



**OECD workshop on  
Effective Public Investment  
at Sub-National Level in Times  
of Fiscal Constraints:  
Meeting the Co-ordination  
and Capacity Challenges**

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**A Private Sector Perspective on the Enabling  
Environment for Effective Public Investment  
EXECUTIVE SUMMARY**

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## **Background**

The present study, conducted by an external consultant to OECD, provided a private perspective for effective public investment.

The review methodology included a desk study of all relevant background documents provided by OECD; interviews with senior business executives. These included staff of small and large corporations; business networks; academia; private investors; and policy-makers.

Interviews with businesses were furthermore conducted in a sample of countries including France, the United States, Canada, Bulgaria, Sweden, Switzerland, Singapore and the UK. The methodology also included the drafting of a few corporate case studies.

### **Good practices in the use of public funds by the private sector**

The overall conclusion of this review is that there are many examples of effective use of public investment funds by the private sector. We noted that government has an important role to play in stimulating public investment through the private sector. Certainly the global financial crisis of 2008-09 has considerably changed the relation between the public and private sectors, creating strong interdependence on each other in some industries. The study revealed that, in the past years, the widespread adoption of a economic policy agenda focused on the recovery and expansion of the private sector has led many governments to undertake several public investment reforms aimed at encouraging private enterprise to flourish, thus creating growth and employment.

Therefore, public investment programmes in infrastructure such as the US Recovery & Reinvestment Act or the French "Investissement d'avenir" have been critical for governments to deal effectively with gaps in key industrial sectors. However, according to some business executives, public investments in infrastructure should not be regarded as the most desirable option on the short-term, e.g. when an economic crisis develops. Most infrastructure investments involve a long lead-time between outlays and

yields. Therefore, infrastructure projects may not show the characteristics of appropriate tools to recover swiftly from market failure.

Moreover, increasing demand from the private sector, in particular the SMEs, calls for higher public contributions to the most vulnerable sectors in times of crisis. Not only governments should target public investment to the SME sector but they should also create the right public investment incentives for viable and profitable SMEs to enter the global economy and increase their potential growth significantly. Although an important window of opportunity has been created by MDBs and ECAs to concretize an expansion of public investment to meet the needs of the private sector in times of crisis (in particular those related to the financing and operating of SMEs in the developing world), the renewal of such programmes should be ensured for coming years.

Many business executives welcomed public funds designed to help create new business start-ups as well as maximising the growth prospects of existing firms. Public interventions usually involve a combination of demand-side measures (public aid and tax relief directly to the private sector) and supply-side measures (relating to support structures, e.g. the financing of regional financing platform and SME networks through EU Structural funds).

A consensus seems to exist from business executives to argue that public investment is a key determinant to foster innovation and entrepreneurship at national and subnational levels. Today, innovation and entrepreneurship are pillars of the knowledge-intensive economies. In most OECD countries, innovation-based public investment schemes are implemented through different channels (national, specialized agencies, sub-national) to foster firms' development and growth.

Interviews confirmed that public investments available at subnational level are indeed very useful to foster the emergence of firms, in particular in the fields of innovation and technology. Not only many public investment schemes allowed to focus on research and innovation but they have been used by local

public leaders as a way to foster an interactive learning process allowing interactions between a range of actors, such as equipment and component suppliers, users or customers, competitors, private and public research laboratories.

As such, public investment programmes are said to create the enabling collaborative environment at subnational level. For instance, Eurostars Programmes dedicated to the R&D performing SMEs and co-funded by the European Communities and 33 EUREKA member countries have been praised for stimulating start-ups growth and international collaborative research and innovation projects by easing access to public funding.

Economic Development Agencies (EDA) are also said to significantly contribute to the promotion of the private sector at sub-national level. EDAs provide the opportunities for regional collaboration and the public infrastructure for business to move forwards and outwards. According to interviews, EDAs can help lift a business or idea to the next level, by finding ways to create clusters or match individuals and organisations with expertise and entrepreneurial flair. In many countries EDAs would also help the regions to align their public investment strategy with the government's economic agenda.

Business executives further noted that public investment in regional hubs and clusters is creating good leverage for the private sector. Because some regions have received substantial level of public investment, they have been able to transform themselves into effective hubs of knowledge. When a right mix of public funds and knowledge is provided, such hubs become locally socialised into a 'local industrial atmosphere' to foster the creation of new ideas and business opportunities.

Indeed, regional clusters, often recipient of large public funding schemes, are a striking feature of all modern economies. Unlike national funding programs, often targeted to larger scale projects in infrastructure (transportation, environment, energy...), regional hubs and clusters are said to be ideal networks to drive productivity and innovation. Such geographic concentrations of firms,

suppliers, support services, producers and specialized research institutions can transact more efficiently, share technologies and know-how more readily, efficiently access "public goods" such as pools of specialized skilled employees, specialized infrastructure, technological knowledge, and others.

### **Constraints hampering the good use of public investment by the private sector**

We also noted Specific constraints of the use of public investment by the private sector.

First, a problem of definition of the "private sector" seems to hamper policy intervention in the most efficient way. Over time, the term "private sector" has been widely used—and sometimes abused. Within this context, the real challenge here is to seek a more proper understanding of the term "private sector" and to gain insight into the driving factors behind it. Indeed, firms located in different nations display systematic differences in their structure and strategies. Therefore, policy-makers have to better understand the needs of the private sector to define appropriate public investment schemes

As mentioned to us, capacity to accurately target public investment interventions on the private sector needs depends on the quality of appraisal work at both a national and regional level and the definition of selection criteria and priorities (SMEs versus large corporates), and then on how these criteria are applied in practice to individual applications.

Second, we noted that management practice reveals that there is no agreement as to what constitutes a good proposition for the use of public investment by the private sector—or what makes one persuasive. Most interviews indicated that the private sector would not privilege any business decision based upon availability of public funds to design corporate strategies. It is indeed the company's core organizational and operational competencies which are said to be crucial to realize a competitive advantage. Therefore, instead of spreading resources over a large variety of businesses, it would be preferable to reach a consensus on how to adapt public investment to specific types of firms or sectors.

Third, many firms argued to privilege a unique strategy to seek tax relief effects on the long run, often to the detriment of other public investment programmes. R&D tax relief has been mentioned quite extensively during interviews with corporate leaders. A few firms indicated that they favour such fiscal scheme to obtain reduction of the global tax bill and sometimes get cash refunds to finance operations. On the contrary, some public investment funds are rarely mentioned or said to be too complex to use by the private sector, in particular in period of economic crisis (e.g. Structural Funds).

Fourth, the risk of competitive distortions to be introduced by public investment was indicated on many occasions. While a range of public investment measures initiated in times of financial crisis combined has induced substantial response by the private sector in recent years, some executives expressed frustrations with the concept of public investment as a substitute of private funding. According to them, most firms, small or large, are affected when economic conditions are grim and it may thus be a “dangerous obsession” to try to maintain global competitiveness of some segment of the private sector through public investment. One of the principal ways in which public investments can do harm by distorting competition is that if a firm get a subsidy and the other would not get it, then the former may retain business, or take business from the other.

Moreover, if the public and private sectors compete for the same resources in the economy, the costs of financing private investment increase while the availability of credit to the private sector declines, which could in turn crowd out investment in the private sector.

Fifth, severe information limitations (lack of comprehensive information systems and data flows) do not facilitate making well-informed decisions for use of stimulus packages by the private sector. It should be noted that classification of the different types of public investment interventions in favour of the private sector cannot be easily obtained and be clear-cut.

Not surprisingly interviews confirmed that the mapping and visibility of public investment aid at subnational level is often lacking. This is perceived as a major challenge for the small and medium size enterprises, which often lack capacity to track down such public investment opportunities. Significant strengthening of information channels about availability of public investment and retooling of cooperation arrangements between the public and private sectors are needed.

Finally, many national or subnational public investment policies schemes have a reputation for complexity, thus deterring the private sector to use them in period of economic crisis when resources have to be fully allocated to business performance in tight markets.

