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**SUBMISSION TO THE JOINT  
STANDING COMMITTEE ON FOREIGN  
AFFAIRS, DEFENCE & TRADE**

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**THE ROLE OF THE PRIVATE SECTOR IN PROMOTING ECONOMIC  
GROWTH AND REDUCING POVERTY IN THE INDO-PACIFIC  
REGION**

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**SUMMARY OF KEY POINTS**

- Private sector growth is a key contributor to alleviating poverty
- Interventions to promote growth must promote inclusivity and minimise risks associated with inequality
- The private sector already 'does' development and has a shared interest in achieving 'development outcomes'
- In order that aid can be used effectively and achieve value for money, donors need to be fully apprised of the context(s) in which they seek to operate
- The private sector of the Pacific is not the same as the private sector of Australia
- The private sector of one Pacific island country may differ significantly from the private sector of another Pacific island country owing to a number of factors
- Interventions to support private sector growth in the Pacific island region should focus on 'home-grown' businesses not on businesses located in Australia
- To develop the private sector, a diversity of markets needs to be identified and the significance of domestic markets should not be overlooked
- There is much that we already know and this knowledge needs to be brokered and leveraged effectively to enhance future activities
- To maximise available opportunities and alleviate the burden of transaction costs, bilateral and multilateral donors need to work together strategically
- Regional 'solutions' should be approached with caution
- Opportunities to work with sub-regional groupings should be explored

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### 1. INTRODUCTION

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Private sector growth is widely acknowledged to be an essential component in the alleviation of poverty as a means of providing more and different economic opportunities in any given society. However, to focus on growth alone generates a risk of creating or exacerbating inequality and this is particularly hazardous in small countries that are in the midst of rapid transition from subsistence-based economies to those that are increasingly cash-based. Development interventions, including use of aid money, must first 'do no harm' in relation to inequality and then act to enhance inclusivity not only in relation to opportunity but also when it comes to benefitting from increased economic growth at the national level.

This submission is provided as a means of informing the inquiry as to the context of **private sector engagement** in the Pacific island region. This submission does not focus on the private sectors of Australia and Papua New Guinea (PNG). Rather it is intended to provide useful background information regarding the private sectors of other, smaller economies of **Melanesia** and the wider Pacific region (e.g. Vanuatu, Solomon Islands, Samoa).

Before moving to more practical issues, there is a question of ideology to be addressed: is it good practice for private sector organisations to be given money from the aid budget in order to pursue 'for profit' activities in the hope that they will also deliver development outcomes?

Many Pacific island businesses already 'do' development. The terminology they use may differ from mainstream 'development speak', and the drivers of business may be different, but **development objectives** are most certainly achieved. Providing regular employment over a long period of time leads to improved livelihood for workers and their families, including increased access to education, health services and more. Private sector operatives have a shared interest in the countries in which they work being secure and stable with healthy, well-educated populations.

However, it is hard to assess this impact either in any one country or across the Pacific island region. This is partly because the private sector is exactly that, private. In addition, the costs associated with collecting this information are high compared to the amount of data collected, owing to the small size of the formal business sector in each country.

### 2. THE IMPORTANCE OF UNDERSTANDING CONTEXT

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There are several aspects of context that need to be appreciated and interrogated in order that any interventions are ones that will maximise available opportunities and minimise risks. The importance of context cannot be underestimated and requires appropriate investment, whether in relation to design, implementation or evaluation of aid-funded activities. This not only enhances **effectiveness** but also contributes to achieving **value for money**.

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#### 2.1 PRIVATE SECTOR CONTEXT

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Historically, aid agencies and their staff have had limited exposure to or engagement with those who work in the private sector, other than as procurers of goods and services. Observations have indicated that there was an absence of a real and nuanced understanding of what business is and what the drivers of business actors actually are. Unless and until donors inform themselves of some basic tenets of what private sector entities do and do not do, meaningful engagement will be hard to bring about. Time and again complaints come from private sector actors who have been 'engaged' that 'no-one in the aid programme has ever run a business' – this is somewhat glib and sweeping but what it indicates is that people who are in business do not feel that the engagement is valid because there is no **shared understanding** of what business is or is not. It is likely that the converse also applies: that many members of the business communities in the Pacific island region do not have a sophisticated or nuanced understanding of what development partners do beyond the project/program level.

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#### 2.2 PACIFIC ISLAND CONTEXT

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'Engaging with the private sector' is a broad formulation. It remains somewhat unclear to what extent this engagement is intended to be with Australian private sector players, the private sectors of the Pacific, or both.

With the obvious exception of PNG (and, to a lesser extent, Fiji) and very small inroads elsewhere (and leaving aside obvious examples such as ANZ and Westpac), Australian companies are not present in the private sectors of the region in meaningful terms. While there may be advantages to encouraging Australian companies to set up shop in the larger economies of South East Asia, the reality in Pacific island countries — with the notable exception of PNG — is that **markets** are generally too small to be attractive or to justify set-up costs.

It is important to be clear that what 'works' for the private sector in Australia will not necessarily work for private sector operations in the Pacific. Perhaps more importantly, the approach to private sector engagement in one Pacific island country will not necessarily be appropriate in another. A number of factors are likely to affect what type of engagement is going to be best in each environment, including national investment policies and procedures, legal frameworks and regulatory requirements for business registration and operations.

It is to be hoped that the envisaged private sector engagement comprises elements designed for **'home grown' businesses**, and there are indications that this will be the case. While visiting Vanuatu late last year, Foreign Minister Julie Bishop announced an allocation of \$15 million over five years to the **Pacific Business Fund** (via the Asian Development Bank) to provide business advisory services to over 250 companies in the region. This appears to

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build on one of the key lessons learned from the experience of the **Enterprise Challenge Fund (ECF)**<sup>1</sup> and bears further comment, as it illustrates the importance of knowing the environments in which these activities are intended to operate.

It is likely that challenge funds (or similar modalities) will be more effective if linked to business advisory services. However, this is a space that is becoming quite crowded especially in the Pacific and there will be a need for **co-ordination** here in order to maximise positive outcomes.<sup>2</sup> Activities aimed at providing more and improved business advisory service need to be nuanced and adopting a ‘cookie cutter’ approach should be avoided. Not all businesses need the same types or levels of support at the same time. Needs may vary according to sector, type and size of business, existing capacity, the location in the business life cycle and the type of any additional technical assistance required from external sources. It is also important to recognise that not every environment is equipped with enough business service providers (accountants, lawyers, financial advisers, graphic designers (for packaging, marketing and so on) etc.) to be able to provide the types and levels of support required. Whilst it might be tempting to go down the track of setting up some sort of ‘regional facility’ approach to delivering services of this type, it is necessary to ensure that appropriate recognition is made of differing regulatory regimes and investment strategies between countries. This is another lesson that should be learned from the ECF experience; the systems and procedures associated with this programme were lacking in this regard, at least in the early stages.<sup>3</sup>

In relation to the provision of knowledge and advisory services it is recommended that they should be provided more broadly rather than at the level of individual firms and projects. The reason for this is that environmental enabling is important and there is value in enabling the overall environment so as to (over time) reduce the need for project subsidies.

There has been some discussion of modifying the challenge fund methodologies so that public subsidies are linked to results and more recently this concept has been explored within the context of Development Impact Bonds (DIB), which are about to be trialled in Uganda and Rajasthan<sup>4</sup>. More needs to be learned about this approach and particular attention needs to be given to their potential (and potential limitations) in small economies such as those of the Pacific island region.<sup>5</sup>

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<sup>1</sup> Disclosure: Tess Newton Cain was the country manager (Vanuatu) of the ECF between 2008 and 2010.

<sup>2</sup> See below for further points regarding the importance of collaboration and coordination by donors.

<sup>3</sup> See below for further comments on adopting a regional approach to private sector support.

<sup>4</sup> See, further, Rita Perakis (2014) ‘Two DIB Pilots Will Test New Development Partnerships’ on Views from the Center blog: [http://www.cgdev.org/blog/two-dib-pilots-will-test-new-development-partnerships?utm\\_content=buffer8c435&utm\\_medium=social&utm\\_source=twitter.com&utm\\_campaign=buffer](http://www.cgdev.org/blog/two-dib-pilots-will-test-new-development-partnerships?utm_content=buffer8c435&utm_medium=social&utm_source=twitter.com&utm_campaign=buffer).

<sup>5</sup> See, further, Center for Global Development (2013) ‘Investing in Social Outcomes: Development Impact Bonds.’ Report of the Development Impact Bond Working Group, <http://international.cgdev.org/publication/investing-social-outcomes-development-impact-bonds>.

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### 3. THE IMPORTANCE OF IDENTIFYING A DIVERSITY OF MARKETS

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Much of the literature on developing economic growth in the Pacific island region has tended to focus on the importance of developing **export potential** and many of the perennial challenges that have been identified as affecting these economies arise within this paradigm. Other than large-scale resource extraction, which is not available in many Pacific island countries, there are very few opportunities to develop exports to the extent that justifies the associated costs.

There has historically been a focus on agriculture, with copra having featured heavily. However, price fluctuations on the world market make this a difficult activity to sustain over time without the use of subsidies. Other agricultural products that have had some success in terms of volume are coffee and cocoa.

However there is more to be done in assisting Pacific island countries in identifying a diversity of markets, whether for agricultural produce or other economic activities, such as tourism.

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#### 3.1 DOMESTIC MARKETS

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An issue that is often overlooked within the context of this debate is the significance of domestic markets to economic growth. Whilst it is true that domestic markets in Pacific island countries are small, it is also the case that they are accessible and that they are growing both in terms of absolute numbers<sup>6</sup> and in terms of an emerging 'middle class' with growing disposable incomes.

In addition, the nature of domestic markets, particularly with reference to agricultural produce, is changing as a result of increasing urbanisation and more people participating in the formal economy. Lack of access to gardens and/or lack of time to prepare traditional foods are leading to a reliance on imported, highly processed foods. This has serious implications both in terms of **health** and **food security**. Improved supply and value chains between primary producers and urban centres are required to address these issues.

In some countries (e.g. Vanuatu, Fiji, Cook Islands) there is a particular subset of the domestic market for agricultural and cultural products, which is the **tourism** sector. More needs to be done to improve linkages between primary producers and purchasers within this sector, notably hotels, resorts and restaurants. For purchasers, key concerns are

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<sup>6</sup> This applies in Melanesian countries where populations are growing although not as fast as might previously have been thought. It needs to be recognised that this does not apply throughout the region and indeed there are some places (e.g. Cook Islands) where the opposite holds true.

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assuring regularity of supply both in terms of quantity and quality and this means that opportunities for establishing aggregators exist and can be further explored and developed.<sup>7</sup>

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### 3.2 NICHE EXPORTS

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Rather than trying to overcome entrenched barriers to developing exports on a large scale (including distance from major markets, susceptibility to natural disaster and lack of skilled labour forces), more attention should be paid to developing **niche agricultural products** that are low volume and higher return. Examples include vanilla, chocolate and specialty nut products. There are opportunities for Pacific island countries to benefit from increasingly sophisticated consumer choices with a focus on organic and ethical production plus the demand for products that come with a 'story' attached. Development of these activities is also focused on increased value adding in country, which fosters skills development as well as improved economic returns.

Australia would be expected to be a significant market for products of this type although there are opportunities to access and exploit other opportunities, including in Asia and Europe depending on the particular product.

A particular area for concern here (and one which requires a **'joined up' approach** to development from the government of Australia) is that of quarantine restrictions, which already prove a very significant barrier to Pacific island countries seeking to export agricultural produce to Australia. More needs to be done to assist Pacific island countries to navigate Australian regulatory procedures in order to access this market now and in the future.<sup>8</sup>

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## 4. THE IMPORTANCE OF COOPERATION & COLLABORATION

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### 4.1 WHAT DO WE ALREADY KNOW?

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There is much to be learned from what has already gone before. The concept of donors (bilateral and multilateral) engaging with and developing the private sector in the Pacific is not new and the space is quite crowded. This indicates that there is a need to invest appropriate resources in establishing what is already known about context, about what works and, possibly more importantly, what doesn't or hasn't so far. There are also lessons to be learned from donor activity in other parts of the world (e.g. DFID's use of challenge funds in Africa). Whilst it is certainly possible to overplay Pacific 'exceptionalism', it is important to maintain a very real sense of how and why the region is different (politically,

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<sup>7</sup> See, further, Astrid Boulekone & Tess Newton Cain (2014) 'Pacific Conversations: Private Sector Development in Vanuatu with Astrid Boulekone' on Devpolicy blog: <http://devpolicy.org/pacific-conversations-private-sector-development-in-vanuatu-with-astrid-boulekone-20140306/>.

<sup>8</sup> See, further, Wesley Morgan (2013) 'Growing Island Exports: High Value Crops and the Future of Agriculture in the Pacific', Crawford School Research Paper No. 05/2013.

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culturally, geographically, etc.) and ensure that these differences are acknowledged and accommodated.

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#### 4.2 WORKING TOGETHER FOR EFFECTIVENESS AND VALUE FOR MONEY

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In relation to **integration of effort**, bilateral and multilateral donors should be doing this already with particular reference to the Cairns Compact. Engagement with the private sector is not new either globally or in the Pacific island region. Numerous players already have runs on the board, including **Pacific Islands Trade and Invest**, the **Asian Development Bank**, the **International Finance Corporation** and the **European Union**, each of which have run several activities receiving co-financing from Australia and/or New Zealand. They have good information to share, based on experience and networks in individual countries. Australia has learning of its own to add from previous activities in this area, including the pilot Enterprise Challenge Fund for the Pacific and SE Asia, which concluded recently.

As the drive for private sector engagement moves from policy articulation to implementation, we would hope to see a real commitment to donor integration and cooperation, as envisaged by the Cairns Compact. Private sector entities in the Pacific island region have small management teams (often the senior management is one person) so there is limited capacity and tolerance for accommodating multiple teams of consultants scoping, designing, monitoring and evaluating the (apparently) same thing.

There is certainly more scope for domestic actors (governments, business groups, civil society) to drive greater integration from their side of the fence and also lead by example – if they come together as a coalition for change around a particular issue and can then present a united front ‘upwards’ to donors then there will be an added pressure for donors to integrate more. Generally, donors should welcome this sort of approach. However, the current reality is that this type of activity is not well established in Pacific island countries, whether in this arena or others.

In terms of how this operates at country or regional level, the key is to be well informed as to what is actually happening on the ground and this requires time and energy to be invested in **relationship building** and establishing **good channels of communication**, including some fairly basic project management components such as using the right location, communicating in the most appropriate language, having realistic expectations as to how much time private sector people can devote to things that are not directly linked to their core business, etc.

It is already apparent that **transaction costs** are high in the Pacific. The IFC reports that it costs them \$3 for every \$1 of finance provided. To a certain extent, this is something that just has to be accepted. The nature of business in the Pacific island region (including the business of aid) is such that it is a costly exercise. However, there are opportunities for donors to share resources (including information) and work strategically to achieve savings at a meaningful level. This may require **adjusting and aligning processes** in some areas (e.g. around design, reporting and M&E).

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### 4.3 REGIONAL VS NATIONAL STRATEGIES

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Adopting regional approaches to delivering services has been a long-held tenet of the way forward for Pacific regional integration and economic development. It forms an integral part of the Pacific Plan for Strengthening Regional Cooperation and Integration. In terms of overcoming the diseconomies of scale associated with Pacific island states, especially the microstates, centralisation of service provision (including service provision to the private sector) would appear to make a lot of sense. It is an approach that is attractive to donors as it reduces overheads and administrative costs to a degree. However, despite many years of attempting to deliver a range of services (including education, shipping, air transport, audit services, bulk procurement...) there has been very little done in terms of assessing the extent to which regional service providers have succeeded in delivering on their mandate. Research undertaken by this author and Dr Matthew Dornan of the Development Policy Centre during 2013 sought to rectify this deficit and established the following:

*The Pacific experience with pooling of services has been one of mixed fortunes. Of the 20 initiatives where pooling of services was a primary objective, 11 could be considered to have achieved some success. Eight initiatives were found primarily to be failures, and one could not be evaluated due to its recent establishment. Initiatives were assessed on the basis of whether pooling was effective; some initiatives that were failures in this respect were nevertheless successful examples of cooperation between states. It was clear that initiatives whose areas of focus are non-commercial have fared better than those that have ventured into commercial areas such as transportation services (e.g. Air Pacific and the Pacific Forum Line).<sup>9</sup>*

This is not to say that regional service delivery in the area of private sector support is never appropriate or successful. Indeed, **Pacific Islands Trade and Invest** was assessed to be one of the more successful 'pooling' activities that were examined.<sup>10</sup>

However, seeking to establish new forms of regional service delivery is something that should, in general, be approached with caution.

Due consideration should also be given to the potential for working at the **sub-regional** level which is where it is expected that future successes in sharing resources and delivering services are likely to be. The obstacles that exist to regional service provision may be more easily overcome when working at the subregional level. The **Melanesian Spearhead Group** has already commenced work on addressing a number of service provision needs collectively (shipping, tourism marketing, bulk procurement of pharmaceuticals) and has been explicit in its desire to work with the private sector in these areas.

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<sup>9</sup> Matthew Dornan and Tess Newton Cain (2013) 'Regional Service Delivery in the Pacific – Have Expectations Been Met', Devpolicy blog <http://devpolicy.org/regional-service-delivery-in-the-pacific-have-expectations-been-met/>.

<sup>10</sup> See, further, Matthew Dornan and Tess Newton Cain (2013) 'Regional Service Delivery among Small Island States of the Pacific: An Assessment', Asia and the Pacific Policy Studies (APPS) Working Paper Series 04/2013.