

**Contribution to the Australian Aid Effectiveness Review
By the International Finance Corporation, the World Bank Group
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Background

The International Finance Corporation (IFC), the private sector arm of the World Bank Group, appreciates this opportunity to provide comments on the Australian Aid Effectiveness Review. Australia, and AusAID in particular, is a key member of the international donor community, and an important partner for IFC. AusAID and IFC have a long tradition of successful partnership in the East Asia and Pacific region and beyond. IFC is pleased to note that the Australian Government remains committed to helping its partner countries – particularly in the Asia Pacific region, for which it has a special responsibility – achieve the Millennium Development Goals (MDGs), and that Australia’s aid is expected to more than double from current levels to 0.5 per cent of Gross National Income (GNI) by 2015.

Our main recommendations to the review, therefore, will only cover a few areas where we think Australia’s aid program could be fine-tuned for greater impact. These include: (i) giving greater prominence to the role of private sector development as a driver of economic growth and poverty reduction, (ii) enhancing the efficiency and effectiveness of Australia’s aid program through leverage with the private sector, (iii) expanding the coverage of Australia’s aid beyond East Asia and the Pacific while keeping it as an anchor region, (iv) placing increased emphasis on measuring development results, and (iv) strengthening partnerships with multilateral organizations.

1. Driving Growth and Reducing Poverty through Private Sector:

We share AusAID’s view that “sustained economic growth is the most powerful driver of poverty reduction and is critical to achieving development outcomes.” For many donor countries this has traditionally meant a focus on reforming public sector institutions and addressing human development issues. In recent years, however, there has been a greater recognition within the development community of how the private sector can spur growth and reduce poverty. The evidence of recent decades shows the need for both direct and indirect channels to address poverty, and the vital role the private sector has to play, and we are encouraged by Australia’s willingness to move in this direction.

The final report of the 2008 Commission on Growth and Development, chaired by Professor Michael Spence and supported by the Government of Australia, provides the most recent and compelling assessment of the relationship between economic growth and poverty reduction. “Sustained growth enables and is essential for things that people care about: poverty reduction, productive employment, education, health, and the opportunity to be creative. ... Growth is not an end in itself. But it makes it possible to achieve other important objectives of individuals and societies. It can spare people *en masse* from poverty and drudgery. Nothing else ever has. ... Growth is, above all, the surest way to free a society from poverty. ... In the last 30 years absolute poverty has fallen substantially. This is almost entirely due to sustained growth.”¹

¹ The Growth Report: Strategies for Sustained Growth and Inclusive Development, Commission on Growth and Development, World Bank, 2008.

The incomes of poor people can increase in two basic ways – if average incomes rise and the distribution of income stays the same, or if the distribution of income shifts to become more pro-poor. Clearly, the biggest impact is if growth is combined with a shift to a more equal distribution of income. Private sector activities lead poverty reduction, both indirectly by contributing to economic growth, and directly for example through the provision of more affordable or better goods and services, as well as through job creation. In most developing countries, up to 90 per cent of job creation comes from the private sector. However, in the lowest income countries, firms largely remain in the informal sector, with low productivity and limited access to finance, and face critical infrastructure bottlenecks. Increased support to the private sector is key to fulfilling its role as the driver of growth and development.

Where the private sector is encouraged to operate efficiently and grow, economic development takes place. Private companies need more than financial investment to do business. They need a favorable legislative environment to enable entrepreneurship, focused on key sectors of the economy; inclusive financial markets with a robust financial infrastructure to increase access to financial services; a competitive infrastructure, which often is supported by public-private partnership; and advice on environment, social and corporate sustainability. AusAID's PSD activities should target these critical aspects and take gender into account.

Women's economic participation – both as entrepreneurs and as employees – is also increasingly understood as a development priority. In the poorest countries, women are more likely to work in the informal sector, less likely to have land, and are often disadvantaged by prevailing laws and customs. There is a growing body of practical experience in tackling gender issues within approaches to private sector-led development.

Supporting private sector development (PSD) is now an integral component of the aid strategies and activities of a growing number of donor agencies, some of which have designed specific PSD strategies and installed dedicated teams to implement them. In this respect, ***IFC would like to encourage AusAID, to give greater attention to PSD in its aid programs and design a clear strategy for its engagement in PSD.*** As an important player in the development community, Australia could add an increased impetus to this growing focus on tackling poverty through active cooperation with the private sector. The Australian government should also consider engaging more actively with its own private sector and facilitating its active participation in development. This helps to provide a direct link between AusAID's work abroad and Australia's domestic private sector stakeholders.

2. Leveraging the Private Sector for Greater Impact

Making an appreciable difference in the lives of the poor will require enormous resources, and traditional grant aid will fall far short of meeting all the funding needs of the developing world. With liquidity high in many markets, the problem is not with a lack of capital but how to mobilize these abundant private sector funds where they are needed most, in a commercially sustainable way. Donor-funded investments offer donor agencies a means through which they can help finance important projects and programs whose perceived risks make them unattractive for private financing. For example, in responding to the global economic crisis in 2008, several bilateral donors collaborated with IFC to supply liquidity for trade finance using their grant funds as investments through international banks active in emerging markets. Similar approaches are gaining ground with other large global initiatives such as the Climate Investment Funds and the Global Agriculture and Food Security Program. Donor funds are also increasingly used in risk-sharing arrangements that support private investment in innovative

activities that would otherwise not be financed. These donor funds are able to significantly leverage private sector funds, sometimes by as much as a 1:10 ratio. IFC's recently established Asset Management Company (AMC) offers the donor community an additional leverage opportunity. AMC, a wholly-owned subsidiary of IFC, partners with sovereign funds, pension funds and other investors to facilitate an increased flow of capital into emerging markets and to assist them in overcoming initial barriers to entry in some countries. It follows IFC's successful track record of investments in emerging markets and relies on IFC's investment processes and standards.

IFC would, therefore, encourage Australia to look into new ways to leverage its aid resources to mobilize private sector funding for greater impact. Donor funded investments and cooperation with the AMC are options to explore. They provide additional opportunities for Australia to involve its private sector in its international development efforts, thus ensuring greater buy-in of the aid program by these key stakeholders.

Australia's vibrant, experienced and sophisticated private sector can also be leveraged to contribute poverty reduction through an active engagement, with the Base of the Pyramid (BOP). Two thirds of the world's population – about 4 billion people – belong to the Base of the Pyramid. Most are the hardworking poor who look to improve their living standards through informal economic activity, and live in congested urban/peri-urban areas or remote rural villages. They are not only consumers, but also distributors, suppliers and producers of goods and services. Increasingly, local and foreign companies are finding ways to tap into this market through inclusive business models. Inclusive businesses productively integrate those living at the base of the economic pyramid into their value chains, and invest in business models serving the poor as part of their core business while being commercially successful. A growing number of donor countries are actively encouraging their private sectors to engage with the bottom of the pyramid. AusAID's Enterprise Challenge Fund for the Pacific and South East Asia is a welcome step in this direction. ***IFC would like to encourage the AusAID to scale up its engagement with the private sector, both in Australia and in partner countries, and encourage them to develop inclusive models that target the Base of the Pyramid.*** IFC, with a broad, global client base, has considerable experience in this area and could be a useful partner for AusAID.

3. Broadening the Geographical and Sectoral Focus of Australia's Aid Program:

Australia has played an important role as a leading donor in the East Asia and Pacific Region. We are pleased to note that it plans to maintain this leadership role, given Australia's geographical proximity, economic and social links, and most importantly, its rich experience in, and knowledge about, the region. With a growing economy and an expanding aid program, however, Australia now has an opportunity to broaden its support to other parts of the world where poverty is most persistent, while continuing to maintain its traditional focus on East Asia and the Pacific. The challenge, of course, will be to ensure that this expansion into uncharted waters does not compromise the quality and effectiveness of Australia's aid program. This calls for care in selecting the regions and countries that would most benefit from its expanded programs. ***IFC envisions a larger role for Australia in expanding its aid coverage to include its Indian Ocean neighbors of South Asia and Sub-Saharan Africa*** where most of the world's poor are concentrated. The Latin American and Caribbean (LAC) region is another region in which Australia could become more active as a donor. Australia's links with the region through the APEC process and the global role Australia has played in championing the cause of small island states, which share development challenges similar to many Pacific Island states, make the LAC region a natural area of increased attention for Australia.

In extending its reach beyond East Asia and the Pacific, Australia may want to focus its support on the sectors in which it has a comparative advantage so as to ensure maximum impact and avoid duplication with other donors' efforts. *We believe that Australia possesses a comparative advantage in such areas as clean water supply, water efficiency, dry land agriculture, renewable energy, and gender.* Given concerns about global climate change and rising food prices, a more active engagement in these areas, especially in South Asia and Sub-Saharan Africa, would make sense both for the international community and for Australia. Engaging with the private sector can only reinforce Australia's expertise in these areas.

4. Enhancing Results Measurement and Monitoring Framework:

We are encouraged to note that Australia's Office of Development Effectiveness gives the highest priority to evaluating the effectiveness of its aid. AusAID's Annual reports and the Annual Review of Development Effectiveness demonstrate the importance AusAID attaches to measuring development results and establishing a robust monitoring and evaluation system. Impact measurement is challenging, especially when it relates to PSD interventions. However, it is crucial, and a body of literature on measuring results and monitoring impact is evolving within the development community and in academia. IFC has invested heavily in the design and implementation of a results measurement system for our investment and advisory services that is focused on achieving development impact through the private sector. This includes a tracking system for inputs, outputs and outcomes, with standardized indicators that enable comparison and aggregation; it includes an increasing body of experience with impact evaluation; and it now includes testing of forward-looking corporate goals with numerical targets that help inform strategy and operational decision-making. We have collaborated closely with other multilateral development agencies in working towards a common results measurement framework, and IFC's system has repeatedly been assessed to be the most consistent with the Good Practice Standards for Private Sector Evaluation agreed among the Multilateral Development Banks. We would be happy to engage with AusAID to share this practical experience.

IFC recommends that AusAID participate actively in the donor community and learn from other donors and from multilateral institutions in the area of results measurement. A more developed measurement approach would enable AusAID to present concrete results on its portfolio, especially as PSD becomes more fully integrated into its aid program. It would also serve as a useful management tool to help AusAID learn from its portfolio and feed these results into future project design, strategy and operations. The key to an effective results framework is to establish practical methodologies for assessing impacts that are custom-made for AusAID's specific needs and circumstances.

5. Strengthening Partnerships with Multilateral Organizations:

Many donor agencies have found that collaborating with other development partners, most notably multilateral organizations, can help enhance their effectiveness. AusAID is already a major partner for IFC in East Asia and the Pacific with a solid track record of results in joint programs. AusAID has implemented a regular high-level dialogue with the World Bank Group for East Asia and the Pacific, which has been working well. This dialogue has also underpinned discussions between AusAID and IFC on how the two institutions can further enhance their cooperation in the whole of the Asia region and possibly in other regions. A closer partnership can leverage both institutions' respective strengths for even greater development impact. It can also create efficiencies by reducing

transaction costs for the two institutions, as well as for the recipients, by broadening the knowledge base and bringing resources to bear on strategic interventions in a more coherent manner.

IFC would like to encourage Australia to continue to make the best use of the broad coverage and convening power of the multilateral organizations to help implement its aid program and disseminate its knowledge through a meaningful partnership that involves thinking and learning together. If Australia opts to incorporate a stronger PSD approach into its aid policy, IFC would be a natural partner. With its leadership position in the PSD space, and with a broad array of innovative instruments and products available across its investment, advisory, and mobilization services, IFC stands ready to deepen its partnership with Australia, and together make an even stronger impact in creating opportunities where there are needed most around the world.