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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT

European Community Co-operation with Third Countries: The Commission's approach to future support for the development of the Business sector

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European Community Co-operation with Third Countries[1]: The Commission's approach to future support for the development of the Business sector[2]

I. The importance of the Business Sector

The important contribution that the business sector and in particular the private sector can make to aid development and help fight poverty, over and above public action, is now widely understood and appreciated. The objective evidence supporting this statement is now abundant. Indeed the main bilateral and multilateral donors, including the United Nations (and its specialised development agencies) and the Bretton-Woods Financial Institutions, as well as the OECD -Development Assistance Committee and NGOs are all now agreed on the importance of business and private sector support. This wide consensus reflects the perception that economic growth creates the resources to combat poverty and that business development and a dynamic private sector are essential for economic growth providing , as they do, the main source of employment in developing countries, particularly when the informal sector is included.

The importance of supporting private sector and, more widely, business sector development is borne out in the guidance issued by the international development institutions, for example, in the DAC orientations for *Development cooperation in support of Private Sector development* (1995) and in the World Bank Report entitled *Supporting Private Sector Development* (1998) and *Africa can compete - A framework for support for Private Sector Development in sub-Saharan Africa* (August 1998), together with other policy documents prepared by the Regional Development Banks , the IFC ,the Multilateral Guarantee arm of the World Bank (MIGA), and the European Investment Bank. Indeed the central role of the private sector is now reflected in the policy objectives of most if not all developing and transition economies as well as in those of the main bilateral donors and multilateral financial institutions.

The central role of the private sector in terms of growth, employment and trade integration was also duly stressed in the conclusions and recommendations of the UN Conferences on Development Finance (Monterrey, March 2002) and on Sustainable Development (Johannesburg, September 2002). The Community is committed to supporting and implementing the main recommendations of these UN Conferences to which it made an active contribution.

Also the recently launched NEPAD (New Economic Programme for African Development) focuses on domestic and international resource mobilisation to support private sector development as a way to reinvigorating the ailing economy of the African continent. In addition to these international commitments, it is important to take account of the Doha

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1 "Third countries" here include the developing countries, the countries in transition and/ or reconstruction, the so-called "emerging economies" and Mexico as OECD countries. The term does not include the candidate countries for accession to the EU.

2 In this paper the term Business sector covers private sector enterprises of whatever size and those public sector enterprises operating under market conditions.

Development Agenda, adopted at the WTO Ministerial Conference in November 2001, which stresses the importance for developing Countries to mainstream trade into their national development policies.

This Communication builds on the above consensus and understanding, and aims to simplify, rationalise and harmonise Community support for business and private sector development in partner countries, and provides a comprehensive set of new proposals to be implemented by the Community at three different levels: the macro-economic , sectoral and enterprise levels.

II. Community experience gained

To encourage the development of the business sector the Community already has in place a wide variety of instruments, each with its own raison d'etre, procedures and legal basis. These instruments are often tailored to meet the specific requirements of the partner countries within the framework of the Community's various cooperation agreements. Moreover, a number of large regional programmes have either a private sector focus or contain private sector- related activities.

In particular in the Mediterranean region Community support has taken the form of traditional project financing, sectoral support to national industrial modernization programmes, support to privatisation and support to the reform of national fiscal and financial systems. Technical assistance, including trade and investment promotion activities, has also been made available in order to strengthen institutional and legal environments, administrative efficiency, good governance and financial transparency and help the creation of integrated Business Centres and local organisations of Entrepreneurs. Support for the private sector has often been undertaken in close co-operation with the European Investment Bank (EIB).

In Asia and Latin America the Community manages the ALA -INVEST instrument through which support is provided to Small and Medium sized Enterprises (SMEs) in the form of Technical Assistance and trade /investment promotion and partnership programmes.

In the Balkans the new CARDS Regulation, approved in the year 2000, provides a new medium term programming framework (2000-2006) for the promotion of Stabilisation and Association Agreements and support for efficient market economies, based upon private sector development and trade integration at both the international and regional levels. The TACIS Regulation has the same medium term objectives for the Newly Independent States (NIS).

In the ACP countries the PRO -INVEST Facility mainly focuses on capacity building and the development of small businesses in the framework of poverty alleviation strategies.

Nonetheless , following a number of evaluations made in the past, some co-operation instruments in the field of private sector development have been discontinued (for instance ECIP, MED -INVEST, EBAS etc). At the same time, new instruments have been created managed mainly by the EIB (the FEMIP Facility for the third partner countries in the MED region and the Cotonou Investment Facility for the group of the ACP countries).

III. The purpose of this Communication

The importance now attached to business and private sector development is clearly set out in a number of documents which the Commission and the Council have adopted in recent years. Thus, in 1998 a Communication was adopted on Private Sector Development in ACP countries; in 1999 the Council adopted a Resolution on Community Strategy for Development of the private sector in Developing Countries and in 2000 the importance of private sector development was stressed in the Communication on Community development policy and the subsequent Joint Declaration of the Council and the Commission. As regards employment, the Commission adopted a Communication in 2001 on *Promoting core labour standards and improving social governance in the context of globalisation* along with a further Communication in 2002 on Corporate Social Responsibility. Moreover, following the Commission's Communication on Trade and Development of September 2002, the Community is committed to expanding market access for Least Developed Countries, to enhancing Trade- Related Technical Assistance (TRTA) and to facilitating North-South and South-South trade.[3]

However, administration of the existing instruments for supporting business sector development requires substantial resources and ensuring their coherence with other instruments and actions is often a heavy task. There is a need to re-assess the role and the "modus operandi" of the Community in providing official (i.e. grant-based) support to the private sector which in many third partner countries is still very weak, and to simplify, rationalise and harmonise the available instruments, in close co-operation with other bilateral and multilateral donors.

Moreover, evaluations of Community policies, programmes and instruments carried out over recent years have pointed to the need for the Commission to focus its energies and resources on what it does best, i.e., the preparation of strategies and programmes, together with strategic evaluation, and ensuring overall policy coherence and donors co-ordination. With the change of focus, policy implementation and direct financing are then better done through a set of well reputed financial intermediaries whilst the Commission continues to maintain general regulation, supervision and control.

With this in mind, the main policy documents cited above highlight the need for a single coherent framework together with harmonised support for the business sector in all third countries allowing the necessary flexibility and adaptability to different regions and programmes.

Against this background, the purpose of this Communication is to set down proposals for the reorganisation and restructuring of the Community's support for the development of the business sector in third countries.

The proposals are based on five considerations:

(1) The importance of the business sector for development.

(2) The experience the Commission has gained in the management of a range of instruments designed to support business and in particular private sector development.

(3) The benefits gained from action at a Community level

(4) The need, given the reform of the Community’s external assistance programmes, to harmonise instruments and procedures so as to improve efficiency and delivery.

[3] COM (1998) 667; Council Resolution of 21.05.1999; COM (2000) 212, COM (2000) 416, COM (2002) 347 and COM (2002) 513.

(5) A clear understanding of what the Commission does best and what is best left for others to do.

The proposed simplification, rationalisation and harmonisation of the management of these instruments, leading to the improved coherence of the Community's external action, will boost the effectiveness and efficiency of the Community's assistance programmes. This will be especially important in those middle-income developing or transition countries where prospects for a dynamic growth of local entrepreneurship are promising, and where European SMEs can develop their business or trade through forms of partnership (Joint Ventures), twinning , technology transfers or technical assistance. This is the important value added that further Community action can now bring.

IV. P*roposed Approach to Supporting Business Sector Development*

Drawing the appropriate lessons from past experience in supporting business sector development in third countries, the Commission has now identified five areas of intervention or instruments on which it will base business sector support:

1. Overall policy dialogue and support, in particular as regards macro- economic and trade policy, and good governance , providing the necessary regulatory framework, institution building and advice.

Objectives: This covers action at *macro-economic level* and was clearly mentioned in the Council's Resolution of May 1999 as the level on which the Commission should concentrate its activities ("More efforts must be undertaken for the analysis of the general policy and the institutional and regulatory framework in which the Private sector is active "). The Community's actions in this area will aim at creating a policy framework, at the national and regional level, which supports and fosters competitiveness , market economy. and "good governance". This would encompass technical assistance in support of reforms, particularly in the fields of legislation, banking and finance, taxation, public expenditure, customs procedures and trade facilitation measures, institutional building, administrative efficiency. In addition, the implementation of appropriate "good governance" and financial transparency measures could facilitate the re-integration of a large informal sector into the formal economy.

Ensuring a harmonised approach: The assistance that the Commission can provide to third countries varies from country to country, and should be tailored to meet specific needs within the coherent programming framework provided by Country Strategy Papers and National Indicative Programmes. It may take the form of a financial contribution to the reform programme agreed with the World Bank , the International Monetary Fund and other donors. The diagnosis and assessment of a given macro-economic and sectoral situation will lead to the identification of projects and beneficiaries, and hence to the mobilisation of the specific instruments and financial intermediaries that seem best tailored to meeting the specific or local requirements. Correct analysis and diagnosis of the situation will also help the Community to engage in a policy dialogue with its local counterparts on what institutional support is needed for successful implementation of the measures for which the Community could provide specific assistance. It should be borne in mind that, thanks to the *acquis communautaire,* the Community has genuine expertise to share with third partner countries.

The measurable results expected from implementing programmes in this field include:

- creation of a better micro/macro- economic environment measurable through a set of economic indicators;
- better functioning institutions and organisation and improvement of local conditions for Small and Medium-sized Enterprises (SMEs), measurable through a set of efficiency indicators;
- accelerated development of the private sector and its contribution to sustainable economic growth for example through initiatives supporting specific privatisation projects or public- private sector - Joint Ventures. Achievements in this area could also be measured through a set of quantitative and qualitative indicators.

To achieve these results the Commission in this field of intervention proposes to focus on three instruments:

- ***Preparation of technical and economic analysis*** focusing on major strengths and weaknesses of the private sector in each given situation, recommending priority fields of intervention, and indicating conditions necessary for the success of externally supported private sector activities.
- ***provision of policy advice***, analytical / diagnostic work and institutional support for capacity building, implementing good governance and financial transparency measures and strengthening the public regulatory and legislative framework, at the national and regional level. Of course it will be also necessary to take into account the impact of regional trade arrangements through Technical Assistance. Policy advice should also focus on ways and means of bolstering the role and functioning of the organisations representing the private sector, and encouraging Foreign Direct Investment (FDI) and international economic co-operation.
- ***Establishing and confirming*** the Economic Dialogue instrument as an important forum allowing to present and establish facts and key policy issues , notably as regards entrepreneurship , private sector development and the de-monopolization/ liberalization policies.
- ***Identification of local institutional partners*** (both at central and local level) or specific sectors of intervention via field work which could involve all the local human resources , including the Commission Delegations .

2. Investment and inter-enterprise co-operation promotion activities

Objectives: The purpose of the Community support for the promotion of investment and technology transfer from industrialised to developing countries will be to enhance, at both national and regional levels, sustainable and environmentally friendly investment and inter-enterprise cooperation agreements. This with a view to increasing the efficiency and competitiveness of the economies concerned, and in particular to enhance export prospects.

Such a support is based upon the assumption that most third partner countries, whilst making progress to improve their overall investment environment and domestic resource mobilisation, still need external support in order to attract Foreign Direct Investment. FDI is also an important vehicle for the North-South transfer of know-how and the development of managerial skills. Depending on the level of development of the countries involved Community support could include strengthening the role of Investment Promotion Agencies (IPAs) and other private intermediaries (Chambers of Commerce and Industry, professional associations, consultancies) and providers of investment - related business services.

The programme will seek to support investment and trade promotion activities, including investments and partnerships that will help both to attain wider social objectives and to facilitate the management of the process of trade integration. EU enterprises could provide capital, technology, access to markets, and technical/management skills to their partners in these countries where entrepreneurial resources are largely untapped.

To ensure a harmonised approach five groups of activities will be considered, according to a flexible "modus operandi" (support is expected to be provided to directly to enterprises or their organizations, and other intermediaries. Sectoral support could also be considered)

a) Institutional strengthening

This first group of activities will be designed to support, mainly on a regional and group basis:

- the development of investment- related intermediary organisations responsible for the organisation and delivery of successful and sustainable investment promotion events;
- a centralized and compehensive provision of investment- related business development services to SMEs (following the positive experience of the Euro Info Correspondence Centres in third partner countries);
- the development of regulatory and supervisory activities at sectoral level;
- the development of project management- elated and event- related skills and information systems;
- the training of local consultants.

b) Support for key sectors

This group of activities would address beneficiaries and stakeholders in both industrialised and developing countries and would include

- the conducting of regional or country surveys to identify key sectors and priority areas of intervention in order to improve the investment environment;
- the preparation of forward studies and surveys of key sectors or sub-sectors identified in the regions and countries concerned;
- the identification of project support due to be delivered by intermediary organisations- and consultancies before, during and after sector or sub-sector, business-to-business cooperation meetings. Special attention will be given to follow-up support for investments and to cooperation agreements initiated during these meetings.

- the strengthening of local private financial intermediaries which play a vital role in entrepreneurship and private sector development.

c) Business-to-Business cooperation meetings

This harmonised approach will provide support for key sectors by encouraging, among other things, direct one-to-one business contacts, with a view to promoting and concluding investment and inter-enterprise cooperation agreements in these sectors. To this end the approach will host sector and sub-sector investment promotion meetings to promote the projects identified and supported.

d) Regional sector investment promotion meetings (e.g. on mining, agro-industry, tourism)

These meetings will cover all EU- (and eventually non-EU) countries, and the developing region concerned (plus other selected third countries, where appropriate).

e) Sub -regional sector investment promotion meetings

These meetings will address smaller specialised sub-sectors of the economy such as leather, horticulture/floriculture, timber/wood products and furniture, or chemical/plastics. They could be organised under the institution- building group of activities on a demand-driven/ cost-sharing basis at the initiative of the Community intermediary organisation or the beneficiary country.

If required, investment promotion meetings could also exceptionally have country or multi-region coverage, and a multi-sector or cross-sector approach.

Certain "ad- hoc" promotion mechanisms could also be identified to address those areas and activities that are not suited to investment promotion meetings. This could be the case with financial services, infrastructure, privatisation projects, information and communication technologies and other horizontal managerial issues (such as financial transparency at sector level, supervisory and regulatory rules and procedures, legislation on twinning and joint ventures, enterprise-banks relations, implementation of core labour and environmental standards, listing of companies in Stock Exchange, and Corporate Social Responsibility matters).

3. Facilitation of investment financing and development of financial markets

Objectives: The Development Council Resolution of May 1999 mentions support for enterprises- *"with particular attention to small companies in the formal and informal sector, channelled as far as possible through local intermediaries… "*. The strategy set out aims to provide the appropriate framework for supplying well- developed- and efficient financial services for Small and Medium- sized Enterprises (SMEs). The instruments used must ensure that high- quality and dedicated financial services are available to private companies in both the formal and informal sectors. More precisely the overall objective of these instruments and services is to mobilise private savings flows (both domestic and foreign) to finance investments that are essential for a thriving business sector. This strategy is based upon the assumption that more efficient financial markets are essential for healthy private sector development in developing countries.Of course these new investment financing facilities supported by the Community should not have distortive effects on the national or international financial market , and they should avoid unfair competition among potential private or public beneficiaries .

Investment financing facilities will be set up with the aim of:

- mobilising private savings (both domestic and foreign) for finance investment;

- ensuring better access to capital markets for commercially -run companies (both private and public) established in developing countries;

- supporting the operations in the partner countries which help small and medium- sized enterprises to gain access to capital markets. This support can be provided in conjunction with support measures aimed at capacity building;

- improving the efficiency and effectiveness of financial systems, including supervision and financial regulation. This support could be provided in conjunction with support measures aimed at capacity building (see above);

- strengthening domestic regulatory frameworks for investment and competition;

- developing innovative and more effective financing instruments. These may include investment funds, risk capital and equity and quasi-equity investments, underwriting guarantees for private (national or -foreign) investment, or supporting private sector guarantee funds as well as Public Private Partnership (PPP) ;

- mobilising loan and credit lines and various forms of conditional and /or subordinated loans.

Ensuring a harmonised approach: When providing financial resources for investment financing, the Community should be sensitive to local market conditions. Nonetheless, where appropriate the Community may also decide, in agreement with partner countries, to provide concessional financing based upon the specific nature of certain operations (as in the case of certain public projects, or projects with significant impact at social or environmental level, even if private). This should be reflected in the political agreements established between the Community and the countries concerned.

An example of this new approach is given by the instrument known as the ***Investment Facility*** now being set up for the ACP countries which will be financed on the 9th European Development Fund (EDF). Such Funds aim to promote commercially viable business primarily in the private sector, or those activities in the public sector supporting the private sector.

Enterprises will have access to the Funds directly or through intermediaries. Operations should include participation in privatisation operations and should aim to mobilise internal and external savings, by helping to build the capacities of local financial institutions and capital markets, and by leveraging foreign investment. Co-financing operations with European and local financial institutions will be facilitated.

Another interesting example is the role of EIB within the context of the ***Euro-MED partnership.*** Following the recent EU Ministerial Summit in Barcelona (March 2002) and the Euro-MED Ministerial Conference in Valencia in April 2002, a new EIB Investment Facility has been launched with the objective of increasing progressively the Bank's loan activities to a level of around 2 billion Euro a year. This investment facility should result in a significant increase in loans to the private sector. The EIB also provides risk capital as well as lending support to SMEs (both European and non-European) from its own resources , making recourse to specialised financial intermediaries and using innovative financial instruments such as global loans etc.

The Community is also active in supporting private sector development through multilateral channels (co-financing with the World Bank, including the IFC, the Regional Development Banks and UN specialised Organisations or Funds).

As far as the management of these instruments is concerned, the Community (i.e. the Commission) will not be involved directly in the implementation and management of financing activities since these programmes will normally fall under the responsibility of specialised institutions such as the European Investment Bank , the European Bank for Reconstruction and Development (EBRD) or other multilateral institutions which may in turn channel the funds through other regional and / or national financial institutions.

On the other hand the Commission will work in close cooperation with these specialised financial institutions and take a leading role in defining regional objectives, financial conditions attached to investment facilities, guidelines for allocation of resources, and monitoring and evaluation procedures. It will also support the necessary reforms or policies in this area.

4. Support for Small and Medium- sized Enterprises in the form of non-financial services

Objectives: Past experiences and empirical evidence suggest that effective business development services are vital for the growth of SMEs and micro-entreprises . The Commission's programme for SMEs will encourage private sector companies to enhance their competitiveness, gain access to modern technology, improve management and seek new markets.

To ensure a harmonised approach a number of supportive measures will aim to improve the macro-and micro-economic foundations of competitiveness of SMEs and micro-entreprises , whilst other measures will focus more directly on developing an effective market for business development services. These will include:

- ➢ initial and on-going guidance for companies and professional associations (usually on a demand -driven basis) or more pro-active strategies paid for, in part, by the beneficiaries (cost- sharing principle), covering the range of services available and how to obtain them (also in this case the experience of Euro Info Correspondence centres as providers of an integrated set of services could be useful);

- ➢ different forms of skills up-grading , to help modernise enterprises and encorage the creation of enterprises' networks or cooperatives

- ➢ assistance with preparing and implementing business plans;

- ➢ coordination with other sub-programmes, - e.g. support for companies - and their organisations and investment financing at company level, linked to opportunities made available by the EIB.

Support measures may be organised and managed on a national or regional basis. However, when European expertise is involved, the Commission will ensure a harmonised approach within each region.

Specific efforts will have to be made in cooperation with the European Investment Bank and other financial institutions to improve the current level of effectiveness of local financial systems and increase the possibilities for SMEs to gain access to the different sources of financing. Where necessary, modernisation plans will have to be drawn up and improvement made to production capacity.

Small businesses and the craft trades should be given consideration in developing countries, since they often do not follow the same pattern as fast- growing SMEs. Yet they are essential for economic and social development. In this regard, the European Charter for Small Businesses approved by the European Council in Feira in June 2000 should serve as a reference for the dialogue with stakeholders from both the Community and third partner countries.

5. Support for micro-enterprises

Objectives: In many countries micro-enterprises offer the ideal opportunity for participation in economic development. More precisely supporting the creation and the-up-grading of micro-enterprises and cooperatives , thereby improving conditions for self- employment, can be an effective way of making economic opportunities accessible to the poor and therefore of fighting poverty. The greatest obstacle to the development of such enterprises is shortage of appropriate local services, both financial and non- financial, the lack of a business culture and information about markets, and access to financial resources.

Ensuring a harmonised approach: Apart from the work to be done to improve the macro and micro-economic foundations of competitiveness - (see above), support for small and micro-enterprises may take the form of;

- ➢ institutional and capacity building of intermediary institutions acting as the voice of micro-enterprises and as providers of public goods;
- ➢ encouraging micro-finance institutions to develop new services and financial products which are well adapted to the medium and long term needs of small and micro-enterprises;
- ➢ helping integrate micro-finance within local financial systems by disseminating best practices and performance standards, setting up a framework for regulation and appropriate supervision, and supporting institutional development;
- ➢ improving and monitoring the performance of micro-finance institutions, their governance mechanisms , and their ability to serve micro-enterprises.

These activities will be carried out in close coordination (possibly by way of co-financing) with multilateral bodies (the Committee of Donors Agencies for Small Enterprise Development, the Consultative group to assist the poor, CGAP, for instance) and with financial institutions (European Investment Bank, other Development Banks, Investment Funds and other local and international financial institutions). Local programmes, intermediary institutions, and service providers could also be involved, to ensure the necessary market analysis and follow-up, needs assessment, and management.

V. Implementation and Follow-up

The Commission plans to retain complete control of the policy, programming and design aspects of these five areas of intervention together with the implementation, where appropriate, of particular actions, including technical assistance. General monitoring and evaluation will also remain under full Commission control.

As regards the implementation and management of financial instruments, including micro-finance, and non-financial services (Business Development Services), the Commission plans to make full use of intermediaries (to be selected) with whom it will establish appropriate management / financial Agreements or Conventions.

The proposals set out above are based on the conclusion drawn from past experience that management of these programmes requires substantial and specialised human resources and that a decentralised approach is best carried out by intermediaries rather than the Commission itself. Nonetheless, given its institutional competencies and responsibilities, the Commission would remain in control of policy matters of which strategies and programming and overall monitoring of the support programme.

The five areas of intervention or instruments set out above are general, i.e. they are available for all regions. The framework of support and the instruments chosen must, as far as possible, be harmonised and rationalised, so as to ensure a coherent approach in all regions. However, there must also be a ***measure of flexibility*** in the use of these instruments to reflect both the more important regional differences and the different political and economic links between the Community and the various third countries. This is why the proposed framework for supporting business sector development will be harmonised but flexible. As a consequence, the mix of support /instruments chosen will clearly differ from region to region, as will the detailed way in which each is implemented.

To follow progress it is proposed to examine whether a set of Private Sector Development indicators could be developed to assess the process of structural change, including the creation of new SMEs, co-operatives and micro-enterprises, and policy implementation.

The Commission is now completing a comprehensive strategy and programming exercise based on a new generation of Country Strategy Papers (CSPs) and National Indicative Programmes (NIPs) as well as Regional Strategy papers (RSPs) and Regional Indicative Programmes (RIPs) for all the countries and regions with which it has cooperation and assistance agreements. The CSPs cover the period to 2005 or 2006 and the NIPs the period to 2003 or 2006 according to the programme. It is intended that the current proposals for ensuring a harmonised and coherent approach to business sector development should be implemented within the above strategy and programming framework as soon as possible, i.e. when the NIPs are subject to major revision. This will take place from 2003 onwards

Moreover, the Commission intends to develop further its strategies to support private sector development in third countries. One of the priority areas is that of the management failures of State-owned enterprises (SOEs), a subject at the centre of structural reform programmes all over the world for the past two decades. As one of the main sources of concessional development assistance, the EU has long been involved in the funding and reforming of SOEs in developing and transition countries.

This experience shows that the Community has a role to play, with its assistance complementary to the International Financial Institutions in promoting and supporting the reform agenda. However, given the numerous shortcomings of privatisation in developing countries, the likely impact of these failures on the attainment of the Millennium Development Goals, and the prominent roles of some European firms in Public-Private Partnerships (PPPs) , the EU must become a more active partner in trying to make reforms more efficient and effective. It is therefore proposed that the issue of privatisation and State Owned Enterprises should be addressed in a separate Communication.

The Commission will also seek to promote and develop more effective cooperation and coordination between the Community's external assistance programmes and the activitites of the European Investment Bank (and other financial intermediaries), particularly in third partner countries.