THE 2015 ARAB-DAC DIALOGUE ON DEVELOPMENT

26-27 January 2015 at the OECD in Paris

Reducing trade and investment costs to promote private sector conribution to development

Economic growth will remain an important part of the post-2015 development agenda and the private sector has a key role in meeting that objective. This issues note provides background information on the context for private sector development in developing countries, on providers' efforts to support developing countries in reducing trade and investments costs and on the challenges in delivering aid for trade and investment.

Key Issues for discussion:

- How can providers of development co-operation work with developing countries to improve the pre-conditions for private sector growth? How can we make sure that our efforts in this area are complementary?
- How can providers of development co-operation best conduct policy dialogue with the private sector, both in their own but also in developing countries? What are the lessons learned in this area?
- Are the instruments (e.g. equity, guarantees, loans, technical assistance) that providers of development co-operation have to support private sector development appropriate for today's business context, with the expansion of global value chains?

The current context for private sector development in developing countries

The changing nature of international business, in particular the expansion of global and regional value chains, provides new opportunities for developing countries. These value chains provide the private sector in developing countries with access to networks, global markets, capital, knowledge and technology, which offer a path to inclusive and sustainable development. This trend has increased trade and investment flows, strengthened the links between them and increased the prospects for sustainable development. The private sector has been responding to these opportunities with significant investment, which has resulted in inward private flows into developing countries increasingly exceeding official flows since the mid-1990s.

At the same time, some developing countries, in particular the least-developed countries (LDCs), continue to remain on the margins of international trade, attracting little foreign or domestic investment. There are still many challenges in doing business in developing countries, such as high tariff- and non-tariff barriers, energy shortages and high logistical and transportation costs. Governments from developing and developed countries cite inadequate infrastructure, access to finance and standards compliance as the three main barriers that developing country firms face in connecting to value chains. The private sector also highlights regulatory uncertainty and a lack of skilled labour as barriers preventing them from entering or moving up value chains. To promote private sector development and attract more private investment, which will be essential for achieving the Sustainable Development Goals, developing countries need to reduce trade and investment costs.

ARAB FUND FOR ECONOMIC AND SOCIAL DEVELOPMENT

OECD
BETTER POLICIES FOR BETTER LIVES

What is being done to reduce trade and investment costs?

Developing country governments are responsible for creating an environment conducive to private sector growth. But development co-operation can help them steer private sector activities to contribute to more inclusive and environmentally sustainable growth. Providers of development co-operation are doing this by supporting partner countries to improve their business environment, educate and train the workforce, invest in infrastructure and promote regulatory reform and good governance.

Aid for trade, in combination with complementary policies, is contributing to lower trade costs and build trade capacities – in the form of additional infrastructure, better institutions such as customs and standards authorities, more trade-friendly policies and regulations, or in regulatory procedures that increase competition and reduce prices. There is now evidence suggesting that aid for trade is correlated with increases in trade. One dollar invested in aid for trade is on average associated with an increase of nearly USD 8 in exports from all developing countries – and with an increase of USD 20 in exports for the poorest countries.

To help mobilise private investment in the infrastructure sector, DAC members provide technical co-operation to build institutional and legal frameworks as well as to up grade the skills of civil servants in central government, Public Private Partnership (PPP) centres, inter-regional institutions and local administrations to work with the private sector. Some DAC members also help establish a well-functioning local capital market which is adequately regulated and supervised. Several providers of development co-operation facilitate south-south knowledge exchange on PPPs. In addition to providing support to the "upstream" aspect of the enabling environment, DAC members also engage in "downstream" support for the preparation of specific infrastructure projects, including providing advisory services or financing project preparation facilities and feasibility studies.

Bilateral and multilateral development finance institutions (DFIs) also have financial instruments to directly support the private sector, such as non-concessional loans, equity and guarantees. In infrastructure, 60% of this support goes to energy, particularly to renewables (e.g. hydro, wind, solar and geothermal energy). Eastern European countries receive the most and Sub-Saharan Africa the least.

Among Arab institutions, the Islamic Development Bank is active in promoting private investment in its member countries, some of which are developing countries. It provides equity investments, non-sovereign loans, technical assistance, investment insurance and export credits to private enterprises. It also uses Islamic financial instruments that are compliant with Shari'ah, such as leasing, Istisna'a and instalment sale, which are gaining popularity with the private sector in its member countries.

What are the challenges in delivering aid for trade and investment

The critical elements on the developing country's government side in enhancing trade and investment for development include: supportive macroeconomic and structural policies as well as good governance; country ownership at the highest political level; effective intra-governmental co-ordination; and active local private sector and civil society participation in the preparation and implementation of activities. Providers of development co-operation, in turn, should ensure: long-term commitment with adequate and reliable funding; integrated approaches by combining public and private investment with technical assistance; leveraging partnerships – including with providers of South-South co-operation; keeping project design flexible to facilitate adjustments in initial plans; and sharing knowledge and transferable lessons at local and global levels.

Further challenges for providers of development co-operation include better co-ordination among relevant institutions – development co-operation agencies, DFIs and export credit agencies – within the provider country or multilateral institution. In addition, transparent monitoring mechanisms of DFI activities need to be established, notwithstanding commercial confidentiality, since the private sector is receiving support from tax payers. These mechanisms should ensure that public funds are not crowding out private finance (i.e. the project would not have otherwise happened if there was no official support) and that the ultimate objective of development supersedes financial returns.