DCED
Donor Committee for Enterprise Development

Business Environment Reform & Investment Promotion

The DCED Business Environment Working Group (BEWG) produces Policy Briefs to provide short, relevant guidance on specific topics related to donor and development agency support for BER in developing economies. The full report is here.

Main takeaways:

- Business environment reforms can catalyse structural transformation when integrated in a broader policy framework for growth and poverty reduction.
- Broad scale business environment reforms can be deepened to sustain structural change. This would include broader liberalisation and market reforms.
- Horizontal business environment reforms designed to improve the general conditions for doing business can be used in combination with vertical reforms within specific sectors and sub-sectors to achieve economy wide impacts.
- While business environment reforms improve business competitiveness and growth, investment policies and promotion programmes provide support and incentives to attract private investment.
- Reforms can be tailored to investment attraction and can improve harmonisation and reform sequencing with concurrent reforms such as export promotion and private sector development.
- Better government, donor and investor coordination can contribute to a virtuous circle of reform programming. This may include an investment promotion agency to connect private investors with government programmes and services.

The BEWG serves as a platform to share information and knowledge on donor-supported BER in developing countries and to identify and support good practices and new approaches in this field. Find more BEWG publications here.

Introduction

There is an expectation that official development assistance and business environment reforms can catalyze private investment and contribute to fulfilment of the United Nations Sustainable Development Goals (SDGs).

Business environment reforms make a positive impact on macro level investment, employment, growth, and poverty reduction. However, many countries require deeper structural reforms that go beyond the business environment if they are to show macro-level results that contribute to the SDGs.

The dynamic link between reforms and impacts

Macro level investment and growth requires a holistic approach that combines business environment reform and investment promotion along with a broader macro policy framework that stimulates structural transformation. See the figure in the next page.

Macro level investment data on foreign-direct and domestic investment show clear surges when business environment reforms are applied concurrently with investment promotion efforts and structural reforms. While structural reforms, such as liberalisation or industrialisation, drive transformation, business environment reforms improve productivity by reducing transaction costs and improving market efficiencies. Business environment-driven improvements to productivity contribute to more competitive business locations, which enhance FDI promotion.

The dynamic links of reforms to impacts

A HOLISTIC APPROACH

- BER
- Investment Promotion
- Structural Reforms

→ CATALYSIS →

STRUCTURAL TRANSFORMATION

- FDI/Domestic Investment
- Labour mobility
- Population Growth

→ TRANSMISSION →

GROWTH/POVERTY REDUCTION

- Capital Accumulation
- Labour Supply
- Total Factor Productivity

Catalysis and transmission

Business environment reforms can incentivise foreign-direct and domestic investment through better access to finance, foreign exchange, infrastructure development, as well as through factor and product market reforms.

Many donor and development agencies support business environment reform within a broader package of support provided for sustainable private sector development. As a result, there is an opportunity to highlight best practices that improve the design and impact of reforms on private firms and the broader economy.

While direct government support to industry sectors, clusters and investors nurtures nascent firms and industries, this support works best when it is integrated with business environment and macro-economic reforms, along with investment promotion and facilitation programmes. These reforms and support programmes should focus on competitive industry sectors.

Care should be taken to avoid possible perverse incentives of direct firm support. While targeted investment promotion services can strengthen the capabilities and absorptive capacities of preferred firms, reform programmes should not be selective. Realising the spill overs effects from foreign-direct investment requires a transformation of the entire economy.

It is important to tailor business environment reform support and investment policies and promotion programmes to the national context. The links between private sector development, business environment reform and investment attraction should be clearly articulated within each country framework.

Business environment reforms enhance the transmission effects of industry reforms. Thus, business environment reforms that create firm-level changes are transmitted through foreign-direct investment linkages, industry development programmes and the replication of good practices by domestic firms and industries to macro level impacts. The transmission of the effects of reforms to investment generation is most effective when benchmarked against private sector development policies, programmes and services.

Donor coordination

Donor support is effective where the coordination is dynamic and relevant. There are different levels of donor coordination, ranging from a light touch (e.g., information sharing) to a more formalised system requiring high levels of reporting and compliance.

Regardless of which level of coordination is adopted, donor coordination should be proactive and flexible, and framed within an integrated assistance strategy. This should encourage coordination, where agencies agree on who will focus on what, as well as sequencing, where one agency picks up where another has left off.

Furthermore, mechanisms to coordinate government, donor, investor, and development finance institutions should be established for a virtuous circle of business environment reform implementation.

Country cases

Ethiopia and Myanmar were identified by the World Bank in 2017 as two Best Reform Award winners. The text boxes below provide some insights from these cases, although these conclusions are based on a somewhat limited evidence base.

Ethiopia

There were considerable improvements regarding private investment and business environment reforms in Ethiopia since the early 2010s. Business environment reforms and investment promotion programmes have contributed to higher levels of foreign-direct investment. The government led most of these reforms and programme under its five-year national development plan which set high priority on the manufacturing sector through FDI attraction and industrial park development, with support from international donor and development agencies.

Growth diagnostics, micro and meso data, and analysis show that structural transformation towards industrialisation is gaining traction.

Structural transformation is still underway and there are several challenges arising for government and donors. It is critically important to catalyse the recent surge in foreign-direct investment by strengthening backward linkages and replicating good practices by domestic firms.

There are also challenges in finding ways to significantly improve donor coordination and information sharing.

Myanmar

Many business environment reform support programmes in Myanmar seek to promote new investment opportunities while developing the private sector and exports. Reforms have focused on streamlining laws and regulations for private investment. Many business environment reform programmes integrate these elements.

Foreign-direct investment has increased substantially after the transition to a new regime in the early 2010s, which made a series of holistic reforms with new investment legal framework.

Government continues to send policy messages of commitment for greater investment attraction and transparent reform process. This has improved investor perceptions of predictability. It has also been conducive toward harmonious support programmes that create a ‘virtuous circle’ of coordination between, the donor community and the private sector.