adjusted investment strategy and an *ex ante* risk differentiation between least-developed countries and other countries with regards to the willingness to take risks. Similarly, an evaluation of the Danish Industrialization Fund for Developing Countries (IFU)[23] concluded that the fund could direct a larger share of its investments to the poorer countries, and could explore instruments, jointly with other development finance institutions, to improve the investment environment in these countries. A review of the obstacles that development finance institutions encounter when considering investments in least-developed countries and sub-Saharan Africa could reveal systemic issues that constitute major impediments for investors less predisposed to enter these markets. It also appears that stronger links between the activities of development finance institutions and the efforts of development agencies/ministries to create a good business environment could be developed further.

Activities that aim to support local businesses may require some rethinking, in part to take account of greater access to information which has come about through greater access to ICTs. Business services should be viewed as a tool but not as an end in themselves. Donors should abstain from getting directly involved and becoming part of the system, allowing interventions to be driven by market forces in order to ensure sustainability. In the ICT area, donors are currently promoting a plethora of initiatives and pilot projects. There is evidence of projects being unhealthily dependent on donor support (and unlikely to be sustainable), inconsistent conditionality and a lack of the strategic, partner country-owned approach supported collectively by the donors that is increasingly the model adopted in other sectors. A clear lesson is to apply to ICTs some of the lessons of sector-wide approaches and of the harmonisation and alignment agenda.

The nature of efforts to promote linkages between firms in developing and industrialised countries may also need to evolve. As a Danish evaluation points out[24], external barriers in the form of high tariffs and restrictive quotas have decreased considerably and a rapid internationalisation of both exporters in developing countries and importers in industrialised countries has taken place. As a result, it has become increasingly important to focus on upgrading quality, competitiveness and stability in the exporting countries, if capacity for market penetration is the objective. This shift points to a need for a continuous monitoring and redirection of activities directed towards private sector development and a closer affiliation to and integration with other activities designed to promote private sector development.

22. Ministry of Foreign Affairs (2003), "Evaluation of the Norwegian Investment Fund for Developing Countries (NORFUND)", Evaluation Report 1/2003, Oslo.

23. Ministry of Foreign Affairs (2004), "Evaluation: The Industrialization Fund for Developing Countries", No. 2004/1, Copenhagen.

24. Ministry of Foreign Affairs (2000), "Evaluation: Danish Import Promotion Office (DIPO)", No. 2000/1, Copenhagen.

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