ODI Submission to the European Commission's Green Paper on

'EU Development Policy in Support of Inclusive and Sustainable Growth'

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There is much to welcome in the EU's Green Paper on EU development policy. The emphasis on the relative importance of growth in promoting development is particularly important. ODI's submission focuses on the growth section of the Green Paper, with contributions from **Dirk Willem te Velde**, the Head of the 'Investment and Growth Programme' together with **Jodie Keane**, Research Officer, **Karen Ellis**, the Head of the 'Private Sector and Markets Programme' and **Claire Melamed**, the Head of the 'Growth and Equity Programme'.

Nevertheless, growth in itself does not drive a new development policy or even a 'modernised' European Consensus on Development. The issues are much wider, touching on all the other topics mentioned in the Green Paper, as well as many others. The Green Paper is ambivalent about whether it is really a paper on growth, or the launch of a wider review. It does not sufficiently address future challenges and global trends, or current policies which have an important impact on development policy. **Simon Maxwell**, ODI's Senior Research Associate and Project Leader of the European Development Cooperation Strengthening Programme (EDCSP) sets out the challenges for the European Commission in designing the EU's development policy as set out in the Green Paper.

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* Disclaimer: The views presented in this paper are those of the authors

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The Green Paper and Development Policy

The Green Paper is billed as a milestone on the way to a rethink of EU development policy, with proposals on 'modernisation' to be made in the second half of 2011. There are other milestones, including the new Green Paper on budget support, and policy papers on finance, climate change and other topics. This is valuable. The European Think-Tanks Group recommended updating the narrative of development policy in their report earlier this year, 'New Challenges, New Beginnings'.

The Green Paper focuses on EU development policy, rather than European Commission policy - in other words, on what the entirety of the 27 Member States should do, rather than what the Commission should do on their behalf. However, the European Commission will be missing an important trick if it does not focus on its own policies and programmes. The DAC multilateral aid report has shown that it is the largest single supplier of ODA in the world, bigger than the World Bank, and almost the whole of the United Nations. If the European Commission wants to maintain that position when the next Financial Perspectives are set, and when the next EDF replenishment is agreed, then it is time to start speaking with the authority it has earned, and focusing on the key issue of comparative advantage of Community action, rather than repeating its need to coordinate the Member States. And it is important not to forget trade, foreign policy and climate, in all of which the European Commission has competence.

The Green Paper includes sections on the MDGs, social inclusiveness, security and even governance. It deals with NGOs, development education, and partnership. It even covers climate change and food security. In that sense, it is comprehensive. The core, however, is found in two sections: first, section 3.1, which deals with inclusive growth; second, section 4.2, which deals with energy and development. These sections contain repeated references to leverage, catalytic impact, risk-sharing with the private sector, investment promotion, new technology and support to innovation. The growth section makes a strong case for growth, emphasising decent work and social protection as the ultimate prize, and targeting investment, credit, regulatory reform and innovation as priorities for intervention. The energy section picks up the same issues, with a special focus on Africa, and a list of issues which includes financing, regulation, technical training and regional integration of energy markets.

Commissioner Andris Piebalgs focused on these issues in his letter to development ministers in June 2010, published on his personal blog. Among other things, he said:

'*I would like to seek your help in refocusing EU development policy on jobs and sustainable growth in the developing world, on leveraging the aid spent, and on increasing the efficiency with which we grant aid*.'

There are two wider issues also to focus on. The first is what the Commissioner might mean by 'refocusing'. The second is what lessons can be learned for European Commission rather than EU comparative advantage.

On the first, it is hard to judge the implications for the European Commission's aid spend, or for wider policy. The latest Annual Report on European Commission external assistance, published in June 2010, shows about 10% of European Commission ODA being used for economic infrastructure and services, including transport, communications and energy – just over €1bn in 2009, compared to nearly €4bn for social infrastructure, including health and education. Does 'refocusing' mean a bigger share? In which case, how big? The Green Paper does not offer options, either for the European Commission itself or for the EU as a whole.

The second issue is European Commission comparative advantage. Historically, the Commission has been seen as having a comparative advantage with respect to infrastructure. The latest Statistics on International Development show DFID bilateral expenditure on transport and energy as being only £172m in 2009/10, from a total bilateral budget of £4bn, i.e. 4%. The case for the European Commission to lead needs to be made, however.

Finally, growth and infrastructure do not in themselves drive a new development policy or a 'modernised' European consensus on development. The issues are much wider – indeed touching on all the other topics mentioned in the Green Paper, as well as many others. But the Green Paper is not a good starting point for that discussion, and is ambivalent about whether it is really a growth paper, or the launch of a wider review. For example, the Green Paper does not say enough about future challenges, or about differentiation among developing countries. It does not provide enough information about how aid is spent. And it certainly does not contain discussion of trade, finance, migration and other policies, which all need to play a part in a modernised EU consensus. The think-tanks began to write that story in their report, and it is one the European Commission should pursue. But it requires a different Green Paper.

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Sustaining and protecting growth in the new context of climate change and emerging powers. What can the EU do?

Economic growth, changes in technology and increases in productivity are crucial for development and hence it is sensible for the EC Green Paper to examine how the EU can best support growth. Growth in poor countries is constantly under threat and needs to adapt to new challenges. Below we focus on some issues where, arguably, the EC has a comparative advantage in responding to such challenges.

Sustaining growth through (regional) aid for trade

An often overlooked threat to developing country growth is whether current high growth rates in low income countries can be sustained. Good quality and appropriate infrastructure has come up as a key bottleneck in growth diagnostic studies. Infrastructure is an area in which the EC has long specialised (even when other donors advocated other sectors). The EC is the world leader in providing aid for trade and it is important that the EC remains active in this field and is pro-active with its grant funds in the new global environment and leverage in EIB lending and other finance for developing country growth. Developing countries desire more support for supply capacity such as infrastructure. Our careful empirical estimations suggest infrastructure aid promotes developing country exports.[1] Aid for trade is often provided in a regional context[2]; and our research suggests that regionalism can be good for development, but especially when it addresses deep integration[3].This means that how Aid for Trade is delivered and corresponds to regional development objectives, is important.

We also underline the need for joint strategies for inclusive growth. It is important there are appropriate state-business relations (SBRs) which in many poor countries are still in their infancy. Effective SBRs are important for promoting growth in Africa[4]. Annex 1 discusses the findings of a collaborative research project on SBRs outlining a ten point conclusion on state-business relations and economic performance.

Protecting growth from slowdowns

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[1] Calı`, M., and te Velde, D. W. (2011 forthcoming) "Does Aid for Trade Really Improve Trade Performance?" *World Development,* doi:10.1016/j.worlddev.2010.09.018, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1430492

[2] For the rationale for regional aid for trade, see http://www.odi.org.uk/iedg/Projects/Aid4trade_files/nab12_regional_aid_for_trade_jan_07%5B1%5D.pdf ,

[3] Meyn and Te Velde (2008), "Literature survey on the state of regional integration in ACP" study for DG DEV, http://ec.europa.eu/development/icenter/repository/Regional-Integration-Report-18-09-2008_en.pdf.
Velde, D.W. te (2008) Regional Integration and Growth, analytical tools http://www.odi.org.uk/resources/download/2498.pdf, WDR 2009 background paper http://siteresources.worldbank.org/INTWDR2009/Resources/4231006-1204741572978/Velde.pdf, forthcoming in journal.

[4] Sen, K. and Velde, D.W. te (2009) "State Business Relations and Economic Growth in Sub-Saharan Africa", *Journal of Development Studies*,

A number of recent global crises have shown that developing countries can be affected dramatically but in a varied way and some can also recover quickly depending on their exposure and resilience[5]. Donor responses to the global financial crisis were fast and at some scale, including by the Euro 500 million by the V-FLEX initiative from the EC. However, this initiative was ad-hoc, and it seems now important to integrate resilience building and shock absorber schemes into one future facility for crisis-resilient growth (a complementary component to development support in the national indicative programmes). The pooling of Member States' resources to reach a certain scale to respond effectively to crises is one of the comparative advantages of the EC.

Climate change, climate finance, energy efficiency and developing country growth

Climate change is one of the biggest threats to long-term growth in poor countries and countries need to support to respond to the threats. In addition, mitigation policies in developed and emerging markets are necessary but these by themselves will also have effects on the economies of poorer countries and hence poor countries need to respond. Normal appropriate economic policies could be supported by additional aid. However, aid which follows climate needs but which is not additional to climate finance will have effects on aid distribution across sectors and countries.[6]

We suggest that the EC needs to be more ambitious in the area of climate finance to protect developing country growth. Europe has traditionally led global considerations on the green economy but this base is increasingly eroded by development elsewhere. A step change is needed, including employing an ambitious climate finance fund which can leverage in climate finance in the same way as e.g. the EU-Africa Infrastructure Fund does for EIB and other lending for cross-border infrastructure in sub-Saharan Africa.

Our work based on firm level surveys in 24 developing countries suggests that greater energy efficiency does not only save energy but also helps poorer countries become more productive.[7] The EC could support developing countries achieve green growth by promoting energy efficiency across sectors. Increasing the energy efficiency of existing production could save carbon and hence attract climate change mitigation finance if the certified emissions reductions are sold to carbon markets such as the Clean Development Mechanism, or the EUs Emissions Trading Scheme. The EC should ensure that the Clean Development Mechanism is kept post-2012 and enhanced so as to incorporate sectoral initiatives that increase energy efficiency, reduce carbon emissions and protects developing country growth.[8]

[5] Te Velde, D.W. et al. (2010), "The global financial crisis and developing countries: Phase 2 synthesis", ODI Working paper 316
[6] J Brown, N Cantore, and D W te Velde (2010), " Climate financing and Development: Friends or foes?", ODI, Jan 2010
[7] Cantore, N. and D.W. te Velde (2009) 'Promoting energy efficiency in developing countries: new evidence based on firm analysis', Paper for the UNIDO Report 2010-11.
[8] Keane and Potts, (2008) Achieving Green Growth in a Carbon Constrained World, ODI Oct 08 http://www.odi.org.uk/resources/download/2449.pdf

Emerging powers, the G20, beyond-aid and developing country growth

The rise of emerging powers offers for the EU and low income countries, but it needs pro-active policies to maximise the opportunities. The EU needs to refrain from protectionist measures which would harm all countries. Poor countries can also benefit from the rise of emerging powers, but need to ensure that they continue to upgrade rather than remain stuck in producing and exporting raw materials.[9] The new G20 (beyond-aid) development agenda might be one way to include emerging markets to benefit developing country growth[10]. Annex 2 includes a 20 point G20–LIC charter for crisis-resilient and transformative growth which the EU can support and help implement. This could provide some inputs into the EC's discussion on policy coherence.

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[9] Te Velde ed. (2010), "The G20 Framework for Strong, Sustainable and Balanced Growth: What Role for Low-Income, Small and Vulnerable Countries?", ODI book, see http://www.odi.org.uk/resources/download/4905.pdf
[10] See article "The G20 and Africa: Unfinished business" in *This is Africa* http://www.thisisafricaonline.com/news/fullstory.php/aid/245/The_G20_and_Africa:_Unfinished_Business.html

The Role of the Private Sector in EU Development Policy

Given that the private sector is the main driver of growth, it is surprising that there is very little discussion of the role played by the private sector in the introduction to the Green Paper, and that there is relatively little focus on how the EU can leverage its own development efforts by promoting private sector development, and engaging more with private sector actors.
The private sector can deliver development gains at a huge scale – far greater than is achievable through aid. There are three broad ways that donors can help to enhance the development contribution made by the private sector:

- Through helping developing country governments to put the right policy and regulatory frameworks in place to create competitive, efficient markets;
- Through promoting private sector development (e.g. through SME financing, market development programmes etc.);
- Through working with business engaged in developing countries to enhance and strengthen their development contribution.

It is clear that, particularly in the aftermath of the financial crisis, the Washington Consensus has been challenged, and there is a new openness to more proactive – yet still market friendly – management of the private sector. Simply cutting red tape is no longer seen as being enough – governments and donors should take more proactive steps to crowd in the private sector and should regulate it appropriately to ensure that economic gains are maximised.

There are a growing number of examples where explicit partnership between government, donors and private sector players can achieve more than any one actor operating on their own. For example, coordinated efforts to tackle barriers to investment, to build infrastructure, and to crowd in private investment through risk sharing, in relation to a particular market or region, can yield far greater gains than any of these interventions in isolation, as is now being demonstrated by some of the 'trade corridor' projects that are now being implemented. There is scope for donors such as the EU to develop and contribute much more to such collaborative initiatives, so as to substantially leverage the funds that are available, and achieve greater impact. These kinds of interventions are also likely to yield more sustainable, long-term impacts, if they contribute to ongoing, commercially viable, private sector activity.

It is recommended that the private sector adopts a much stronger focus on identifying opportunities to work with the private sector in this way. Aid for trade is one case where there is scope to work with the private sector – who are after all, the main players in trading relationships, and thus also have much to gain from removing supply side constraints to trade. The private sector can work with donors to identify the most important barriers to address, and can potentially collaborate in tackling them, e.g. through public-private partnerships to build suitable infrastructure (e.g. a port, better road transportation etc.) or to build capacity (to meet standards and certification requirements for example, or to build skills in the local community, or promote linkages with local input suppliers), or provide trade finance etc.. ODI research shows a number of promising case studies where the private sector has collaborated in Aid for Trade initiatives.

Another area where the private sector must be involved is in promoting low carbon investment and growth. If the right incentive frameworks are put in place to stimulate green investment and innovation by the private sector, then business will do much of the work needed to achieve the transition towards low carbon growth paths for developing countries. There are also potentially significant win-wins for poverty reduction, in terms of access to energy for the poor, as well as the creation of new employment opportunities in 'green growth' sectors. Thus we would recommend that priority is given to developing mechanisms and policies that create incentives for the private sector to undertake low carbon investment in energy generation and agriculture. This includes – though is not limited to - the creation of carbon markets, though public money can speed up this process where carbon markets are slow to develop.

On natural resource management, the private sector is already active in many sectors, and has developed processes and mechanisms to govern access to natural resources itself, or in collaboration with governments. Coordination of such processes through organisations such as the EU could help to promote more of this kind of responsible 'corporate citizenship' and collaboration, to tackle some of the biggest challenges of the current day, including access to energy, land and water.

The paper does highlight several ways through which these kinds of objectives can be achieved, which is welcome. But a much stronger emphasis on finding innovative ways to work with and through the private sector to tackle development issues is needed, and ODI has a growing evidence base which suggests this can yield substantial development dividends.

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Growth, Poverty & Inequality

The focus on inclusive growth is an important one – recognising that growth is important, but that unless the benefits are distributed, it will not by itself reduce poverty. Recent research by ODI reviewing evidence on how growth has been linked to improvements on specific MDGs provides some additional elements to complement the EU's existing approach:

1. Growth and MDG 1 – inequality is the missing link
   Economic growth does tend to raise incomes overall, but the impact of growth on poverty varies enormously from one country to another, depending on the structure of growth and on government policies. The impact of growth on poverty is mediated through inequality – it depends on both the initial rate of inequality in a country and the extent to which growth itself, leads to increases or decreases in inequality. The initial inequalities that determine who benefits from growth are not just about income. Indigenous people comprise one-third of the nearly one billion extremely poor rural people worldwide. Poverty among scheduled castes in India, including those once known as 'untouchables', is much higher than among the rest of the population. Increasing the opportunities for poor people to benefit from growth is not just a matter of, for example, increasing employment or access to credit at the aggregate level, but also of specific policies to overcome centuries of multiple and complex social, economic and political inequality. Policies to redress these multiple inequalities are an important part of increasing the poverty reducing impact of growth, and of forestalling widening inequalities that are putting poverty reduction further and further out of reach for some groups.

   Overcoming inequality to strengthen the link between growth and poverty is largely a matter for national governments. But donors can help by:

   - Improving growth diagnostic tools to incorporate a stronger focus on inequality.
   - Encouraging and piloting innovative approaches to improve understanding of how to incorporate the most excluded into growth processes
   - Include an equity component in assessment of any new funding proposals – for example, to ensure that new transport infrastructure development will improve market access for the poorest.
   - Including an explicit objective of increasing employment opportunities for the poorest as a criterion in awarding any contracts for infrastructure or other major projects.

2. Growth and MDGs 2-7
   Our review found little evidence of any systematic correlation between growth and achievement of MDGs 2-7. This shows the extreme variability in governments' commitment to redistributing the proceeds of growth in form of social spending which

improves health and education outcomes for the poorest. In some cases, donors can make this situation worse through restrictive conditions – for example, recent research on the impact of the IMF's health spending found that tough conditions imposed on government spending actually meant that health spending grew more slowly if a country got support from the IMF for its health sector than if it didn't. Our review also found evidence that charges for services can significantly reduce uptake.

Again, choices about how to raise and spend public money are largely a matter for national governments. However, donors can improve the situation by:

- Ensuring that the conditions under which they provide aid do not create negative outcomes.
- Supporting civil society groups who are monitoring government budgets and provision of services
- Ensuring that equitable provision is a criterion in awarding contracts for service provision.

More information is available in ODI's Briefing Paper No.60, *Economic Growth and the MDGs*, June 2010

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Annex 1: A ten point conclusion on state-business relations and economic performance - based on Te Velde (ed), (2010), *State-business relations, industrial policy and economic growth. Theory, practice and policy implications,* ODI and IPPG book.

1. Institutions matter. Economic growth depends directly on economic fundamentals such as skills and capital formation as well as the efficiency through which factors of production is put together, but the nature of SBRs is a crucial factor behind efficient skills development, capital formation and ultimately higher productivity and incomes.

2. Agencies and their interactions matter. The role of agencies and their effective interactions constitute a useful complement to the price mechanism in allocating resources and promoting efficient wealth creation. Effective SBRs can address market and coordination failures and government failures through cooperation, and can reduce policy uncertainty. When the state and business interact effectively, they can promote more efficient allocation of scarce resources, conduct a more appropriate industrial policy, remove the biggest obstacles to growth and create wealth more efficiently.

3. SBRs are not always directly observable, yet there are ways to measure the key factors behind effective SBRs through the organisation of the business and government actors, the fora that bring the two sides together and the presence of competition principles ensuring absence of collusive behaviour.

4. There is considerable debate about the precise pathways and effects of SBRs, whether current SBRs are actually conducive to or hamper economic performance, and about how the nature of state-business relations conditions the conduct of more active policies encouraging economic growth.

5. Selective industrial policies may work even in countries with limited government effectiveness. The risk of failure is high, however, especially when strategic decisions are taken without sufficient involvement of the business community (and hence SBRs).

6. Establishing successful SBRs requires an appropriate policy framework which allows the state to support industrial development and technological upgrading but also minimises opportunities for rent seeking, which is more likely when it is consistent with a country's comparative advantage.

7. Formalised state-business relations can promote economic performance, e.g. through improved allocative efficiency of government spending and better growth and industrial policies (e.g. Mauritius). Yet, state business relationships need to be disciplined by a set of competition principles, or risk becoming collusive rather than collaborative. Not all formal SBRs work well (e.g. South Africa), and informal SBRs can play a key role (e.g. Egypt).

8. Examples show that harmful collusive relationship can be turned into a more collaborative relationship (India), e.g. when leaders and elites can work to form positive growth or developmental coalitions.

9. Policy conclusions involve building capacity to conduct meaningful SBRs, ensuring buy-in from all actors to the effective functioning of SBRs, and putting the spotlight on informal SBRs where they are not functioning well. Informal SBRs could promote growth, but a setting must be created that avoids corruption and maximises inclusiveness through an organised private sector, strong monitoring agencies and free media.

10. Further research could a) build an enhanced theoretical underpinning of effective state-business relations by modelling the economic behaviour of key actors engaged in SBRs; b) create a world-wide index of effective state-business relations; and c) build up a set of empirical studies on successful economic functions of SBRs

Annex 2: A G20–LIC charter for crisis-resilient and transformative growth, based on Te Velde ed. (2010), "The G20 Framework for Strong, Sustainable and Balanced Growth: What Role for Low-Income, Small and Vulnerable Countries?", ODI book, see http://www.odi.org.uk/resources/download/4905.pdf

A G20–LIC 20-point charter for crisis-resilient and transformative growth

- **The G20 to recommit to the framework of strong, sustainable and balanced growth and follow core policies in order to achieve this, including:**
    - Deficit countries to increase savings (US);
    - Europe to consolidate its budgets and engage in structural reforms to boost growth;
    - Emerging economies to revalue the exchange rate (e.g. China);
    - Emerging economies to boost domestic demand by raising social safety nets ensuring that households save less; and
    - Germany and Japan to provide greater incentives for their companies to invest.

- **LICs to provide plans, and benchmark their efforts, to promote transformative growth by:**
    - Building productive capacities and fostering productivity change;
    - Promoting economic diversification and competitiveness;
    - Promoting private sector development;
    - Providing energy and power infrastructure, and responding to the challenges of development in a carbon-constrained world;
    - Investing in good quality and appropriate human capital to improve labour productivity;
    - Ensuring and improving technological capacity to adopt new and implement old technologies;
    - Streamlining governance and bureaucracy.

- **The G20 to consider the effects of its core economic policies on LICs and, where appropriate, make its policies more developmentally friendly in areas such as:**
    - Exiting fiscal and monetary stimuli in a developmentally friendly way;
    - Appropriate financial regulation taking into account the capital needs of poor countries; and
    - Rebalancing the global economy, using reserves for global growth and promoting flexible exchange rates.

- **The G20 to consider the policy coherence and effects of their external policies on growth in LICs in areas such as:**
    - Aid to address global challenges and transformative growth (AfT, e.g. supporting technical change and infrastructure, or filling the skills capabilities gap);
    - Provision of global financial liquidity, stimulating financial inclusion and investing international reserves for global growth;
    - Providing incentives for outward FDI to LDCs and support for SEZs drawing on local capabilities;
    - Promoting open trading rules; and
    - Removal of fossil fuel subsidies.