EFFECTIVE PUBLIC INVESTMENT AT SUB-NATIONAL LEVEL IN TIMESOF FISCAL CONSTRAINTS

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A perspective from the private sector?

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Background information

- Scope of work: A private sector perspective
  - What are the direct and indirect conditions for a private investors/firms to participate in national/sub-national public investment?
  - What are the main remaining barriers for the private sector to use public investment programs?
  - Could the dialogue and/or the partnership between the public and private sector be enhanced? If yes, how?
  - How can the public and private sectors work together to enhance innovations, growth and job creation?
  - What has been the effects and impacts from the use of public investment by the private sector?

Background information

- Methodology:
  - Desk review of key strategic documents
  - Corporate one-on-one interviews
  - Analysis of a selection of projects and corporate case studies
  - Other interviews with public bodies (Incubators, innovation agencies, SME networks…)
- Limits of the study:
  - 25 interviews of the corporate sector
  - Could not cover the wide spectrum of public investment schemes
  - All regions not covered
  - Timetable

Defining the private sector

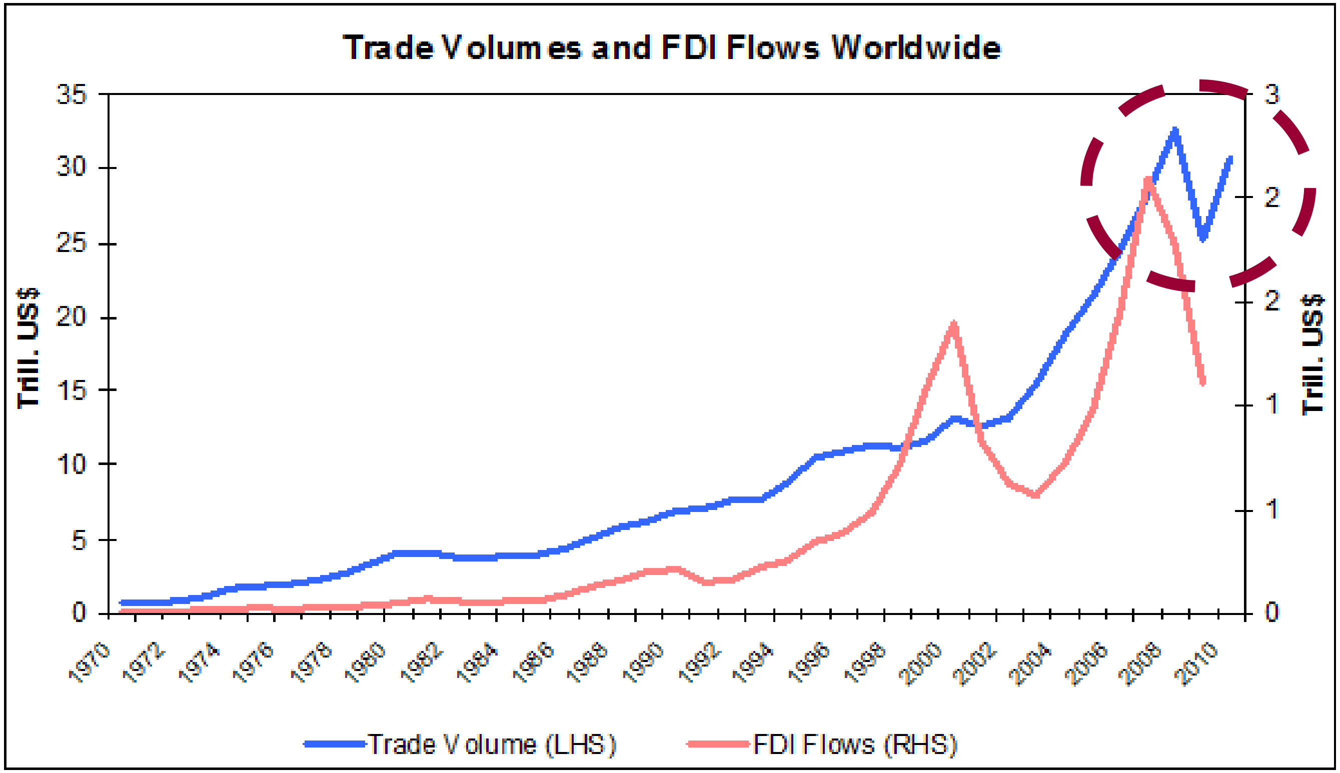
- What is the private sector?
  - A problem of definition of the “private sector” seems to hamper policy intervention in the most efficient way
  - Over time, the term “private sector” has been widely used—and sometimes abused
  - Little demand-side inputs from the private sector and a relatively large number of national and sub-national agencies offering aid

- Still SMEs are the drivers of the global economy
  - Global trade estimated at USD 25 trillion per annum (USD15 trillion for exports)
  - Most of it goes through SMEs (Small: <50 employees, medium<250)

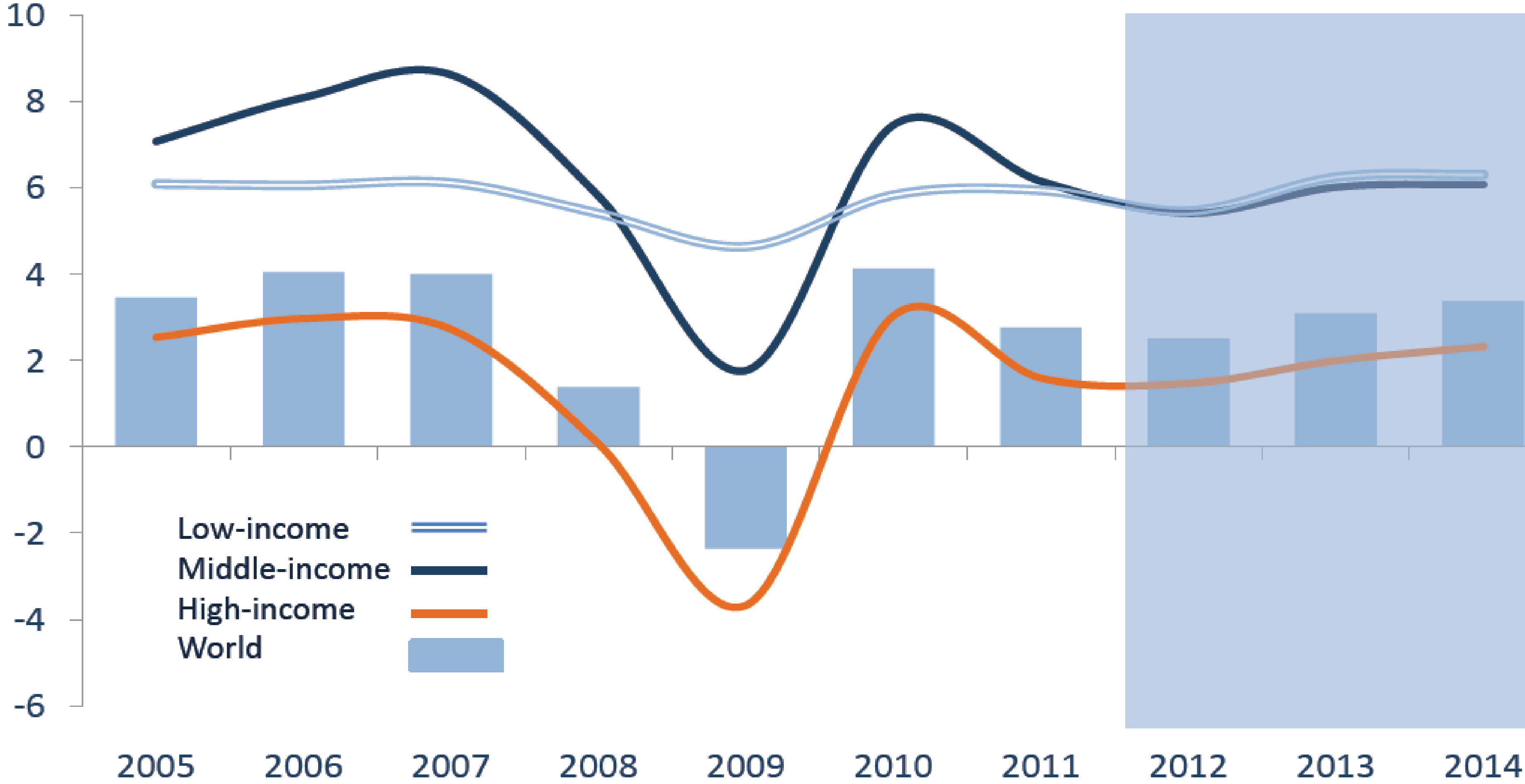
- First question: Are policy-makers targeting the right private sector entities?

Effectiveness of public investment for the private sector in times of crisis

- The global financial crisis of 2008-09:
  - Different views, depending on the type of firms
  - According to many, it is not an issue of investment or not (public or private) but how to boost "demand" in a global downturn



Projected GDP growth



Source: World Bank, Development Prospects Group.

Effectiveness of public investment for the private sector in times of crisis

- SMEs are the first hit, in particular in developing countries
  - For instance, during the 2008-2009 financial crisis, the global supply of trade credit in Asia fell by some 20%, leading to a 20% drop in Asian trade volumes, and a 10%-point drop in GDP growth
  - The impact on developing countries was immediate: 670,000 Chinese SMEs shut down and 6.7 million people lost jobs in China. Nearly 1.2 million export-related jobs were lost in India in 2008-09
- Government interventions through multilateral organizations and ECAs in times of crisis have significantly helped the private sector (SMEs)
  - For instance, banks and SMEs have been provided with different liquidity pools but not all funds have been used for various reasons
  - The economics of public investment is complex: time lags, compounding of regulatory effects, fiscal consolidation in the high-income world, protectionism…)

Large infrastructure public schemes

- Public investment in infrastructure is said to be needed:
  - French Investment for the Future; Infrastructure Canada Program; American Recovery and Reinvestment Act 2009

- Co-financing with the private sector: A good practices from an MDB's perspective

- Should public investments in infrastructure 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
  - For many sectors, e.g. urban transportation, potable water, wastewater, or rail, provision of infrastructure does not directly involve the private sector
  - Infrastructure projects may not be the tools to address "market failure"

When public investment creates the enabling environment for the private sector

- Public investment is seen as a key determinant to foster innovation and entrepreneurship at national and subnational levels

- Public investment programmes can create the enabling collaborative environment at subnational level

  – Eurostars Programmes dedicated to the R&D performing SMEs and co-funded by the European Communities and 33 EUREKA member countries, stimulate start-ups growth and international collaborative research and innovation projects

  – Capsum and Givaudant have been developing the Neobulles project from the French Single Interministerial Fund grant

When public investment creates the enabling environment for the private sector

- The availability of specific public investment through regional funds/agencies, e.g. EDAs, is mentioned as a key factor of the enabling environment at the sub-national level
  - "CanNor" (CAD 11.8 million in annual funding supporting economic development in Northern Aboriginal businesses and entrepreneurs)
  - Swedish Agency for Economic and Regional Growth (Tillväxtverket) for managing structural funds
  - Nelson Regional Economic Development Agency in New Zealand to fund Cawthron Aquaculture Research and Technology Park
- Clusters are more than "hubs of knowledge":
  - the French Cosmetic Valley is about 550 companies accounting for 47,000 jobs, EURO 12 billion in turnover, 6 universities, 200 public research laboratories, 7680 scientists, 41 research project worth EURO 75 million and 136 training institutes

Specific constraints of the use of public investment by the private sector

1. **The business model:** Centered around business performance, in particular in times of crisis

2. **Tax relief strategy (or lack of "public investment" strategy):** Many firms privilege a strategy to seek tax relief effects on the long run, often to the detriment of other public investment programmes

3. **R&D or research tax credits**:
   - In fiscal year 2009 alone, the US credit "Credit for Increasing Research Activities" represented an estimated USD 5.6 billion federal subsidy for R&D

   - In France, it is estimated that EURO 5.27 billion of taxes will not be perceived but redirected to R&D tax relief

Specific constraints of the use of public investment by the private sector

4. Distortion of competition and crowding out effects:

- It may thus be a “dangerous obsession” to try to maintain global competitiveness of some segment of the private sector through public investment

- In specific cases, if a private operator wants to be involved, the local government may not get the public financing to build the infrastructure OR better tax advantages for the public operators

5. Information gap: A great varieties of public investment with little visibility for the private sector

- Identified more than 250 public incentives in Wallonia, regardless of the level of government (Federal State, Walloon Region, etc.) directed to the private sector

6. Complexity

In summary

- Some good practices for the use of public funds by the private sectors
- At subnational level, public funds can create the enabling environment to foster growth and employment
- Infrastructure programmes are not said to be ideal to address market failures
- Some key constraints:
  - Information gap, competition distortions, complexity of use, a default strategy by the private sector (tax relief)

THANK YOU

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