The Role of the Private Sector in Supporting Economic Growth and Reducing Poverty in the Indo-Pacific Region

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Foreign aid was once the primary delivery vehicle for development, but today private investment and private enterprise drive growth and human progress. Foreign assistance thought leaders and the mainstream aid architecture also reflect this reality, including the High Level Panel around the next round of the Millennium Development Goals, the "post Busan" process, and major thought leadership from the World Bank[1]. Australian official development assistance (ODA) totaled approximately $14.9 billion from 2010-2012, while private financial flows from Australia to the developing world were over $36 billion for the same period[2]. Given this reality, Australia can provide the strongest development impact by encouraging private enterprise led growth, mobilizing increased trade and investment, and deepening its partnerships with developing countries, private companies, non-governmental organizations (NGOs) and philanthropic institutions. Australia's new development strategy needs to be backed up by instruments and approaches that integrate trade, investment and development into a coherent package so that Australia fully contributes to and benefits from a more stable and prosperous world.

Australia should become a donor of choice for the middle income countries of the Asia Pacific region by focusing on areas of greatest interest to those countries– namely, private enterprise, energy, infrastructure and trade. Australia will still be required to provide basic assistance for health, education, and emergency situations in areas like the Pacific Islands, Papua New Guinea, and East Timor where Australia has the "lead." However, given the Asia Pacific's increasing prosperity, Australia ought to establish itself as the world leader in economic growth, trade and good governance—all the sorts of assistance that countries increasingly want but donors often find difficult to provide. Australia should also become the donor of choice on the management of oil, gas and mining revenue by supporting good economic governance of this increasingly common set of resources. Australia should also support "all of the above" energy strategies and large infrastructure projects by providing finance, risk sharing and advice to governments to enable the full spectrum of energy and road infrastructure projects favored by developing countries. Many donors are unwilling to take this position for domestic political reasons, but China and others will happily fill this void. Supporting the energy needs of the developing world will require that Australia establish development finance capability similar to the U.S. Overseas Private Investment Corporation (OPIC) and USAID's Development Credit Authority. These skill sets are not currently present in the DFAT ministry and will require cooperation with the Australian Treasury as well as significant support from the world class Australian banking and investment banking sectors.

Economic growth in the developing world presents a tremendous opportunity, and Australia's economy and location provide it with a number of advantages to encourage economic growth. Australia's new strategy rightly pays particular attention in the Asia Pacific region, where it can share the benefit from the increasing prosperity of its neighbors and partners. Australia's strong private sector, significant trade with the developing world, as well as existing foreign assistance resources can enable an ambitious development agenda. Australia has a diverse set of large multinational operators from the mining, agribusiness, and financial sectors capable of offering skills and tools to supplement development programs. Developing nations want trade and business relationships, not aid, driving their growth.

To help Australia leverage its existing resources to deliver improvements in Australian lives while reducing poverty and creating business opportunity in the developing world, CSIS as three strategic recommendations:

- Make broad based economic growth– an underfunded yet crucial initiative– the central tenet of Australian development policy.

[1] See Annex
[2] OECD Development Statistics, Total Net Private Flows by DAC Country

    - Aid investment is needed in economic governance related projects including rule of law, anti-corruption, reducing the regulatory burdens, and e-government.
    - Aid support for the Doing Business Indicators and related Investment Climate, including support for Property Rights.
    - Support for Domestic Resource Mobilization serves to increase the capacity of governments to collect taxes and deliver basic services—most Asia Pacific countries have the wherewithal to pay for their own development and Australia can facilitate this.
    - Major commitments to the management of oil, gas and mining revenues including government capacity building to create capable, responsive and clean government.
- Align Australian development resources and tools to leverage the private sector in promoting development outcomes.
    - DFAT must cultivate capacity to partner with private companies far more closely by developing a cadre of private sector savvy development practitioners, new instruments within DFAT, and resources to work directly with mining, energy and other companies.
    - Given the human resource flight from DFAT following the AUSAID merger, DFAT needs to directly address issues of talented employee retention and morale. DFAT has to consider “outsourcing” expertise from Australian and non-Australian partners including the World Bank, IFC and the Asian Development Bank.
    - Increased strategic collaboration with traditional Australian implementing partners such as Coffey and WorldVision Australia will remain crucial, and can be maximized by deeper engagement with both for-profit and non-profit actors in tri-sector partnerships and networked arrangements.
    - Diaspora and remittance flows coming into Asia are significant, and a partnership to provide innovative delivery of this finance would have significant benefits.
- Facilitate broader and more effective engagement in developing countries by utilizing the full array of trade and investment instruments at Australia’s disposal.
    - Australia should join the other G-7 countries and either create a stand-alone Development Finance Institution or a set of instruments akin to the United States USAID Development Credit Authority. Either would allow Australia to work more closely with lenders in sectors that require private capital but lack private sector support.
    - Trade Capacity Building especially around TPP and other meaningful global or pluri-national trade agreements including whatever happens around the Trade Facilitation negotiations at the WTO.
    - Australia’s goal of spending 20 percent of its assistance resources in alignment with trade offers Australia the ability to lead on making big investments in trade facilitation and trade capacity building—sectors that other traditional donors including the United States and the UK support rhetorically but have proven unwilling to lead on because their foreign assistance dollars are already “spoken for.”

Broad Based Economic Growth

Economic growth in the formal economy reduces poverty and promotes development outcomes. The 2008 Commission on Growth and Development, now known as the Spence Report, highlighted the central role of economic growth in poverty reduction. By reviewing cases where countries had sustained high growth, the commission was able to identify common patterns in successful development. The report revealed that successful development required a series of structural conditions which created a business and growth enabling environment[3]. Growth and poverty reduction in developing economies result directly from new jobs, 9 out of 10 of which are created by the private sector[4]. Economic growth leads to jobs, and jobs move families out of poverty and foster greater civic participation. This is the best way to engender social change.

Policy reform plays an important role in advancing broad based growth; creating an economy that extends opportunity to the broadest cross-section of society requires strong institutions capable of securing and supporting future growth. The annual *Doing Business Report* measures 11 factors that contribute to a national business environment, and has been a useful tool for identifying key regulatory and policy reforms to improve business climate. The popularity of the index reflects its utility in measuring reform, and Australia could benefit from a development approach that promoted structural and policy restructuring along the recommendations provided by the Spence Commission and the *Doing Business Report*. Costa Rica serves as a strong example of reform leading to economic growth; Costa Rica made significant investment into infrastructure, education, and business regulation in a push to spur high tech investment. The effort to create a better business enabling ecosystem was successful, and high tech products now account for more than 40 percent of Costa Rica's manufacturing output[5]. Policy reform and strong institutions play an important role in attracting investment and enabling business, but also assure that these activities take place in the formal economy. Host countries can then benefit from the economic growth, and mobilize its own domestic resources to fuel further institutional strengthening.

Australia can distinguish itself and help force a much needed division of labor by specializing in sectors that support private sector led growth and utilizing its instruments to work with the private sector. Initiatives that support rule of law, property rights, and governance all enable private sector success as well as competent and reliable governments. As tax bases increase, developing countries can rely more directly on domestic resource mobilization to drive development. In this regard, development should support self-sufficiency, not propagate a system of dependence. A successful and growing economy undergirded by strong institutions and regulations provides the conditions and motivation for long term sustainable development success.

Private Sector Partnership

The private sector is the world's largest driver of international development. Many companies have a large stake in the progress of developing countries, and have come to see business success as an outcome of health and economic vibrancy in the communities where they operate. As a result, companies are pursuing an array of development initiatives, either unilaterally or in partnership with NGOs and donor governments. Businesses want improved market access, operational efficiency, and a secure operating environment. All of these conditions can prove challenging in developing countries. By aligning core business practice with social interest, companies are able to transmit investment, technology, and skills. The scale of business investment in the developing world is massive, particularly compared to official aid. Opportunities for partnership provide a multiplier for development investment.

Private sector actors, including private development companies and NGO's, offer valuable experience, insight, and resources for achieving development outcomes. In addition, a growing number

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[3] Commission on Growth and Development, *The Growth Report: Strategies for Sustained Growth and Inclusive Development* (Washington DC: World Bank, 2008).
[4] World Bank, *World Development Report 2012: Jobs* (Washington, DC: World Bank, 2012), ix
[5] Legatum Institute, *The 2012 Legatum Prosperity Index- Tracing a Path to Prosperity: Why Costa Rica and Botswana Outperform their Neighbors* London: Legatum Institute, 2012), http://www.prosperity.com/snapshots-3.aspx

of philanthropic offer valuable expertise and resources. The Bill and Melinda Gates Foundation spent $2.3 billion on global health and agricultural development in a single year, which is on par with a mid-size donor country budget. NGOs often operate as valuable on-the-ground partners and implementers with significant private resources. Australia's WorldVision raises 90 percent of its $300 million Australian Dollar budget through grassroots funding from the Australian public in support of its child sponsorship initiatives. Every time DFAT partners with WorldVision Australia they leverage their Australian Dollar 10 to 1. NGOs like WorldVision provide broad networks through which local implementation is possible, and represent the first line of development execution.

Australia must also consider the power of diaspora and remittance flows. In many developing countries in Asia remittance flows are a significant percentage of the economy. DFAT should partner with private enterprise to support innovative resource delivery to developing countries through Australia's new innovation fund. The U.N. projects that in 2014 remittances to developing countries will exceed $441 billion, with approximately $241 billion heading to Southeast Asia and Pacific regions[6]. Innovations that make the delivery of these financial flows more efficient have huge economic and developmental potential.

The process by which governments partner with the private sector is often arduous to navigate, with multiple entry points and confusing contractual processes. While many countries have introduced partnership vehicles, the United States, through USAID's Global Development Alliance (GDA), remains one of the most successful global partnership programs. The GDA approach effectively combines funding, capacity, and knowledge from relevant actors across multiple communities. DFAT should consider the creation of a partnering unit along the lines of GDA to engage private sector actors and illicit involvement early in the development process. Capturing the benefits offered through partnership with corporations, philanthropic organizations, and NGO's is crucial to maximizing development impact.

Integrating New Development Tools

Constructing successful business enabling environments requires input from trade, investment, and development assistance, all of which achieve mutually supportive goals. Australia should pursue a coherent development strategy that blends these instruments, and should empower an office with the resources to administrate this policy. Specifically, development finance and trade capacity building are two innovative instruments that Australia should consider incorporating into its development strategy.

Development finance instruments fill the investment gap in countries where business, investment, or political climate would otherwise dissuade private sector engagement, and are crucial in driving the expansion of local and international companies into the developing world. Following initial funding, most development finance institutions are self-sustaining, and often turn a profit on investments. Worldwide, DFIs now provide $40 billion per year in investment projects, which is four times the amount available as of the early 2000's[7]. As DFIs demonstrate their relevance and efficacy, this amount will continue to rise. Australian development efforts could be greatly bolstered by a DFI which would allow for a more diverse set of development investments. An energy and infrastructure DFI focused on the full spectrum of energy needs could serve Australian interests, as well those of its regional partners. For domestic political reasons, many OECD countries have been unable to engage in this type of investment, leaving opportunities in this sector on the table. Australia could become the investor of choice for

[6] World Bank, *Outlook for Migration and Remittances 2012-2014* (New York, NY, 2012). Dilip Ratha
[7] International Finance Corporation (IFC), *International Finance Institutions and Development Through the Private Sector: A joint Report of 31 Multilateral and bilateral development finance institutions* (Washington, DC: IFC, 2011), 21

developing countries with "all of the above" energy needs. The imperative for new energy to support development in Asia is great, and if Australia does not fill this role, another actor certainly will.

Trade provides the opportunity for a variety of economic engagements, ranging from one way generalized system of preferences to comprehensive free trade agreements. Australia currently has seven free trade agreements in force, with two more signed and eight under negotiation[8]. While FTAs represent the highest standard for trade engagement, trade and investment framework agreements and bilateral investment treaties are intermediate steps that nonetheless strengthen economic ties and drive development. Trade capacity building, a relatively new mechanism in trade agreements, is another useful tool in promoting development. TCB chapters in trade agreements target a range of policy barriers and institutional weaknesses which prevent countries from meeting obligations and inhibit benefit capture from trade agreements. Assistance spending targeted towards trade initiatives unlocks additional economic benefits, and is a high impact alternative to traditional development spending. With the ongoing Trans-Pacific Partnership negotiations, Australia has the opportunity to explore cutting edge trade engagements, including trade capacity building.

[8] http://www.dfat.gov.au/fta/

Annex

Our Shared Opportunity: A Vision for Global Prosperity. Johanna Nesseth Tuttle and Daniel F. Runde.
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