BACKGROUND NOTE – SESSION 2

Innovative approaches to support more inclusive growth

International cooperation has played an important role in tackling structural impediments to growth, supporting the development of productive capacities, the creation of productive employment and the integration of developing countries in the world economy. New actors and approaches have emerged, and there is increasing recognition of the importance of partnerships and of the catalytic role of development finance to achieve the common goal of more inclusive growth. All stakeholders, including partner counties, development cooperation agencies and the private sector are adapting approaches to the evolving development co-operation landscape. New modes of working together going beyond traditional north-south approaches are now in play. Broader and more inclusive policy dialogues around Partner County owned policy frameworks and results based management are changing the ways that stakeholders interact. There is greater attention to what public-private cooperation can deliver and to make the most of ODA within a growing pool of financial resources for development.

Development co-operation helps to support government capacities, address infrastructure deficiencies, and improve education, health care and social protection systems for the poor. These areas are especially important in the poorest, most fragile and conflict-affected states. For such countries, official development assistance (ODA) accounted for over 60% of external financing over the 2005-2010 period (by contrast, for middle income countries, ODA represented a mere 4%, (Adugna *et al.,* 2011). Because of the wide variations in aid per inhabitant, the different goals at which aid is aimed, and the comparatively small amounts involved (USD 31.5 per capita per year according to Tarp (2006), it is not easy to quantify the impact of ODA on growth. However Arndt et al (2012), finds that ODA equivalent to 1% of GDP raised GDP growth by 0.1% on average over the 1970-2000 period, a small but helpful impact. Similarly, studies on the role of ODA in assisting Inclusive Growth by reducing poverty and promoting health and education have been positive, but with room for improvement (Collier and Dollar, 2002; Bourgignon and Sundberg, 2007; Virtanen and Ehrenpreis, 2007; Alvi and Senbeta, 2012). Also, Huang and Quibria (2013) find that foreign aid has a positive impact on Inclusive Growth in their sample of countries, especially when aid is directed at the areas of health and education.

Development co-operation can help expand access of poor people to vital and proven technologies, such as high-yield seeds, immunisations, modern contraception or Internet connectivity (Sachs, 2005). Easterly (2006) notes that such interventions “give the poorest people the health, nutrition, education, and other inputs that raise the payoffs of their own efforts to better their lives”. While investing in health and education is essential in ameliorating social conditions, creating incentives for private sector development, trade and employment are necessary but not sufficient conditions for sustained, inclusive economic growth. The key question is if and how economic and social goals can be achieved simultaneously. Inclusive growth requires sound market-led policies, an environment for business to flourish, strong institutions, and the right mix of good human resources, appropriate technology and financial investments to support trade and industrial development. The panel will discuss innovative uses of public policies, development co-operation and private initiatives to catalyse inclusive growth. This note, while not exhaustive sketches out some of the major themes, and provides a list of illustrative questions to inform the discussion.

Private sector development

Policymakers can help to till the soil to foster commerce, but it is ultimately businesses that plant the seeds of growth. Aid can be useful in improving the overall business environment, lowering trade and transport costs, providing access to finance and promoting education and skills. But private sector development programmes have often been criticised. Schulpen and Gibbon (2002) critically reviewed private sector development policies, arguing that they were shaped mostly by the nature and interests of the private sector in donor countries themselves, incorporated a high proportion of tied aid, and failed basic tests of coherence. Recent reviews however, are more positive. For example, an EU evaluation of private sector development (PSD) programmes found that while there is broad consensus on the importance of PSD for job creation, linkages between EU support for PSD and employment generation have remained very distant (EC, 2013). The evaluation also found that the EU has made valuable contributions to the development of the private sector in middle income countries, notably through policy dialogue, alignment, and the clarity of the EU's role in PSD.

A Danish development co-operation (Danida) meta-evaluation of private sector development (Denmark, 2009) showed that interventions supporting supplier and producer enterprises organised in value chains have gained increasing importance among donors. Furthermore, intervention approaches have been improved on the basis of experience and best practices. There are only a few evaluations of long-term impact and sustainability, but the indications are positive. With this kind of intervention it is possible to achieve a systemic positive impact on the stakeholders and actors operating in value chains.

The International Trade Centre (ITC) is actively involved in assisting firms in the Least Developed Countries (LDCs), including participation in the Enhanced Integrated Framework initiative, which sets the standards for delivering Aid for Trade to LDCs; providing trade-related technical assistance; assisting LDCs on how to respond to challenges on sustainable tourism development; establishing industrial partnerships, the use of trade intelligence and the activation of market opportunities with international buyers; enhancing supply-side capacities in LDCs; and strengthening the role of women in agriculture. LDCs accounted for about 60% of ITC's technical assistance in 2012 and LDCs will continue to remain ITC's priority in the years to come.

- What innovative approaches has the ITC adopted to stimulate the indigenous private sector, particularly in LDCs, and help suppliers connect to value chains?
- What role can lead firms play in diffusing knowledge, skills, innovative business practices and technology to firms in developing countries and thus promote more inclusive development?

Trade

Trade-induced growth promotes poverty reduction. Exports act as the conduit through which countries exploit their comparative advantage, improve their overall efficiency and productivity, and enable industries to employ their resources more efficiently and profitably. These factors expand demand, spur consumption, and reduce risks associated with reliance on the domestic market. They also increase employment in labour-intensive sectors and raise wages and standards of living. Imports permit countries to gain access to a wider range of goods and services and allow local firms to benefit from more, cheaper and newer technologies that increase productivity and competitiveness (OECD, 2011).

All stakeholders should help to identify barriers to growth and take steps to increase the inclusiveness of the growth process, for example by increasing processing of raw materials and not just their extraction (where this makes economic sense) and by providing infrastructure that helps the poor to access markets (OECD, 2007). For instance, the greatest potential for inclusive growth in Africa may be found in agriculture and agroindustry and where there is a great need for better rural roads and storage facilities to help reduce waste. While export markets are important, local and regional markets also offer potential, buoyed by steady demographic growth, urbanisation and rising income levels.

The emergence of value chains strengthens the rationale for trade-related assistance. Developing countries seek value chain participation to achieve their economic growth, employment and poverty reduction objectives. Small and Medium Enterprises (SMEs) sometimes operating in informal markets, often bear high costs of complying with customs and border procedures and other non-tariff measures, so they require technical assistance in overcoming the barriers and becoming competitive suppliers. Easing the movement of imports and exports across borders can significantly reduce the costs of trade. OECD analysis shows that comprehensive trade facilitation reform has the potential to reduce trade costs by as much as 15% for some developing countries. Reducing global trade costs by 1% would in turn increase worldwide income by more than USD 40 billion, 65% of which would accrue to developing countries.

Some of the thickest borders in the world can be found in Africa, and Trademark East Africa (TMEA) aims to promote rapid advances in East Africa's integration, trade and global competitiveness. TMEA is working in collaboration with key partners and stakeholders to sustainably speed up transit trade, reduce non-tariff barriers (NTBs) and harmonise standards to improve the region's competitiveness in international trade.

- What approaches have been particularly effective in reducing the thickness of borders?
- How can improvements in trade performance contribute to productive employment and inclusive growth?

Youth Unemployment

If growth is to be truly inclusive, it must address youth unemployment. The African Economic Outlook estimates that 53 million of Africa's 200 million young people between the ages of 15 and 24 are in unstable employment and 40 million young Africans are out of work. However, while 18 million of them are looking for a job, 22 million have already given up (OECD/AfDB, 2014).

Productive employment and decent work are the main routes out of poverty. Well-functioning labour markets and an enabling environment for local entrepreneurship are essential to increase employment opportunities. Small and medium sized enterprise can play a significant role in providing jobs. Removing burdensome and unnecessary policies, laws, and regulations would help businesses to more easily do business. Governments can provide services such as reliable electricity, access to finance, social insurance and support for entrepreneurs to register businesses and invest in their businesses and spur job creation. Education and skills also play an important role. Both third level education in science and engineering and training in specific skills can make workers more attractive to firms and make locations more attractive to foreign investment.

- What can donor agencies do to support public policies to address youth unemployment? What has been achieved to date?
- How can job creation within the private sector be catalysed?

Innovative Approaches

In an integrated world, the behavior of rich countries and powerful institutions can profoundly affect the lives of people in poor countries. Poverty and weak institutions in developing countries can breed public health crises, security threats, and economic crises that know no borders. Committing to policies that promote development and well-being is a global imperative: no human being should be denied the chance to live free of poverty and oppression and to enjoy a basic standard of education and health. The Centre for Global Development's Commitment to Development Index (CDI) looks at whether the policies of rich countries match aspirations we all share to promote respect for human life and dignity.

Development co-operation can help to improve the business environment, provide market information and infrastructure while cutting red tape. The significant risks to doing business in developing countries can be mitigated via loan guarantees and other debt and equity instruments. Development Impact Bonds offer a potential way to shift incentives and accountability to results, transfer performance risk to the private sector, and increase efficiency in program implementation.

- The Development Impact Bond is a good example of an innovative approach to financing development. What is its potential and what is the experience to date?
- What does CGD's Commitment to Development Index tell us about the current whole-of-government approach to development within the OECD? How could the findings stimulate more innovative approaches to development, beyond aid?