Development–Environment Ministerial Consultation

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BIAC Discussion Paper

I. Addressing the sustainable development challenge

Sustainable development is a global issue that OECD and developing countries can only achieve through joint efforts. Actions by OECD countries alone to resolve major global environmental challenges, such as climate change, will not be sufficient without the involvement of developing countries. A forward-looking approach is required that integrates economic growth, social development and environmental protection and close cooperation between developed and developing countries.

The effective management of environmental resources is critical to development. The poor are heavily dependent on natural resources to earn their livelihoods. They encounter substantial barriers to deriving the full benefits from environmental assets and bear the greatest burden from environmental costs. The economic importance of environmental resources combined with significant consequences of resource depletion and climate change, therefore, implies that environmental considerations have an important role to play in development strategies.

However, acute poverty forces people to focus on short-term challenges. The struggle for daily survival often implies that not much attention is paid to long-term environmental considerations. Increased prosperity is therefore a prerequisite for enabling countries to better consider the needs of future generations and address environmental concerns. With the appropriate policy environment in place, economic development can advance societal welfare and environmental protection, which in turn can enable further economic development. The challenge for policy reform is therefore to develop coherence across societal, economic and environmental policies in a mutually reinforcing manner enabling synergies.

Sustainable development is best achieved through open and competitive markets that encourage efficiency and innovation. Key elements to higher, more inclusive and more sustainable development are private investment, attraction of international capital flows and promotion of international trade and innovation. Coherent policies to support a favourable business environment and mobilise private sector investment is, therefore, imperative for broadly based sustainable development that facilitates poverty alleviation and wealth creation in the poor countries of the world.

II. The importance of investment for development

Significant and sustained poverty reduction in developing countries cannot be realised without the private sector. The private sector is the main engine for economies' growth and development. It allows entrepreneurs to set economic activity in motion by bringing resources together to produce goods and services. It thrives and delivers sustained growth when a number of factors are combined to produce a conducive investment environment. Vigorous and sustained growth is facilitated by a virtuous circle whereby entrepreneurship and investment lead to higher productivity, making it possible to invest larger sums in the future. In the process, new jobs are created, new technologies, including technologies that help address environmental challenges, are promoted, and government revenues needed to improve health, education and infrastructure services are enhanced.

Domestic resources play the main role for financing private investment in developing countries, and will do so in the future. However, additional foreign resources are indispensable to finance the investment needed for sustained development. Official Development Assistance (ODA) has an important role to play. In the poorest countries, ODA even constitutes the main part of external finance. However, ODA alone is clearly an insufficient resource for external finance to trigger the investment needed to achieve the Millennium Development Goals.

Developing countries must attract foreign direct investment (FDI) as a supplement to domestic investment. FDI contributes to the host countries' integration into the world economy and has the potential to increase economic efficiency by fostering enterprise restructuring and competition. FDI triggers positive spill-over effects, such as human capital formation and the transfer of technologies including environment friendly technology. It also indirectly enhances the quality of public governance as attracting FDI requires sound policies and the application of best practices for regulation and policy making. Therefore, the promotion of investment is central to growth and poverty reduction that will benefit societies in developing countries, including better environment protection.

III. Promoting investment for development

A. The importance of an enabling investment environment

In too many countries, the quality of the investment environment is insufficient to generate the private investment and economic growth needed to reduce poverty and protect the environment on a sustained basis. In countries with high growth, gross fixed capital formation often exceeds 25% of gross domestic product (GDP) while the share of investment is only at about 20% in Asia (excluding China and India) and has been even lower in Sub-Saharan Africa for the past two decades. In order to attract and retain necessary investment for development, developing countries with the help of OECD countries and the donor community, have to improve the enabling environment for investment, that is establish a well functioning legal, political, social and economic environment in which companies can operate successfully and competitively.

Good public governance is a pre-requisite for an attractive investment environment. Good governance includes government accountability, transparency and predictability of rules, rigorous law enforcement, cost-effective regulatory frameworks based on sound science, and a strong commitment to fighting bribe solicitation and corruption. Developing countries have to apply more open investment and trade policies that provide for a level playing field where domestic and foreign companies can compete effectively. Openness to trade and investment fosters the beneficial integration of the host country into the global economy. The availability and quality of physical infrastructure is another key determinant for the overall investment environment. Likewise, conditions for private sector participation in infrastructure need to be improved significantly.

Adequate attention to the environmental consequences of investment is essential for sustainable development. Enabling environmental policies, based on scientific assessment, are an important part of a stable policy framework in developing countries. Transparency and reliability of these policies are important to ensure that companies can factor in costs for long-term investments and avoid high compliance costs due to rapid and arbitrary changes. Further important elements of an enabling investment environment include efficient financial markets, efficient investment promotion and facilitation, flexible labor markets, the creation of human capital, good corporate governance as well as transparent and predictable tax systems with low tax rates and a broad tax base.

B. Public-Private Partnerships

In addition, to providing a better general environment for investment, governments should consider how to directly support investment by combining public and private funds in a sustainable manner. Public-Private Partnerships (PPPs) can be an effective tool in generating investment for development, in particular in the areas of infrastructure and public services. PPPs also play an important role in addressing environmental and sustainable development challenges in developing countries. Through PPPs, the private sector can bring in additional funding for projects, but also valuable technical and managerial experience. Thus, partnerships between public authorities and the private sector can allow for a better and less costly provision of services compared to public sector provision of service. However, experience with PPP projects shows that effective PPPs are a challenge.

In order to provide for successful PPPs, public authorities need to ensure that private partners can deliver their services according to sound commercial principles. These include ensuring transparent and predictable legislation/regulation, the opening of infrastructure sectors to domestic and foreign private investment, effective co-ordination of preparatory measures between the different public authorities involved and a fair allocation of risks. In addition, private companies must be allowed to boost productivity and set tariffs at market levels in order to work profitably. Where social policy objectives prevent profitable pricing policies, donors should consider offering broad-based support to private service providers. Furthermore, donors should help mitigate non-market risks that cannot be covered by the private insurance market by offering appropriate guarantee schemes.

IV. Promoting environmental innovation worldwide

A successful policy for sustainable development aims to make environmental protection and economic growth and development mutually supportive. The spread of innovative approaches to non-OECD countries will be crucial for environmental improvements worldwide. Innovation is key to reconcile worldwide growth and increased investment with environmental and sustainability concerns. Population growth and the environmental pressures it entails, including rapidly rising energy demands, make increased focus on innovation, both technical, economic and managerial, indispensable. With the right framework conditions in place, economic growth should also permit higher environmental and living standards world-wide. As national regulations are further developed, policies should be designed that promote innovation and the absorption of technology and thereby reinforce improved environmental performance.

With the right framework conditions in place, FDI can act as an efficient means by which cleaner technologies and better environmental practices can be introduced. Foreign investors, particularly global companies, generally standardise technologies and management systems across countries in which their facilities are located. When they mainstream a single standard for environmental practices, they must of course meet legal requirements in the most stringent jurisdiction. Therefore, their single standard is set at a high level, and carried as a practice to countries with less strict jurisdictions.

The arrival of foreign investors also has the potential to have a beneficial impact on the environmental operations of domestic companies. Local firms try to match the project characteristics and quality standards of foreign-owned companies, and suppliers will have to increase process and product quality to meet higher standards. Finally, employees that move from foreign-owned to local facilities bring with them the expertise gained in these companies. In a similar manner to the transfer of environmentally friendly technology and know how, foreign direct investors also introduce efficient management practices in their host country production facilities. As local firms try to match product characteristics and quality standards of foreign-owned operations, processes become more efficient and product quality improves.

V. A role for OECD

Each country faces a different set of challenges. For each country, policy makers should focus on the priority areas which could maximise the impact of development and investment efforts taking into account environmental considerations. Therefore both governments and intergovernmental organisations play a major role in helping create the right framework conditions for development-oriented business strategies. As a multi-disciplinary organisation, the OECD could play an important role in the following areas:

- Expand work with developing countries on the identification and effective promotion of high quality benchmarks for policies impacting on private investment.

- Use ODA as leverage for promoting private investment and PPPs: ODA should increasingly be used to support developing countries' own efforts to provide an attractive investment environment. DAC's donor guidance on using ODA for mobilizing private investment is a step in the right direction. In addition, we recommend that donors consider how to use ODA to directly support private investment by combining public and private funds in PPPs.

- Identify impediments to private sector participation in infrastructure: Carry out further work in this area and help promote successful PPPs by developing best practice guidance and benchmarks for good policies for more private sector participation in infrastructure.

- Support developing countries' efforts to implement good policies for investment through targeted capacity building.

- Expand cooperation with non-member countries on global environmental challenges, such as climate change, and include developing countries in its analytical work on measuring and addressing environmental challenges.

- Encourage and be supportive of voluntary approaches and partnerships as an important complement to governmental efforts in the area of sustainable development.

- Foster innovation and technology to find socially and environmentally sustainable solutions that spur economic growth development throughout the world.