

# Trade and Private Sector Policy and Development

Support programmes financed  
by EU external assistance

November 2010



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## ACRONYMS

<b>ACAA</b>	Agreements of Conformity Assessment Acceptance
<b>ACP</b>	African, Caribbean and Pacific (States)
<b>ACTS</b>	ASEAN Customs Transit System
<b>ADB</b>	African Development Bank
<b>AEO</b>	Authorised Economic Operator
<b>AGOA</b>	Africa Growth and Opportunity Act
<b>APLAC</b>	Asia-Pacific Laboratories Accreditation Cooperation
<b>ASEAN</b>	Association of South-East Asian Nations
<b>ATC</b>	Agreement on Textiles and Clothing
<b>BDS</b>	Business Development Services
<b>BEST</b>	Business Environment Strategic Toolkit
<b>BGI</b>	Business Growth Initiative
<b>BIO</b>	Business Intermediary Organisation
<b>BIPM</b>	International Bureau of Weights and Measures
<b>CA</b>	Conformity Assessment
<b>CAB</b>	Conformity Assessment Body
<b>CAFTA</b>	Central America Free Trade Area
<b>CAU</b>	Competent Authority
<b>CEN</b>	European Committee for Standardisation
<b>CENELEC</b>	European Committee for Electro technical Standardisation
<b>CGAP</b>	Consultative Group to Assist the Poor
<b>CIPM</b>	International Committee on Weights and Measures
<b>CLAC</b>	Coordinadora Latinoamericana y del Caribe de Comercio Justo
<b>CLP</b>	European Regulation on <b>C</b> lassification, <b>L</b> abelling and <b>P</b> ackaging of chemical substances and mixtures
<b>COMESA</b>	Common Market for Eastern & Southern Africa
<b>CPD</b>	Continuous Professional Development
<b>CRS</b>	Creditor Reporting System
<b>CSR</b>	Corporate Social Responsibility
<b>CUB</b>	Berne Convention
<b>CUP</b>	Paris Convention
<b>DAC</b>	Development Assistance Committee
<b>DCED</b>	Donor Committee on Enterprise Development
<b>DC</b>	Developing Country
<b>DDA</b>	Doha Development Agenda
<b>DFID</b>	Department for International Development (UK)
<b>DP</b>	Development Partner

<b>DTIS</b>	Diagnostic Trade Integration Study
<b>EA</b>	European Cooperation for Accreditation
<b>EAC</b>	East African Community
<b>EBRD</b>	European Bank for Reconstruction and Development
<b>EC</b>	European Community
<b>ECOWAS</b>	Economic Community of West African States
<b>EDF</b>	European Development Fund
<b>EIB</b>	European Investment Bank
<b>EIF</b>	Enhanced Integrated Framework
<b>EPA</b>	Economic Partnership Agreement
<b>EPZ</b>	Export Processing Zones
<b>ETSI</b>	European Telecommunications Standards Institute
<b>EU</b>	European Union
<b>EUROMET</b>	European Collaboration on Measurement and Standards
<b>FAO</b>	Food and Agriculture Organisation
<b>FDI</b>	Foreign Direct Investment
<b>FEMIP</b>	Facility for Euro-Mediterranean Investment and Partnership
<b>FIAS</b>	Foreign Investment Advisory Service
<b>FLEGT</b>	Forest Law Enforcement, Governance and Trade
<b>FLO</b>	Fairtrade Labelling Organisation
<b>FSC</b>	Forestry Stewardship Council
<b>FTA</b>	Free Trade Agreement
<b>FVO</b>	Food and Veterinary Office
<b>GAP</b>	Good Agricultural Practice
<b>GATS</b>	General Agreement on Trade in Services
<b>GATT</b>	General Agreement on Tariffs and Trade
<b>GHG</b>	Greenhouse Gas
<b>GHS</b>	Globally Harmonized System
<b>GSP</b>	General System of Preferences
<b>GTZ</b>	Gesellschaft für Technische Zusammenarbeit (German Technical Cooperation)
<b>HACCP</b>	Hazard Analysis and Critical Control Points
<b>HRD</b>	Human Resource Development
<b>HS</b>	Harmonised System (WCO Convention)
<b>IAAC</b>	Inter-American Accreditation Cooperation
<b>IAF</b>	International Accreditation Forum
<b>IAMS</b>	Inter-American Metrology System
<b>ICT</b>	Information and Communication Technology
<b>IEC</b>	International Electro-technical Commission

<b>IFAT-LA</b>	Asociación Internacional de Comercio Justo Latino America
<b>IFC</b>	International Finance Corporation
<b>IIA</b>	International Investment Agreement
<b>ILAC</b>	International Laboratory Accreditation Cooperation
<b>ILO</b>	International Labour Organisation
<b>IPA</b>	Investment Promotion Agency
<b>IPD</b>	Innovative Partnerships for Development
<b>IPPC</b>	International Plant Protection Convention
<b>IRU</b>	International Road Transport Union
<b>ISO</b>	International Organisation for Standardisation
<b>ITC</b>	International Trade Centre
<b>ITTU</b>	Intermediate Technology Transfer Units
<b>ITU</b>	International Telecommunications Union
<b>LDC</b>	Least Developed Country
<b>LGU</b>	Local Government Unit
<b>LRED</b>	Local and Regional Economic Development
<b>MATRI</b>	Market Access Trade Restrictiveness Index
<b>MDG</b>	Millennium Development Goal
<b>MENAMET</b>	Middle East North-African Cooperation in Metrology
<b>MERCOSUR</b>	Southern Cone Common Market
<b>MES</b>	Minimum Efficient Scale of production
<b>MFA</b>	Multi-Fibre Arrangement
<b>MFI</b>	Micro Finance Institution
<b>MIGA</b>	Multilateral Investment Guarantee Agency
<b>MNC</b>	Multinational Corporation
<b>MRA</b>	Mutual Recognition Agreement
<b>MSE</b>	Micro and Small-scale Enterprise
<b>MSME</b>	Micro, Small and Medium-Sized Enterprise
<b>NAFTA</b>	North American Free Trade Agreement
<b>NAP</b>	Network of Asian Producers
<b>NCTS</b>	New Computerised Transit System
<b>NGO</b>	Non-Governmental Organisation
<b>NSA</b>	Non-State Actor
<b>NTB</b>	Non-Tariff Barrier to trade
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>OIE</b>	Office International des Epizooties (World Organisation for Animal Health)
<b>OIML</b>	International Organization of Legal Metrology
<b>PACA</b>	Participatory Appraisal of Competitive Advantage



<b>PCA</b>	Post-Clearance Audit
<b>PFI</b>	Policy Framework for Investment
<b>PPP</b>	Public-Private Partnership
<b>PSDP</b>	Private Sector Development Programme
<b>PSI</b>	Pre-Shipment Inspection
<b>PSIA</b>	Poverty and Social Impact Analysis
<b>PSSP</b>	Private Sector Support Programme
<b>Q&amp;CS</b>	Quality and Conformity System
<b>QI</b>	Quality Infrastructure
<b>RAPEX</b>	Rapid Alert System for Non-Food Products
<b>REACH</b>	Registration, Evaluation, Authorisation and Restriction of Chemicals
<b>RKC</b>	Revised Kyoto Convention
<b>RSP</b>	Regional Support Programme
<b>SACU</b>	Southern African Customs Union
<b>SADCA</b>	Southern African Development Community Accreditation
<b>SADCMET</b>	Southern African Development Community Cooperation in Measurement Traceability
<b>SAFE</b>	Framework of Standards to Secure and Facilitate Global Trade
<b>SCP</b>	Sustainable Consumption and Production
<b>SDC</b>	Swiss Agency for Development and Cooperation
<b>SEDO</b>	Small Enterprise Development Organisation
<b>SDF</b>	Social Development Fund
<b>SIA</b>	Sustainability Impact Assessment
<b>SME</b>	Small and Medium-Scale Enterprise
<b>SPS</b>	Sanitary and Phytosanitary Measures
<b>STDF</b>	Standards and Trade Development Facility
<b>TA</b>	Technical Assistance
<b>TAAG</b>	Trade-At-A-Glance
<b>TAXUD</b>	European Commission DG Taxation and Customs Union
<b>TBT</b>	Technical Barrier to Trade
<b>TPSPD</b>	Trade and Private Sector Policy and Development
<b>TF</b>	Trade Facilitation
<b>TFP</b>	Total Factor Productivity
<b>TIR</b>	Transit International Routier
<b>TPR</b>	Trade Policy Review
<b>TPRB</b>	Trade Policy Review Body
<b>TRIMS</b>	Trade-related Investment Measures
<b>TRIST</b>	Tariff Reform Impact Simulation Tool
<b>TVET</b>	Technical-Vocational Education and Training

<b>UN/ CEFAC</b>	United Nations Centre for Trade Facilitation and Electronic Business
<b>UNCTAD</b>	United Nations Conference on Trade and Development
<b>UNDP</b>	United Nations Development Programme
<b>UNECE</b>	United Nations Economic Commission for Europe
<b>UNEP</b>	United Nations Environment Programme
<b>UNESCO</b>	United Nation Educational Scientific & Cultural Organisation
<b>UNIDO</b>	United Nations Industrial Development Organisation
<b>UPOV</b>	Union for the Protection of new Varieties of Plants
<b>USAID</b>	United States Agency for International Development
<b>VCA</b>	Value Chain Analysis
<b>WIPO</b>	World Intellectual Property Organization
<b>WCO</b>	World Customs Organization
<b>WFTO</b>	World Fair Trade Organization
<b>WHO</b>	World Health Organization
<b>WTO</b>	World Trade Organization

## **PART I.**

# **GENERAL INTRODUCTION TO EU TRADE AND PRIVATE SECTOR POLICY AND DEVELOPMENT**

## FOREWORD

This reference document relates to support programmes financed by EU external assistance in the areas of Trade and Private Sector Policy and Development (TPSPD) and replaces the 2003 Guidelines for EC Trade Related Assistance and the 2003 Guidelines for EC Support to Private Sector Development. The document aims to take into account relevant developments which took place since, both at policy level and in terms of approaches and practices in relation to support programmes in these areas. In particular, it takes into account the global Aid for Trade initiative launched in 2005 and the resulting EU Strategy for the implementation of Aid for Trade adopted in October 2007, as well as the general initiatives to improve the effectiveness of aid and donor coordination: the Paris Declaration on Aid Effectiveness (2005) and the subsequent Accra Agenda for Action (2009).

The document is aimed at all those involved in developing, implementing and monitoring such EU support programmes, in particular the Commission's cooperation sections in the Delegations of the European External Action Service in the recipient countries, as well as the Commission's services in Headquarters. It seeks to enhance the Commission's capacity and effectiveness in designing and implementing TPSPD programmes and projects. The document is therefore of an operational nature.

One of its specific features is that it covers both trade-related assistance and private sector development, as being intrinsically linked areas of intervention, both from the enterprise and policy perspectives, as also recognised and underlined by the Aid for Trade initiative and the EU Aid for Trade strategy.

While the document frequently refers to regional integration, it does not pretend to deal with regional integration in depth. A separate reference document, to be published in 2011, will analyse more in depth concepts and approaches for support to regional economic integration.

In a similar way, this reference document addresses succinctly microfinance issues, but it refers to the 2008 Guidelines for EC Support to Microfinance for a more elaborated guidance.

Throughout this document, reference is made to publications and studies issued both by EU institutions and other development agencies and donors, for more in depth analysis of specific topics. Complementary documents will be published on EuropeAid's website, in particular to update readers with new policy documents.

This document is composed of two parts:

- **Part I** gives the context for the TPSPD areas, summarises the importance of TPSPD together with its linkages to broader aspects of development cooperation and wider external assistance, including the one provided to the so-called Neighbourhood countries (Southern-Mediterranean and Eastern Europe). This Part covers the relationship between TPSPD and EU development cooperation and other external policies; an overview of Aid for Trade; the principles and arrangements contained in the Paris Declaration and Accra Action Agenda on Aid Effectiveness; aid delivery methods; cross-cutting issues (governance, gender, decent work, environment); an introduction to the thematic reviews developed in Part II of the document and some of the links between them.
- **Part II** contains ten specific thematic reviews dealing with all the major themes covered by TPSPD. Each thematic review can be read in isolation and is designed to give the user an introduction to the topic, explaining
  - What the theme covers (definition, terminology, concepts; rationale for intervention in the specific area; legal and regulatory framework, both at the international and country level; key issues and key actors).
  - What can be done through support programmes (problem identification and diagnostic tools; broad areas of intervention).
  - How it can be done (methods and levels of intervention, sequencing of activities, expected results and result measurement, cross cutting issues, risks).
  - Bibliography and pointers as to where more in-depth information can be obtained.

This reference document was prepared by the Unit Private Sector Development, Trade and Regional Integration of DG EuropeAid of the European Commission. Initial contributions from external experts and staff were further developed, structured and tailored by the following persons: Jan ten Bloemendal, Thaïs Leray, Alessandra Lustrati, Sonia Pagliaro and Stefaan Pauwels.

The consultation with line DGs of the Commission provided valuable inputs to the final version of this document. Modifications and adaptations will be made when necessary. Comments, questions and suggestions are welcome and can be sent to EuropeAid at the following email address: [Europeaid-C4-1@ec.europa.eu](mailto:Europeaid-C4-1@ec.europa.eu)

# 1. The overall context

## 1.1 Private sector, trade and development

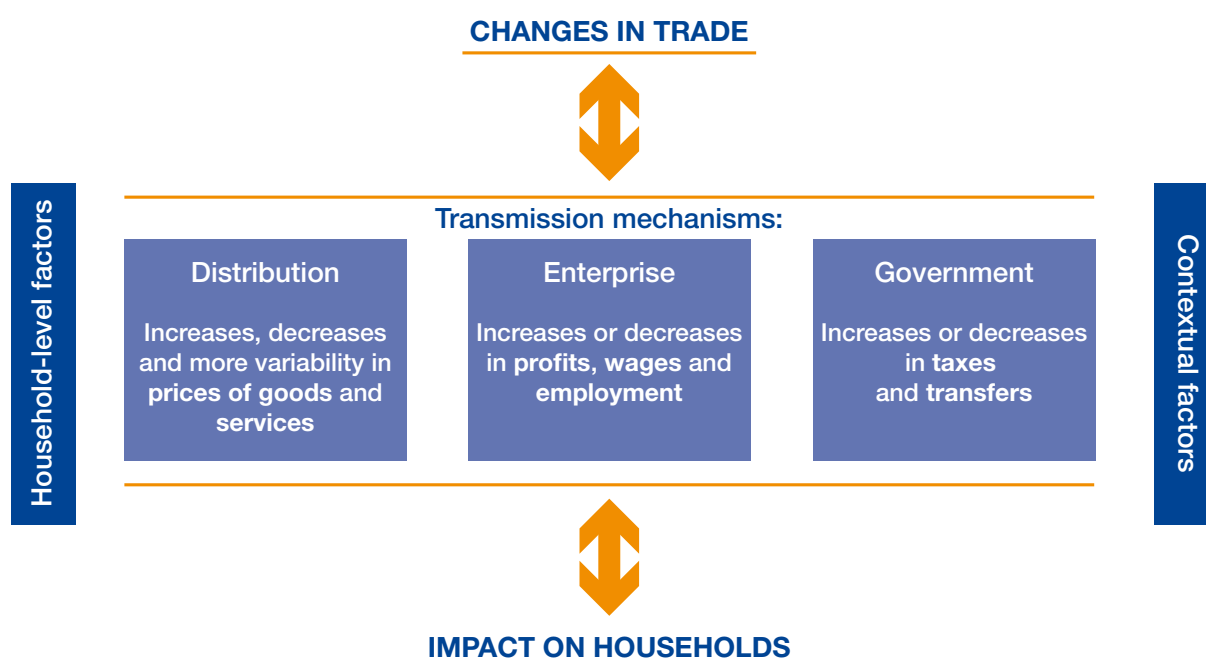
The importance of private sector and trade for development is widely recognised. No sustainable development could take place without participation of developing countries to international trade and without appropriate growth of their economies. Growth is essential for a sustainable generation of public revenues needed to implement policies and deliver services to the citizens, as well as for private income for a wide range of actors and groups in society. This is more likely to happen if the pace and pattern of growth are sufficiently inclusive.

Poverty reduction cannot sustainably be generated by public actors only. It requires a key role of the private sector which in all developed countries is a major source of prosperity. Market-based approaches to poverty reduction are gaining growing interest from the private sector, the developing countries and donors. Public intervention can only be a part of the solutions for the multiple problems with which developing countries and their populations have to cope. Donors, including the European Union, are also looking for engaging better with the private sector in development, as several decades of development aid did not bring about the expected results in terms of sustainable development. It is about ways of engaging with the private sector which can leverage its potential contribution towards development objectives, not only in economic terms, but also in social and environmental terms. Moreover, a greater role for private sector in development would seem necessary from an overall governance perspective: a stronger and diversified private sector can help strengthen the civil society, thanks to its potential impact in terms of capacity building and empowerment, on income generation and on wider access to education and employment for larger strata of populations. This contributes to the development of more balanced socio-economic and political capacities of different social groupings in the countries. All these are key components for sustainable development.

Economic growth may lead to poverty reduction through its effect of job creation and improved wealth. However, the effective poverty reduction impact of economic growth depends on the pattern of growth and the distribution of income. Some countries have very unequal income distribution and an economic growth relying on unsustainable patterns of consumption of natural resources, or with unmitigated negative impacts on human health and the social tissue. Therefore, in order to make growth sustainable and inclusive, policies for stimulating economic growth need to be accompanied by policies pursuing social and public service delivery across the country, avoiding or reducing too large inequalities in distribution of revenue, and ensuring sustainable patterns of production and consumption and the mitigation of negative environmental or other impacts of economic activities.

A further issue relates to the importance of trade for economic growth. There is a growing recognition of the positive correlation between trade openness and economic growth. This is particularly relevant for developing countries, where domestic purchasing power is very limited. The transmission mechanism of trade openness to poverty reduction is mainly through the beneficial effects for enterprises and households.

Figure 1 shows how trade impacts on households through three different transmission mechanisms: through distribution channels, at the enterprise level and through government. At the distribution level, households will feel the impact through changes in prices of goods and services and a wider consumer choice. At the enterprise level, more trade openness will lead to improved resource allocation, changes in profits (experienced by the owners) and in wages and employment levels (experienced by the employees). At the government level there will be increases or decreases in taxes and other transfers.

**Figure 1. Mechanisms transmitting changes in trade to households**

*Adapted from Higgins K. & Prowes S., "Trade, growth and poverty: making Aid for Trade work for inclusive growth and poverty reduction", ODI Working Paper n. 313, Feb 2010*

Trade and investment linkages with other countries also open up avenues for introduction of new technologies and more competitive working systems. The impressive record of an increasing number of developing countries, particularly in Asia, bears witness to this. However, there are many countries, especially the poorest and smallest, particularly in Africa, that have achieved only modest development progress in recent years.

Trade openness is however not sufficient in itself. In particular, trade liberalisation will inevitably create 'winners' and 'losers' in a country: it will benefit some enterprises or even sectors while in the short term adversely affecting others. This will therefore affect the short term poverty reduction impact of trade and may lead to maintaining or even increasing existing inequalities. Furthermore the resilience of many developing countries is insufficient because of the lack of a diversified economy. Without the appropriate framework, trade openness may also lead to overexploitation of natural resources and to negative impacts on the environment and human health affecting the short term and long term poverty reduction impact of trade. Furthermore, there are many constraints in developing countries that limit the potential benefits of trade openness. These include supply-side constraints, resource (human and financial) constraints, inappropriate trade and investment policies and inadequate infrastructure. Finally, the benefits of trade reform are more-over often longer term.

Full integration into the world economy requires thus a successful and inclusive growth and development pattern, going clearly beyond creating more trade openness. Appropriate and properly sequenced complementary policies are required to mitigate negative effects and help maximise the longer term positive effects. And trade and economic development policies are needed to improve a country's competitiveness. Improving the performance of developing countries remains therefore a significant challenge. Assistance in these areas by donors may range from support for building productive capacities, including support for inclusive business projects which draw upon the capacities of the poorest sections of developing communities, through provision of finance, improved supply of business development services and development of new markets (national, regional and international), to technical assistance for trade and investment policy formulation, negotiation and implementation.

Diversification of the economy and the development of a stronger internal demand will allow a country not to be over-dependent on export of one or very few commodities and its economy to become more resilient. Donor support can help with that.

## 1.2 The informal economy

Effective and sustainable pro-poor growth also requires taking into account the informal economy and reducing it through progressive formalisation. Enterprises of the informal sector are those which are not recognised

or recorded by public authorities, as they do not comply with all the regulations that apply (registration, tax payment, labour law or licenses). In addition, they operate with almost no workers' protection. However, their role is not marginal or peripheral in developing countries' economies: statistics published by the ILO and the World Bank<sup>1</sup> indicate that this sector accounts for over 90% of the new jobs that are created in Africa. It cannot be confined to marginal activities, as it includes also gainful enterprises and over the last two decades it has become clear that the informal economy has a significant potential in terms of jobs and income generation. Furthermore, the activity of informal enterprises helps to meet the needs of poor consumers as they often provide cheaper goods and services.

As a result, it may be appropriate for a developing country to implement policy frameworks and strategies focusing at the informal economy on the short term; at the same time, but on the medium to long term, these countries should plan and implement strategies to ensure graduation from the informal to the formal sector.

Incentives to formalisation of enterprises should be studied on a country by country basis, but there are some common features on the business environment that should be considered by governments wishing to stimulate legal recognition and empowerment through compliance:

- Reduction of the regulatory and administrative barriers to registration (i.e. number, complexity and cost of business licenses, permits, approvals).
- Reduction of the regulatory and administrative fiscal requirements.
- Facilitation of access to property rights.
- Promotion of business linkages with formal enterprises (including through subcontracting within the framework of larger value chains).
- Incentives to scaling-up operations, i.e. support to cooperatives, clusters, other groups of micro-enterprises.
- Increase the capacity of the public sector (at national and local level) to understand and support informal enterprises in their efforts to upgrade to the formal sector.

Many donors and multilateral agencies provide support through projects dealing with the informal sector, as it represents the part of the economy from which the largest and poorest part of population get their living. Technical cooperation could support governments in their efforts to help implement their strategies to facilitate access to formal economy for informal enterprises, thus enlarging the tax base (leading to more even distribution of tax burden) and improving the status of their workers.

1 SIDA/World Bank "Fact finding study: The Informal Economy" 3/2004

## 2. Trade and private sector in the overall context of EU external policies

EU support related to TPSPD in third countries is embedded in the wider objectives of EU external policies, in particular:

- **Development Policy**, which aims at the sustainable economic, environmental and social development of developing countries, as well as their smooth and gradual integration into the world economy.
- **Neighbourhood policy**, with the objective of offering EU neighbour countries a privileged relationship through stronger political association and deeper economic integration, increased mobility and more people-to-people contacts, building upon a mutual commitment to common values (democracy and human rights, rule of law, good governance, market economy principles and sustainable development) and going beyond existing relationships.
- **Trade Policy**, with the integration of developing countries into the world economy and the multilateral trading system as one of its priority objectives. Unlike most other areas, where competence is shared between the EU and its Member States, trade policy is an EU exclusive competence.
- **Foreign and Security Policy**, which is centred on the promotion of stability, peace and security, consolidation of democracy and the rule of law, and human rights and fundamental freedoms.

The following sections briefly examine the more specific TPSPD relevant framework thus set by the first three policies.

### 2.1 Development policy

Development is at the heart of the overall EU's external action. The primary and overarching objective of EU development policy is the reduction of poverty through sustainable development, including the achievement of the Millennium Development Goals (MDGs)<sup>2</sup>. Support in the field of TPSPD relates to the achievement of both the first MDG (eradication of hunger and poverty) and the eight MDG (global partnership for development). The first MDG includes amongst its sub-targets the one to achieve full and productive employment and decent work for all, including women and young people. Amongst the sub-targets of the eight MDG figure the one to develop an open, rule-based, predictable, non-discriminatory trading and financial system as well as the one

to make available, in cooperation with the private sector, benefits of new technologies, especially information and communications.

The framework for overall EU action in the field of development is contained in the **European Consensus on Development**<sup>3</sup>, signed on 20 December 2005, whereby EU Member States, the Council, the European Parliament and the Commission agreed to a common EU vision of development. This Consensus represents a policy statement that reflects the EU's willingness to eradicate poverty and build a more stable and equitable world. The Consensus identifies shared values, goals, principles and commitments which the European Commission and EU Member States are to implement in their development policies. The Consensus states that the Community will be active in nine main areas of which the first is trade and regional integration (paras 72-74).

At the time of publication of this reference document, the Commission has launched a public consultation on future development policy by publishing a green paper which aims to explore how development policy could better contribute to inclusive and sustainable growth.

During the period covered by the ongoing (EU) multiannual financial framework (2007-2013), the legal basis for the funding and implementation of development actions by the EU is provided by two instruments:

- The **Development Co-operation Instrument** (DCI), adopted in January 2007, replacing a wide range of geographic and thematic instruments. The DCI became the legal basis for EU development co-operation in Latin America, Asia and Central Asia, the Gulf region (Iran, Iraq and Yemen) and South Africa and also for some specific sector specific programmes which cover specific groups of developing countries, including some ACP countries (such as relating to the sugar and banana sectors)<sup>4</sup>.
- The **ACP-EU Partnership Agreement**<sup>5</sup> (the "Cotonou Agreement") signed in 2000 and concluded for a period of 20 years, governing the overall EU's relations with the ACP countries. The overseas countries and territories<sup>6</sup> (OCTs) continue to be associated with the EU through successive Association decisions of the Council. At present, 78 ACP countries are signatories to the Cotonou Agreement (48 African states, covering all of sub-Saharan Africa, 15 states in the Caribbean and 15 states in the Pacific). Out of

<sup>2</sup> [www.un.org/millenniumgoals](http://www.un.org/millenniumgoals)

<sup>3</sup> The European Consensus on Development (2006/C 46/01); [http://ec.europa.eu/development/policies/consensus\\_en.cfm](http://ec.europa.eu/development/policies/consensus_en.cfm)

<sup>4</sup> In addition to the described geographic coverage, the DCI provides the framework for two other types of initiatives: the thematic programmes benefiting all developing countries (investing in people; environment and sustainable management of natural resources including energy; non-state actors and local authorities in development; food security; migration and asylum) and the accompanying measures for the 18 African, Caribbean and Pacific (ACP) Sugar Protocol countries, in order to help them adjust following the reform of the EU sugar regime.

<sup>5</sup> [http://ec.europa.eu/development/geographical/cotonouintro\\_en.cfm?](http://ec.europa.eu/development/geographical/cotonouintro_en.cfm?)

<sup>6</sup> [http://ec.europa.eu/development/geographical/regionscountries/regionscountriesocts\\_en.cfm?](http://ec.europa.eu/development/geographical/regionscountries/regionscountriesocts_en.cfm?)



the 49 least developed countries<sup>7</sup> at end of 2010 (also covered by the EU's Everything But Arms<sup>8</sup> initiative), 40 are ACP countries.

Though South Africa is also a signatory to the Cotonou Agreement, its membership of the ACP Group is qualified<sup>9</sup>.

The Cotonou Agreement sets the priorities of EU support to ACP countries in the areas of trade and regional integration. The trade chapter of the Agreement reflects the new trade relationship and the expiry of preferences, contained in the Agreement, at the end of 2007. Indeed, whereas the trade relations between the EU and ACP had previously been primarily based on non-reciprocal trade preferences granted by the EU to ACP exports, the Cotonou agreement provides the entering into Economic Partnership Agreements (EPAs), which are to be WTO-compatible trading arrangements, progressively removing barriers to trade between them and enhancing cooperation in all areas related to trade. It reaffirms the role of these Agreements to boost economic development and integration into the world economy and underlines the importance of trade adaptation strategies and aid for trade. EPAs are negotiated with ACP regions engaged in a regional economic integration process and intended to consolidate such regional integration initiatives, while fostering the gradual integration of the ACP countries into the global economy. The negotiations have so far led to the conclusion of a full EPA with the Caribbean region. Those in the other regions have led to the conclusion of a number of interim agreements, while those for comprehensive EPAs are still going on.<sup>10</sup> Like the Cotonou agreement, the EPAs refer to a range of economic areas for cooperation between the parties.

With its Communication "Policy Coherence for Development—Establishing the policy framework for a whole-of-the-Union approach" (2009)<sup>11</sup>, the EU further confirmed its engagement to contribute to the sustainable development of developing countries' progress towards the MDGs. The aim is to maximise the positive impact of these policies on partner countries and to avoid or reduce incoherence. Policy coherence requires that the EU takes account of the objectives of development cooperation in all external and internal policies that it implements which are likely to affect developing countries, and that these policies support development objectives.

## 2.2 Neighbourhood policy

The **European Neighbourhood Policy**<sup>12</sup> (ENP) was first outlined in a Commission Communication on Wider Europe published in May 2004<sup>13</sup>. The objective of the ENP is to share the benefits of the EU's enlargement

with neighbouring countries in strengthening stability, security and well-being and to establish a corresponding strategic partnership with the Russian Federation. It is designed to prevent the emergence of new dividing lines between the enlarged EU and its neighbours and to offer them the chance to participate in various EU activities, through greater political, security, economic and cultural cooperation. Building upon a mutual commitment to common values (democracy and human rights, rule of law, good governance, market economy principles and sustainable development), it proposes a privileged relationship defining, together with partner countries, a set of priorities whose fulfilment will bring them closer to the European Union.

The ensuing bilateral ENP Action Plans draw on a common set of principles - in particular to align on EU rules and systems - but differ according to the existing state of relations with each country, its needs and capacities, as well as common interest. The level of ambition of the relationship depends on the extent to which these values are effectively shared.

In particular, through the Neighbourhood relationship, the EU offers economic integration with its own Internal Market, through the establishment of Deep and Comprehensive Free Trade Areas (DCFTAs). Going beyond a simple tariff dismantling, they also cover market access in services, investment, public procurement and many other sectors, choosing approximation to EU law as a privileged tool in areas where this can lead to increased trade.

All partner countries with Action Plans have subscribed to this approach. It should be noted that the ENP does not seek to export the EU *acquis* wholesale. However, with only a few regulatory models in the globalised world, the EU model tends to be attractive, reducing the 'invention cost' of political and economic reform. Many partners have thus adopted a broad-ranged approach to convergence with EU policies and regulatory standards.

For the southern neighbourhood countries, the Euro-Mediterranean Charter for Enterprise serves as a reference text for the co-ordination and definition of technical assistance to the private sector at regional, sub-regional and national levels. It contains common principles on which the Mediterranean partners can base enterprise policy to create an environment conducive to investment and private sector development.<sup>14</sup>

The legal basis for the funding and implementation of actions by the EU within the framework of the European Neighbourhood Policy and the Strategic Partnership with the Russian Federation is the European Neighbourhood and Partnership Instrument (ENPI).

7 [www.un.org/special-rep/ohrls/ldc/list.htm](http://www.un.org/special-rep/ohrls/ldc/list.htm)

8 <http://ec.europa.eu/trade/wider-agenda/development/generalised-system-of-preferences/everything-but-arms/>

9 The provisions of the bilateral Agreement on Trade, Development and Cooperation between the European Union, its Member States and South Africa signed in 1999, take precedence over the provisions of the Cotonou Agreement.

10 <http://ec.europa.eu/trade/wider-agenda/development/economic-partnerships/negotiations/>

11 [http://ec.europa.eu/development/policies/policy\\_coherence\\_en.cfm](http://ec.europa.eu/development/policies/policy_coherence_en.cfm)

12 [http://ec.europa.eu/world/enp/welcome\\_en.htm](http://ec.europa.eu/world/enp/welcome_en.htm)

13 Wider Europe—Neighbourhood: A New Framework for Relations with our Eastern and Southern Neighbours, 2003. See also the Communication from the Commission COM(2004) 373 final: European Neighbourhood policy – Strategy Paper.

14 [http://ec.europa.eu/enterprise/policies/international/files/euomedcharter1949\\_en.pdf](http://ec.europa.eu/enterprise/policies/international/files/euomedcharter1949_en.pdf). Progress on the implementation of the Charter is also monitored using 77 indicators. The latest evaluation report is available under [http://ec.europa.eu/enterprise/policies/international/files/2008\\_report\\_charter\\_en.pdf](http://ec.europa.eu/enterprise/policies/international/files/2008_report_charter_en.pdf)

## 2.3 Trade policy

Through a wide range of measures and policy initiatives, the EU supports the gradual integration of developing countries into the world economy and the open, rules-based multilateral trading system and ensures that its trade policy is placed at the service of development. In this connection, and as mentioned above, coherence between European trade and development policies is a standing commitment under the Policy Coherence for Development (PCD) agenda.

In trade negotiations - both multilateral and bilateral - the EU objective is to promote partners' development by weighting their particular needs and situations carefully, and tailoring policies, rules and expectations to reflect their different vulnerabilities - and different potential strengths. Thus, in the WTO's Doha Development Agenda (DDA), for example, the EU has supported well-designed 'special and differential treatment' to ensure that trade opening and rules commitments reflect the development level and capacities of individual countries. The Economic Partnership Agreements (EPA) and other FTAs are also customized to reflect regional and country-specific development needs.

It is to be noted that such country- or region-specific development processes (there is no one-size-fits-all magic formula) usually involve gradual liberalisation (of both goods and services) to facilitate integration into global markets, but not necessarily rapid deregulation. Indeed, how to regulate domestic markets is a prerogative of individual governments and international trade rules allow individual countries considerable latitude to do so in the way they choose.

Through its trade policy the EU aims to ensure that developing countries are able to benefit from access to its own markets and from the openness of the global economy:

- The EU's **Generalised System of Preferences** (GSP) is a unilateral trade arrangement through which the EU provides preferential access to the EU market to 176 developing countries and territories, in the form of eliminated or significantly reduced tariffs for their goods. There is no expectation or requirement that this market access be reciprocated.
- The **GSP+** programme offers additional tariff reductions on top of the general GSP to selected developing countries (some 15 countries) that are vulnerable and have ratified and are implementing specified international standards in the field of human rights, core labour standards labour as well as environmental standards and good governance principles.
- Under the **Everything But Arms system** (EBA), a specific GSP arrangement for LDCs established in 2001, all LDCs enjoy permanent duty free and quota free access to the EU market.

- Rules of Origin are the rules that dictate how much of a product must originate from a country in order to qualify for preferential tariff rates on entering the EU. This is an important issue in a world where the production chain is fragmented over many countries. It is part of EU trade policy to make sure that our 'rules of origin' do not take away with one hand what we are giving with the other, whilst at the same time ensuring that the system is not open to abuse - that goods from one country are not just re-packaged as coming from another to exploit tariff benefits. In the context of the EPAs, Rules of Origin are negotiated individually for each EPA which encourages intra-regional processing trade: e.g. Caribbean bakers can source goods like flour from around the region and still export at preferential rates to the EU; Pacific fish processors can source fish from the whole Pacific region.
- As a result of the various arrangements, the EU has the most open market in the world for developing countries. It imports more goods from developing countries than any other market. The EU is also the biggest market for developing world agricultural exports; almost 70% of all agricultural imports into the EU come from developing countries - more than \$ 100 bio in 2008. The EU imports more agricultural products from developing countries than the US and all other developed countries combined.
- 98% of exports from African, Caribbean and Pacific (ACP) developing countries entered the EU duty and quota-free in 2008. The EPAs are to eliminate all duties and quotas for all ACP exports to the EU - whether the country is a Least Developed Country (LDC) or not.

However, trade preferences are slowly being eroded by the fact that customs tariffs that are applied to *other* countries also tend to decrease as a result of multilateral or bilateral trade liberalisation. To offset this process, the EU is pursuing several avenues, in particular better integration of developing country markets (regional integration, as in the case of EPAs), encouragement of other developed countries to match the openness of the EU and promotion of South-South trade (in particular the opening up of emerging markets to imports from the poorest economies).

South-South trade is much more affected by trade barriers than South-North or North-North trade. It is estimated that over 60% of customs taxes paid in the world are paid by developing countries to other developing countries. Progressive trade opening amongst developing countries themselves is therefore as important for development as access to the markets of the North. This is why, in the context of the DDA, the EU is promoting better access for poor countries to emerging markets, such as China, India or Brazil, whilst encouraging regional integration in the developing world.

### 3. Specific policies related to trade and private sector development in developing countries

#### 3.1 Aid for Trade

##### 3.1.1 The global Aid for Trade initiative

The 2005 World Trade Organisation (WTO) Ministerial Meeting in Hong Kong put the spotlight on the “Aid for Trade” (AfT) initiative, which constitutes a complementary though separate initiative to the international trade negotiations Doha Development Agenda. AfT aims to broaden the scope of assistance directed towards trade, encompassing a wider range of activities than the ones covered by Trade Related Assistance (i.e. Trade Policy and Regulations and Trade development). The key point was to include supply-side capacity, trade-related infrastructure and trade related adjustment issues in the overall approach to strengthen productive and trade capacities of the developing countries.

The initiative aims at improving quantity and quality of Aid for Trade with a view to allow developing countries to more easily access the benefits of the WTO Agreements and expand their productive sectors and hence ability to trade. As a consequence of the greater attention brought by the initiative to these issues, donors and multilateral agencies (including WTO and OECD) have increased their policy focus and funding in the areas concerned. The initiative aims to support a better framing of donor support, including an improved specific framework for monitoring, which constitutes the main new element of the AfT initiative, in addition to the broadening of scope of what is to be seen as trade related assistance. The framework under which existing and new ODA is monitored divides the AfT into the categories set out in Box 1.

#### Box 1. Which programmes fall under the Aid for Trade initiative? The Aid for Trade categories.

The Aid for Trade Task Force report of 2006 stated that *‘Projects and programmes should be considered as Aid for Trade if these activities have been identified as trade-related development priorities in the recipient country’s national development strategies’*. It specified the six groups of activities set out below as trade related. Categories 1, 2 and 6 correspond to ‘classical’ ‘trade-related assistance’ (TRA). Together, TRA and the newly added categories are usually referred to together as *‘the wider Aid for Trade agenda’*. (It should be noted that Category 2 is in fact a subcategory of Category 4 and only used for ensuring the link between past (Doha Database) and present reporting system (OECD CRS). It is not relevant for operational purposes.)

To increase transparency, the OECD has sought to streamline reporting on the AfT categories identified by the Task Force. In particular, it has endeavoured to link each AfT category to one or more specific codes in the general OECD Creditor Reporting System, to which donors report on overall ODA.

**Category 1 — Trade policy and regulations:** trade policy and planning, trade facilitation, regional trade agreements, multilateral trade negotiations, multi-sector wholesale/retail trade and trade promotion. This category also includes training of trade officials, analysis of proposals and positions and their impact, support for national stakeholders to articulate commercial interests and identify trade-offs, dispute issues, and institutional and technical support to facilitate implementation of trade agreements and to adapt to and comply with rules and standards.

**Category 2 — Trade development:** includes all support aimed at stimulating trade by domestic firms and encourage investment in trade-oriented industries, such as trade-related business development and activities aimed at improving the business climate, privatisation, assistance to banking and financial services, agriculture, forestry, fishing, industry, mineral resources and mining, tourism. This Category is the trade-related subset of Category 4 (which includes all building productive capacity of a trade-related *and* non-trade-related nature - see below).

**Category 3 — Trade-related infrastructure:** economic infrastructure including transport and storage, communications, and energy generation and supply.

**Category 4 – Building productive capacity:** includes business development and activities aimed at improving the business climate, privatisation, assistance to banking and financial services, agriculture, forestry, fishing, industry, mineral resources and mining, tourism. Includes trade- and non-trade-related capacity building.

**Category 5 – Trade-related adjustment:** This category led to the adoption of a separate code by OECD/DAC at the end of 2007. It covers contributions to the government budget to assist with the implementation of recipients' own trade reforms and adjustments to trade policy measures taken by or agreed with other countries; and assistance to manage balance of payments shortfalls due to changes in the world trading environment.

**Category 6 – Other trade-related needs:** refers to programmes supporting trade in sectors not comprised in the other five categories, such as vocational training or public sector policy programmes. Is also used to report on larger cross-sectoral programmes with important subcomponents in the other AfT categories. This is useful, as the CRS methodology requires the use of one single CRS code per reported programme, an approximation which limits in some cases the ability of the CRS to capture TRA.

At the global level, donors and recipient countries participate every couple of years to a Global Review of AfT, with the objective of reporting on advancements in terms of increased quantity and quality of Aid for Trade<sup>15</sup>. In that framework, they complete specific questionnaires which aim to better assess quality aspects of the assistance needed and that provided. The OECD secretariat assists the WTO by taking care of the analytical part of this global monitoring. The global reviews are supported by a joint WTO/OECD publication on "Aid for Trade at a Glance", which provides all the data and main updates challenges of the initiative. Other events are also organised regularly by WTO and OECD at the global and regional levels, as well as technical meetings with donors and partner countries on specific topics. These technical meetings aim at strengthening the common approaches and to improve quality of Aid for Trade.<sup>16</sup>

As for the quality dimension of Aid for Trade, the building of capacities is key but also an enormous challenge. This is so for building both public and private sector capacities. The building of productive capacities in particular requires action in relation to multiple facets, both for industrial and services productive capacities. The challenges in relation to the agricultural sector are even greater, due to the climate related specificities of this sector, to the predominance of family farming and the fact that smallholders generally follow a mix of social and economic logics.

### 3.1.2 The Enhanced Integrated Framework for Least Developed Countries<sup>17</sup>

The Integrated Framework was originally set up in 1997 at the WTO and subsequently reviewed from 2005, carrying greater momentum in connection with the launch of the Aid for Trade Initiative. Renamed the "Enhanced Integrated Framework" (EIF), this Aid for Trade partnership involving LDCs, donors and international organizations, supports

LDCs to be more active players in the global trading system by helping them tackle obstacles to trade. EIF activities are financed through the EIF multi-donor Trust Fund.

There are two funding mechanisms for the EIF Trust Fund: Tier 1 and Tier 2. Projects under Tier 1 fund "Diagnostic Trade Integration Studies" (DTIS, a standard framework for comprehensive trade needs assessments in LDCs) and DTIS updates; and support to increased institutional and management capacity of LDCs to formulate and implement trade-related strategies and implementation plans. Projects under Tier 2 fund more specific sector activities to build up trade-related and supply-side capacities.

The EIF governance structure includes at the global level a Board, the EIF decision making body, composed of three donors, three LDC representatives and the main international agencies in this area; a Steering Committee, which meets once per year; an Executive Secretariat, an independent entity housed in the WTO; and the Trust Fund Manager, a role taken up by the United Nations Office for Project Services (UNOPS). Striving to bring additional financial resources to match LDCs' demand, this Geneva-based multi-donor facility faces the challenge of doing so while ensuring country-ownership and co-ordination at country-level with other donor support to LDCs. At the country level, the governance structures usually include a government level Focal Point, a National Steering Committee (including private sector and civil society), a National Implementation Unit designated within the governmental administration and a Donor Facilitator.

The European Commission plays, as one of the larger donors to the EIF, an important role in this initiative, having taken a seat on the Board for 2009-2011 as one of the three donor representatives, and acting as Donor Facilitator in several LDCs.

15 For latest reports and updates on global monitoring of Aid for Trade, go to [www.oecd.org/department/0,3355,en\\_2649\\_34665\\_1\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/department/0,3355,en_2649_34665_1_1_1_1_1,00.html) and [www.wto.org/english/tratop\\_e/devel\\_e/a4t\\_e/aid4trade\\_e.htm](http://www.wto.org/english/tratop_e/devel_e/a4t_e/aid4trade_e.htm)

16 More on these topics can be found on the Aid for Trade Community Space, moderated by the OECD, [https://www.oecd.org/login/0,3357,en\\_17642234\\_17642806\\_1\\_1\\_1\\_1\\_1,00.html?appId=378965](https://www.oecd.org/login/0,3357,en_17642234_17642806_1_1_1_1_1,00.html?appId=378965)

17 This section is a short summary about the EIF. More information is available on the website [www.integratedframework.org](http://www.integratedframework.org)



### 3.1.3 The EU Aid for Trade Strategy

Following the Commission Communication of 4th April 2007, the EU Council and the Commission adopted a common AfT Strategy on October 15, 2007<sup>18</sup>. It includes five key activities<sup>19</sup>:

- Scaling-up total EU AfT in general as well as increasing the specific funding of Trade-Related Assistance (Categories 1, 2 and 6) to reach €2 billion annually by 2010 (€1 billion from EU, €1 billion from EU Member States), as pledged by the EU at the summer 2005 G7 summit and re-confirmed at the end 2005 WTO Ministerial.
- Enhancing the impact and pro-poor focus of EU AfT.
- Increasing EU-wide and Member States' donors capacity in line with globally agreed aid effectiveness principles.
- Supporting the ACP regional integration process.
- Ensuring effective monitoring and reporting to sustain the process of implementing commitments.

In practical terms, the EU Strategy emphasises the need for ownership of AfT initiatives on the part of partner countries and a clear prioritisation of needs articulated in national development strategies.

This includes use of the EIF, for which the EU AfT Strategy explicitly sets out the ways in which to proceed:

- Lending full support to partner countries' efforts to manage the Diagnostic Trade Integration Studies (DTIS) process.
- Taking advantage of the DTIS process to engage in a policy dialogue serving to translate trade related needs into poverty reduction strategies (PRS) and equivalent policies.
- Ensuring that EU decisions to support AfT programmes include explicit consideration as to how the programs take account of needs identified during in the DTIS.

At the EU level (EU and EU Member States), a yearly monitoring report<sup>20</sup> is issued by the Commission services to inform on the implementation of the EU Aid for Trade Strategy. It takes the form of a Staff Working Paper as part of the Commission's yearly report on monitoring of the implementation of the Monterrey Commitments to Financing for Development. It contains information and analysis of EU Aid for Trade flows (commitments and, to a certain extent, disbursements), mainly drawn from the OECD Credit Reporting System (CRS) database<sup>21</sup>. It also contains sections on the more qualitative aspects of the EU Aid for Trade. The inputs for the qualitative analysis are essentially

provided by the EU Delegations through a yearly Aid for Trade questionnaire. Delegations, in collaboration with the in-country field offices of EU Member states, reply to specific questions on the trade policy context and level of dialogue, the availability of comprehensive trade needs assessments, the effectiveness of EU Aid for Trade, and the regional dimension.

### 3.2 Other Commission Communications on issues relating to private sector development, trade and regional integration within the framework of EU external assistance

In 2008, the Commission issued a **Communication on Regional Integration in ACP countries**<sup>22</sup> against the background of the negotiation of Economic Partnership Agreements (EPAs) and the related significant increase of funds foreseen for regional integration in the regional programming documents for actions to be financed by the 10<sup>th</sup> European Development Fund (EDF). The Communication identifies the following three main benefits of regional integration:

- Political stability: solving existing conflicts, preventing new ones, and improving administration, governance and economic development
- Prosperity: larger and more effective markets which integrate more smoothly into the world market
- Addressing common challenges: the fight against HIV/AIDS and certain other diseases, the protection of natural resources and migration can be dealt with more effectively at regional level.

The Communication goes succinctly into the various areas of intervention which should allow to achieve the benefits of regional integration and underlines the importance of making a prominent link with regional integration in country programming activities.

In May 2010, the Commission services have announced the preparation of a new Communication on **private sector**, to be transmitted to European Parliament and Council in autumn 2011. It is to highlight how the role of private sector in development should be seen and understood in the present context.

<sup>18</sup> For the full texts see the Commission's Communication COM(2007) 163 and Council document 14470/07

<sup>19</sup> 'EU Strategy on Aid for Trade: Enhancing EU support for trade-related needs in developing countries - Conclusions of the Council and of the Representatives of the Governments of the Member States meeting within the Council', Council of the European Union, October 2007 [http://trade.ec.europa.eu/doclib/docs/2008/november/tradoc\\_141470.pdf](http://trade.ec.europa.eu/doclib/docs/2008/november/tradoc_141470.pdf)

<sup>20</sup> The latest EU monitoring reports can be found at [http://ec.europa.eu/development/policies/9interventionareas/trade/aid-for-trade\\_en.cfm](http://ec.europa.eu/development/policies/9interventionareas/trade/aid-for-trade_en.cfm)

<sup>21</sup> Access to the database is public. See [www.oecd.org/document/21/0,3343,en\\_2649\\_34665\\_43230357\\_1\\_1\\_1\\_1.00.html](http://www.oecd.org/document/21/0,3343,en_2649_34665_43230357_1_1_1_1.00.html)

<sup>22</sup> Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions: Regional integration for development in ACP countries; October 2008

## 4. Aid delivery practices and methods

### 4.1 Paris Declaration on Aid Effectiveness and Accra Agenda for Action<sup>23</sup>

By adopting the Paris Declaration on Aid Effectiveness in March 2005, donors and international agencies committed their countries and organisations to step up their efforts in harmonisation, alignment and managing aid for results with a set of actions and indicators that can be monitored. It covers five key dimensions<sup>24</sup>:

- **Ownership** - Developing countries set their own strategies for poverty reduction, improvement of their institutions and tackling corruption.
- **Alignment** - Donor countries align themselves behind these objectives and use local systems.
- **Harmonisation** - Donor countries coordinate with each other, simplify procedures and share information to avoid duplication.
- **Results** - Developing countries and donors shift their focus to development results and ensure results get measured.
- **Mutual Accountability** - Donors and partners are both accountable for development results.

A survey of progress towards implementation of the Paris Declaration published in 2008<sup>25</sup> showed that whilst progress had been made in some areas, there was still a long way to go in others, such as donors using local systems, using coordinated mechanisms for aid delivery, and coordinating their country missions and studies. The Accra Agenda for Action (AAA) was the outcome of a follow up meeting in 2008 to review progress on implementation. It is an agenda to accelerate progress and covers the following aspects:

- **Predictability** – Donors will provide 3-5 year forward information on their planned aid to partner countries.
- **Country systems** – Partner country systems will be used to deliver aid as the first option, rather than donor systems.
- **Conditionality** – Donors will switch from reliance on prescriptive conditions about how and when aid money is spent to conditions based on the partner's own development objectives.
- **Untying** – Donors will relax restrictions that prevent developing countries from buying the goods and services they need from whomever and wherever they can get the best value for money.

Three main challenges were identified in this Agenda:

- **Country ownership and local capacity building** – Requiring partners to take a stronger lead, but for donors to do more to build local capacity, to listen to what the partners are saying and to use local systems.
- **Building more effective and inclusive partnerships** – Recognising that there are now more development actors – middle income countries, global funds, the private sector and civil society organisations as well as the traditional donors.
- **Achieving development results – and openly accounting for them.** Attention must be given to ensuring measurable results.

In several developing countries and regions nowadays there are thematic or sector donor coordination groups, including for trade related assistance and/or private sector development. These constitute very useful platforms for coordination between government and donors and donor funded projects as well as for joint initiatives.

In this context, the Enhanced Integrated Framework (see section 3.1.2) also aims to contribute to further strengthening aid effectiveness in support of LDCs, through:

- Joint country-level needs assessments, funding the DTIS, in order to provide a common basis for donor support;
- Joint country-level institutional capacity building and mainstreaming of trade through EIF-funded actions;
- Country-level coordination mechanisms between the government and the donor community;
- Joint country-level and global analysis and monitoring of state-of-play and progress in mainstreaming trade and capacity building.

### 4.2 Aid delivery methods in the areas of TPSPD

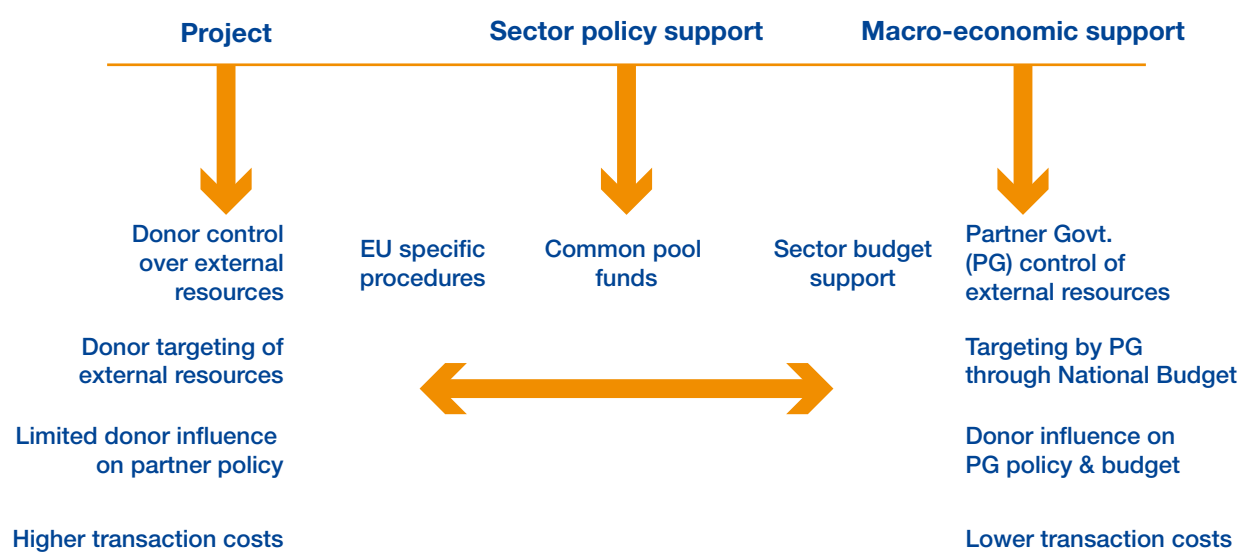
Aid can be delivered through various methods: a project approach, sector programmes (including through sector budget support – SBS), or, as the case may be, through macro-economic support (general budget support). The choice between these approaches should be based on the type of support that is relevant for the context, the level of “maturity” of the sector (i.e. to what extent policies, plans, budget and sector coordination are well defined), the direct beneficiaries, and the level at which the responsibility for implementation is best placed.

23 [www.oecd.org/dataoecd/11/41/34428351.pdf](http://www.oecd.org/dataoecd/11/41/34428351.pdf)

24 [www.oecd.org/document/18/0,2340,en\\_2649\\_3236398\\_35401554\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/18/0,2340,en_2649_3236398_35401554_1_1_1_1,00.html)

25 2008 Survey on Monitoring the Paris Declaration – Effective Aid by 2010? – What will it take, OECD

Figure 2. Aid Delivery Modalities



#### 4.2.1 Budget support

Budget support could be considered and has been practised in areas of TPSPD where implementation responsibilities are with the government and the conditions for budget support are met.

There are two main types of budget support:

- **General Budget Support (macro-economic support approach)**, representing a transfer to the national treasury in support of a national development or reform policy and strategy;
- **Sector Budget Support (Sector Policy Support approach)**, representing a transfer to the national treasury in support of a sector programme.

General Budget Support (GBS) and Sector Budget Support (SBS) are distinct to the extent that they have different objectives. GBS aims to support a national development policy and strategy; SBS aims to accelerate progress towards the partner country's sectoral goals. The difference in objectives will be reflected in the conditions and in the policy dialogue.

To receive budget support a partner country has to meet certain eligibility conditions. These cover three main areas:

- **National or Sectoral policy and strategy:** a well-defined national (GBS) or sectoral (SBS) development or reform policy and strategy should be in place or under implementation.
- **Macroeconomic Framework:** a stability oriented macroeconomic framework should be in place or under implementation.

- **Public Financial Management:** a relevant and credible programme to improve public financial management should be in place or under implementation.

Both GBS and SBS have been used to support reforms in the business environment as well as to support mainstreaming of trade in a country, in particular with a view of strengthening the trade institutional and overall policy framework. Since GBS has been designed for macroeconomic stability in support of the general development objectives, it has traditionally been more focused on macroeconomic/PFM issues and sectors considered key for poverty reduction, in particular health and education. However, there are cases where GBS programmes included specific components on trade and private sector development, due to the relevance of these sectors to broad development strategies and growth objectives. Though key reforms which could be supported by GBS thus might include also those which relate to trade and private sector development, SBS offers the advantage of allowing for a more focused policy dialogue with and support to the Ministries competent for the areas on which the programme focuses. In fact, the policy dialogue may lead to agreement on capacity development measures that are important accompanying measures. It may however be wise to foresee such complementary technical assistance up front to better support specific institutions through accompanying measures. Policy dialogue and technical assistance may then interact as mutually reinforcing instruments to build capacity as well as to strengthen accountability.

As SBS should relate to programmes for which the implementing responsibilities are at the governmental level, it may be used essentially to support reforms of regulatory frameworks in various trade or other business related areas; for support to trade related adjustment to adapt to tariff changes implemented by temporary compensation for loss of tariff revenues, coupled with fiscal reforms; or for support in the areas of trade facilitation (in particular customs). In the latter case, complementary technical assistance may however be strongly recommended with a view to ensure appropriate institutional capacity building. An increased proportion of technical assistance compared with the budget support component should then be considered in the light of the type of results to be achieved and the availability of appropriate and measurable indicators.

Sector Budget Support also requires the close monitoring of specific sector elements which are part of the assessment criteria for sector support (see section below on Sector Support).

The ins and outs of budget support are described in detail in the Budget support Guidelines issued by the Commission services, to which it is referred<sup>26</sup>.

#### 4.2.2 Sector support

When following a sector approach, Governments in consultation with partner donors and other stakeholders, need to develop a **Sector Programme**, which should progressively include:

- An approved sector policy document and an agreed strategic framework with clear measurable outcomes, a timeframe and an institutional framework to ensure efficient implementation.
- A medium term financing framework that is set within realistic medium term budget expectations sourced from all funds.
- A co-ordination process amongst the donors in the sector, led by Government and a harmonisation and alignment process of coordination led by the government.

- An agreed performance monitoring system which includes a systematic client consultation mechanism.

These are the main characteristics of a **Sector Policy Support Programme** (SPSP), the term used by the EU to identify the programmes designed to support a partner government's sector programme. An SPSP may use the following financing modalities: Sector Budget Support, common pool or basket funding (resources from a number of donors pooled using one agreed set of procedures); or a project, using EU procedures. This approach is described in detail in the SPSP Guidelines issued by the Commission services, to which it is referred.<sup>27</sup>

In the areas of TPSPD, SPSPs may be considered to support interventions in the field of quality infrastructure or intellectual property rights, which usually entail a significant deal of government participation, partly through public or semi-public bodies or private bodies with specific public missions, partly through co-funding on the public budget for transitional or even longer periods. As capacity building is most often the main focus of programmes in these areas, the pool funding and project approach implementing modes seem to be more indicated than budget support.

#### 4.2.3 Project approach

In all other cases, the project approach is to be seen as the recommended implementation mode. Indeed, given the frequent need in the TPSPD areas to direct support at the micro and meso levels rather than just at the macro level, there may be fewer opportunities for TPSPD sector approaches than in some other areas.

This is the case in particular for those programmes which are to support business both through capacity building of business organisations and business services providers and, in combination with that, through co-funding of direct provision of non-financial business services to local enterprises where the absence of sufficient meso-level capacity justifies that.

<sup>26</sup> [www.cc.cec/dgintramet/europeaid/activities/thematic/e1/guidance\\_instructions\\_en.htm](http://www.cc.cec/dgintramet/europeaid/activities/thematic/e1/guidance_instructions_en.htm)

<sup>27</sup> See Guidelines for EC Support to Sector Programmes, 2007, [http://ec.europa.eu/europeaid/infopoint/publications/europeaid/105a\\_en.htm](http://ec.europa.eu/europeaid/infopoint/publications/europeaid/105a_en.htm)



## 5. Cross-cutting issues

It is necessary to look at a number of cross-cutting issues when designing projects and programmes in the TPSPD arena. This section looks at them in more general terms, whilst each Thematic Review addresses cross-cutting issues in relation to the specific topic.

### 5.1 Governance

In several areas of TPSPD action, governance is not just a cross cutting issue but at the core of the intervention. This is the case for trade policy and trade facilitation as well as for the enabling business environment and the regulatory framework of the financial and other services sectors. Appropriate governance mechanisms enhance the trust in institutions and their accountability, and are required to ensure policy is not driven only by the vested interests and that corruption is reduced. Where such governance is lacking, programmes may not have the desired outcome.

More in general, governance is an essential issue to be taken into account in programme design and implementation. A reference document has been developed by the Commission services for “Analysing and Addressing Governance in Sector Operations”<sup>28</sup>. While it is not specific to trade and private sector operations, it provides guidance on how to organise the analysis of stakeholders and their governance/accountability relations, in order to assist in the identification of the governance priorities in programme design and review. The approach set out in that document is very relevant in a configuration where many public and private actors need to work together. For example, in the field of quality infrastructure, where each of the following elements is key for a sustainable and successful implementation of interventions:

- The participatory approach (e.g. participation of business and consumer organisations in standards setting and in defining the national quality policy).
- Transparency (market surveillance, websites with documentation on national standards, technical regulations and conformity assessment procedures).
- Accountability (e.g. clear definition of roles and responsibilities of different entities involved in the quality system).

A specific aspect of governance relates to countries with significant public intervention in the economy through state owned enterprises. In 2005, the OECD published a Guideline on Corporate Governance of State-Owned Enterprises ([www.oecd.org/daf/corporateaffairs/soe/guidelines](http://www.oecd.org/daf/corporateaffairs/soe/guidelines)). One of its key recommendations is to ensure a level playing-field in markets where state-owned

enterprises and private sector companies compete, in order to avoid distortions (for example, state-owned enterprises should not be exempt from the application of general laws and regulations and they should face competitive conditions regarding access to finance).

### 5.2 Gender

Gender equality is an important aspect in poverty reduction and economic development, and for the impact that can be made through TPSPD support the following references highlighted by the DAC<sup>29</sup> are interesting:

- If the ratio of female to male workers in India were increased by 10%, the Gross Domestic Product (GDP) would rise by 8%.
- In sub-Saharan Africa agricultural productivity could increase by up to 20% if women’s access to resources such as land, seed and fertiliser were equal to that of men.
- Women reinvest 90% of their income in their families and communities, compared to men who reinvest only 30% to 40% of their income.

Trade policies themselves are rarely gender neutral and can have “strong redistributive effects between economic sectors, favouring some economic activities while disfavours others.”<sup>30</sup> The impact will be dependent on the relationship between specific trade policy issues and those sectors where women play an important role. International trade may contribute positively to greater income equality between men and women, due to greater trade in manufacturing and services increasing employment opportunities, especially for women. This leads to greater empowerment of women as their incomes rise. However, export-oriented industries often favour women workers because women are generally more available, cheaper and less unionised, the corollary of this being that women’s work is often paid less than comparable men’s jobs and may be less secure. Women also feature strongly in the informal sector, which is usually outside the legal and regulatory frameworks, which in turn leads to high vulnerability. In order to determine the likely gender impact of new trade and competitiveness policies, it would be important for countries to undertake a gender impact assessment of the possible outcomes of policy options.

Gender mainstreaming requires different key steps: 1) obtaining statistics disaggregated by sex and qualitative information on the situation of women and men; 2) conducting a gender analysis,<sup>31</sup> in order to determine whether or not the planned activity will contribute to or

28 [http://ec.europa.eu/europeaid/infopoint/publications/europeaid/149a\\_en.htm](http://ec.europa.eu/europeaid/infopoint/publications/europeaid/149a_en.htm)

29 DAC Guiding Principles for Aid Effectiveness, Gender Equality and Women’s Empowerment, DAC, 2008

30 Report of the Expert Meeting on Mainstreaming Gender in Trade Policy, UNCTAD, 2009

31 Gender analysis provides the basis for gender mainstreaming and is described as the study of differences in the conditions, needs, participation rates, access to resources and development, control of assets, decision-making powers, etc., between women and men in their assigned gender roles’. Gender analysis is also necessary to determine whether specific actions are needed for women or men, in addition to mainstreaming activities.

challenge existing inequalities, and whether there are any gender issues that have not been addressed; 3) identifying possible entry points for actions; 4) putting in place a gender-sensitive monitoring and evaluation system from the design phase onwards, including the establishment of indicators to measure the extent to which gender equality objectives are met. [The EC toolkit on Mainstreaming Gender Equality](http://ec.europa.eu/europeaid/sp/gender-toolkit/index.htm)<sup>32</sup> provides an extensive description of these issues and a section dedicated to each of the six priority areas of EC development cooperation.

Typically women have been under-represented in the business communities in developing countries. However women often play a particularly important role in Micro and Small Enterprises, as well as sometimes in medium and larger business. TPSPD assistance can be skewed in favour of those enterprises that typically are those developed and run by women. Similarly in designing access to finance projects, such as Venture Capital Funds and Challenge Funds, or skills training projects, specific targets or criteria can be set for women.

### 5.3 Environment

The private sector is a major stakeholder in the process of fostering sustainable economic, social and environmental development. The poor are generally more vulnerable to natural resource degradation, pollution and ecological disasters. The Environment is thus a crucial dimension for the overall objectives of development cooperation: sustainable development and poverty reduction. Environmental investment and promotion of sustainable use of resources, such as improved land and water management, investments in sanitation, waste management and clean air, often yield high rates of economic and social return.

Increasing trade can have both positive and negative effects on the environment. Liberalisation, by promoting growth, can lead to greater pollution as production increases. If a country has a comparative advantage in polluting industries then greater specialisation in these activities will increase country level pollution. However, growth may lead to the adoption of less polluting standards and greater demand for higher environmental standards that reduce environmental degradation. Furthermore, greater specialisation can also reduce global pollution. For example, by encouraging the relocation of agricultural production from land scarce to land abundant countries trade can potentially reduce the use of fertilizer. Greater regional integration and regional markets development also can help improve developing countries trade prospects while reducing the carbon footprint of long-distance trade.

The private sector should be encouraged to employ methods of production that are environmentally sustainable and ensure that environmental considerations are integrated into their operations. This would include environmental management systems, environmental

auditing and reporting and adherence to internationally agreed codes of conduct.

The private sector can actually benefit from improved environmental management and better taking into account environmental considerations. On the one hand, it can help firms generate economies when applying principles of resources and energy efficiency. On the other it offers opportunities for differentiating products (as environmentally friendly alternative) or stimulating innovative products or solutions, in effect developing new products and markets.

The Guidelines on the Integration of the Environment and Climate Change in Development Cooperation<sup>33</sup> provide a comprehensive reference framework for integrating the environment and climate change into the different stages of the EU development cooperation's cycle of operations, from the programming to the evaluation. The guidelines identify a number of specific areas for consideration in designing projects and programmes, including:

- (1) Environmental pressures and impacts from the sector (to mitigate or to enhance), e.g. pressures on shared or exported resources (e.g. timber, minerals, fish), risk of exhaustion, etc.
- (2) Environmental factors affecting sector objectives or activities: problems to be addressed or opportunities/constraints to be taken into account, e.g. trans-boundary pollution or impacts resulting in regional disputes and state of shared resources.
- (3) Ways to recognise and realise opportunities for enhancing environmental conditions while at the same time exploiting opportunities offered by environment and climate change, such as access to additional market opportunities, technological innovation, energy savings, etc.
- (4) Entry points for environmental integration in sector programmes, such as:
  - Carrying out Sustainability Impact Assessments (SIA) of Economic Partnership and other trade agreements and implementing their recommendations.
  - Creating regulatory frameworks for the private sector relating to environmental issues and supporting environmental management capacities of the private sector.
  - Promoting import of clean technologies.
  - Regulating the trade of environmentally sensitive commodities (e.g. timber, gold).

The Information note "EC Cooperation: Responding to climate change. Sector Script for Trade & Investment (2009)"<sup>34</sup> provides guidance on the links between climate change and trade and investment, together with possible responses to climate-related challenges.

32 <http://ec.europa.eu/europeaid/sp/gender-toolkit/index.htm>

33 Guidelines on the Integration of Environment and Climate Change in Development Cooperation, 2009, available at: [http://ec.europa.eu/europeaid/infopoint/publications/europeaid/172a\\_en.htm](http://ec.europa.eu/europeaid/infopoint/publications/europeaid/172a_en.htm)

34 [http://www.cc.cec/dginttranet/europeaid/activities/thematic/e6/documents/environmental\\_integration/cc/cc\\_sector\\_script\\_ti\\_version\\_2009-07\\_ec\\_internal\\_use\\_en.pdf](http://www.cc.cec/dginttranet/europeaid/activities/thematic/e6/documents/environmental_integration/cc/cc_sector_script_ti_version_2009-07_ec_internal_use_en.pdf)

## Box 2. Sustainable production and consumption

The World Summit on Sustainable Development (WSSD) stated that “all countries should promote SCP (**sustainable consumption and production**) patterns, with the developed countries taking the lead and with all countries benefiting from the process”. The EU-funded SWITCH programme in Asia was designed to take this objective forward. Its purpose is to promote sustainable production, i.e. development of less polluting and more resource efficient products, processes and services (energy, water, raw materials) and sustainable consumption patterns and behaviour in the Asia region, through an improved understanding and strengthened cooperation between Europe and Asia, notably by mobilizing the private sector, i.e. SMEs, retailers, producer and consumer organisations, along with relevant public sector authorities. There are four main results expected from the programme: i) Increased use of environmentally-friendly technologies and practices by SMEs; ii) A switch to consumption of products that are less environmentally damaging; iii) Reinforcement and implementation of legal environmental and safety instruments; and iv) Development and application of effective economic instruments that enhance SCP.

## 5.4 Social issues

Employment issues clearly need to be taken into consideration in TPSPD programmes. Given that high levels of unemployment feature strongly in most developing countries, impact on employment must be taken into account as from the stage of identification and design of the programmes. Therefore, in those cases where TPSPD programmes may have implication for employment levels in specific sectors of a local economy, it is important to consider what type of measures could be put in place, in order for the affected country to cope with such changes. Such cases may for example relate to the introduction of new technologies and/or the use of ICT, which may lead to loss of jobs through the reengineering of production/delivery processes in manufacturing and service industries; or to trade policy reforms that may expose a developing country to more intense global competition.

In this perspective, it is useful to verify the existence or possibility of parallel support to trade-related adjustment (e.g. helping a developing country's government to manage its budget so as to provide safety nets to buffer shocks in the short term) or of targeted programmes for skills development and requalification (e.g. through vocational training aimed at facilitating the transfer of labour to other promising sectors of the local economy, in the longer term). Such measures may help to ensure that the overall net impact of trade reform in a developing country is positive also from the point of view of employment creation.

Another aspect relates to the type and quality of work that the private sector generates and which can vary greatly. Whereas a number of countries have adopted the ILO conventions on fundamental rights at work and/or have similar local laws, compliance with such standards is most often problematic. However, providing decent work is not only a matter of compliance with laws and international conventions, it can also make good economic sense. The respect of internationally recognised standards or codes of conduct can bring new opportunities to businesses which can cater to new markets and link up into more “socially/environmentally responsible” consumers/buyers/supply chains. This, in turn, is generally acknowledged as to provide increased revenues, closer and longer-term relationships with buyers, improved productivity from workers and decrease in the number of errors and defects. At the end of the Multi-Fiber Arrangement in January 2005, a number of developing countries all feared their apparel industries would lose out to China. Cambodia, highly dependent on its garment industry for foreign exchange and jobs, decided to differentiate itself on the basis of continuous efforts towards better working conditions. While a number of countries did see their garment exports decline in early 2005, Cambodia continued to enjoy a certain growth of its exports.

## 6. Introduction to the Thematic Reviews

### 6.1 Structure of the Thematic Reviews

Part II of this reference document contains ten thematic reviews, which give introductions to particular themes that constitute significant dimensions of trade and private sector policy and development, and main areas for donor interventions. These thematic reviews attempt to capture in a few words the most salient aspects of the theme to introduce the topic and give enough information to know whether there could be scope for undertaking more detailed study regarding possible interventions in this field. They have been developed with a practical approach, for an operational use in identification and design of development projects and programmes. They do not focus on any particular region of the world. They aim to assist Commission's cooperation sections in the EU Delegations at country level as well as HQ services in better understanding key elements of the topics and to provide them with a structured basis to lead or simply accompany their work in identification and formulation of development projects.

Although each thematic review can be read on its own, they deal with topics which are intertwined. For this reason, one review may point to another for further information. In some cases, some information that is highly relevant for more than one theme may be repeated in other thematic reviews.

Each review is divided into four sections:

- **Section 1** answers the question **“What does the theme cover?”**. This gives a brief definition of the theme and presents key terminology and concepts. It explains why the topic could be important and gives the rationale for support to developing countries in the specific area. Where relevant, it also refers succinctly to the legal and regulatory context for actions in the field concerned. Finally, it identifies the key actors who would be involved and the key issues that would need to be carefully looked at.
- **Section 2** answers the question **“What can be done?”**. This section explains how one can identify the specific issues and context in any country to initially determine whether or not there is a potential need for assistance in this area. Where appropriate, it identifies specific diagnostic tools that can be used to assist in this process. It then introduces the broad areas where interventions could theoretically be made, and the main activities that could be considered for implementation in those areas.

- **Section 3** explains **“How can it be done?”**. This gives more specific information, where relevant, on the levels of intervention and sequencing of activities. The levels could be regional, national or local, as well as at macro, meso or micro-level, and/or combinations thereof. It provides a selection of typical expected results of projects in the specific areas and indicators to measure them, along with sources and means of verification, when possible. Specific cross-cutting issues are identified, so that due attention can be given to them in the preparation phase. Finally this section identifies possible risks which may be identified in the specific area.
- **Section 4** helps the reader to know **“Where to find out more?”**. This section gives a bibliography and identifies relevant websites, with brief annotations on each reference.

Examples of projects and programmes are given to illustrate the type of interventions and lessons that can be learned. Whilst these examples are usually from EU-funded interventions, references are given sometimes to interventions funded by other development partners.

### 6.2 Brief introduction to each theme

**Trade policy and trade-related adjustment** focuses on how to integrate trade into a country's overall development strategy, on assistance to beneficiaries to effectively manage trade policy formulation and trade negotiations, as well as examining support for trade-related adjustments which temporarily compensate countries for the transitional negative revenue effects of changes and reforms in domestic trade policies and regulations.

**Trade facilitation** refers to “the simplification and harmonisation of international trade procedures including import and export procedures, the latter being the activities (practices and formalities) involved in collecting, presenting, communicating and processing the data required for movement of goods in international trade”<sup>35</sup>.

**Quality infrastructure** is the system of laws, functions and institutions which are necessary to ascertain the conformity of a product (or productive process) with technical regulations or standards. Quality may relate to the safety of use (e.g. electrical appliances), to health (e.g. food, cosmetics, pharmaceuticals, veterinary medicines), to consumers' information (e.g. labelling, transaction fairness), or to other features. This TR also develops the themes of **Sanitary and Phyto-Sanitary measures (SPS)** and **Technical Barriers to Trade (TBT)**.



**Intellectual property rights** refers to the general area of law that encompasses industrial property (patents, trademarks, industrial designs, etc.) and copyright (protection of author's rights) and related rights.

**Business enabling environment** focuses on the “complex array of policy, legal, institutional, and regulatory conditions that govern business activities. It is a subset of the investment climate and includes the administration and enforcement mechanisms established to implement government policy, as well as the institutional arrangements that influence the way key actors (e.g. government agencies, regulatory authorities, business membership organizations) operate”<sup>36</sup>.

**Investment promotion and facilitation** refers to “activities that disseminate information about, or attempt to create an image of the investment site and provide investment services for the prospective investors”<sup>37</sup>. The objective of investment promotion is to attract potential investors, either national or foreign, whereas investment facilitation supports investors in the process of establishing and running their investment projects.

Facilitating **access to finance** can be defined as any measure which improves the availability of finance in an economy. In the context of private sector development, the end users of finance are typically enterprises. This theme starts from the observation that a common problem which hinders economic development in partner countries is limited access to financial services.

**Competitiveness** focuses on issues which are essential to strengthen productive capacities and promote innovation. This thematic review starts from the ‘enterprise’ as the analytical entry point and analyses the role of value chains, clusters, industrial upgrading and economic sectors. The concept of strengthening productive capacities stems from the aim to enhance the national capability to deliver efficiently goods in terms of time, cost, and quality. Innovation, which refers to the successful production, assimilation and exploitation of novelty in the economic and social spheres, constitutes an integral part of this thematic review.

**Business Development Services (BDS)** covers a wide range of non-financial services (e.g. training, advisory services, marketing assistance, business linkage promotion) provided by public and private suppliers (BDS providers) to micro, small and medium enterprises who use them to efficiently operate and make their business grow. It encompasses guidance on care to be taken in relation to business linkages initiatives.

**Doing business with the poor**, aims at presenting the various concepts and projects that have been/are being developed in the areas of corporate social responsibility, fair trade, base of the pyramid, inclusive business and social entrepreneurship, to inform and stimulate further

thinking on these concepts. It refers to the growing body of literature and project experience which suggests that market-based approaches to poverty reduction and innovative business models can increase the private sector's contribution to poverty reduction, development and achievement of the Millennium Development Goals, through better inclusion of the poor in business models and value chains.

### 6.3 Links across the areas covered by the Thematic Reviews

The enterprise is at the centre of TPSPD support; development projects and programmes in the area of trade and private sector development should aim at enhancing their inner capacities (micro level), their access to adequate services (meso level) and the wider environment in which they operate (macro level). This is reflected in the approach adopted to develop the thematic reviews included in this reference document. They cover interventions at the macro level, working on the policy, legal and regulatory issues to create an enabling environment; at the meso level, working through intermediary organisations, including private sector representative organisations and providers of business development and financial services; as well as at the micro level, improving directly the enterprise capacities and/or engaging directly with enterprises. This is shown in figure 3.

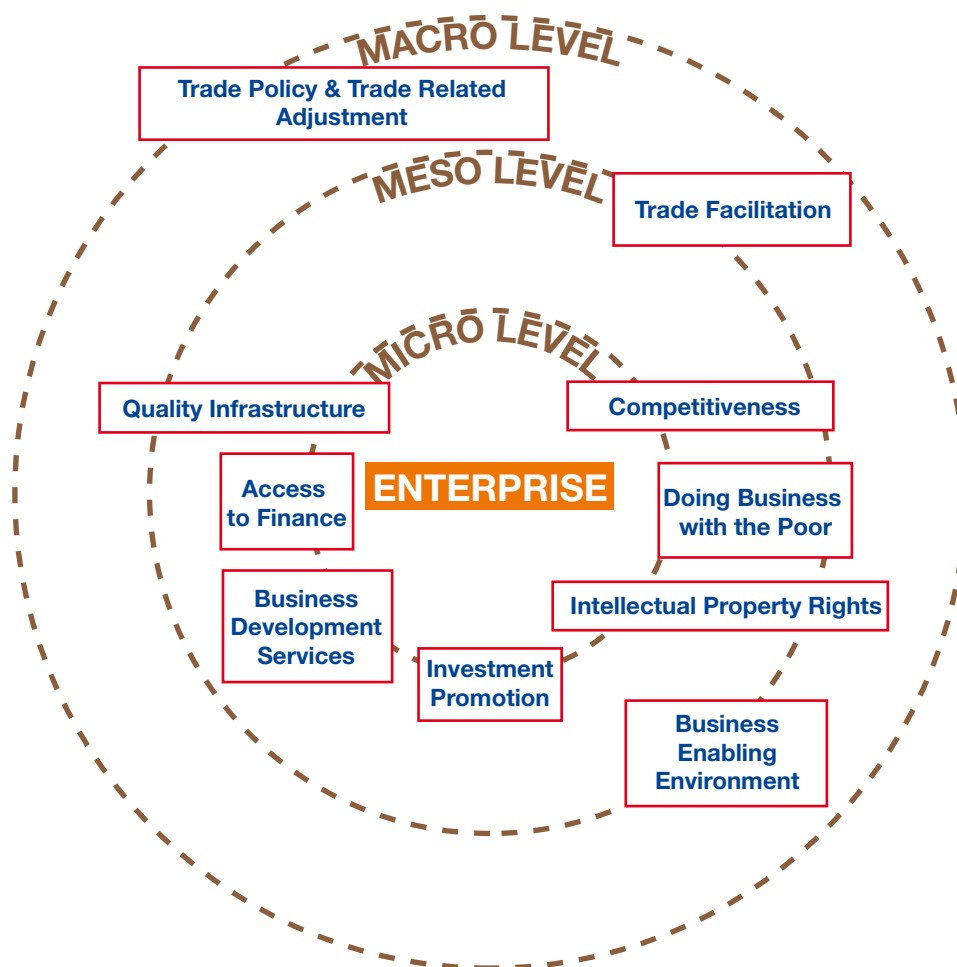
A number of the thematic reviews will be relevant to more than one level, depending on the focus of the support to be provided. For example, on Business Development Services it is pointed out that the key point will be the strengthening of supply side capacities at meso level (business organisations and business services providers) but also that for reasons linked to the needs of the learning process and the need for demonstration effects on both sides of the market, intervention will generally be both at meso and micro level. Another example is the TR on Quality infrastructure which explains the importance to create or strengthen the institutions, other bodies and rules and systems at different levels.

Another type of link relates to the fact that, as already mentioned, a few topics may be relevant to more than one thematic review. As a result, they may be quoted in various TRs but they may be developed only in one, where more details can be found, i.e. clusters and value chains are developed in the TR Competitiveness; but further guidance on initiatives to create or strengthen business linkages have been included in the TR Business Development Services. Business development services are the subject matter of a separate TR, but a reference to them is made in the TR Competitiveness, as use of BDS and strengthening of the BDS supply side of the market are both addressed by business support programmes that are developed in that TR.

36 Donor Committee on Enterprise Development (DCED), ‘Supporting Business Environment Reforms – Practical Guide for Development Agencies’, 2008 Edition.

37 Wells Jr., Louis T./Wint, Alvin G. 1990: Marketing a Country: Promotion as a Tool for Attracting Foreign Investment, Washington, DC: IFC and MIGA.

Figure 3. Thematic areas and levels of intervention.



There may also be some links between the intervention areas in terms of sequencing of activities or priority setting. As explained in the TR on Investment promotion, it could appear inappropriate to provide support in this area if the business environment is extremely difficult and intricate, and no public policy shows the country's engagement to improve it. However, it should not be suggested or recommended to avoid business support at meso level or, a fortiori, at micro level while the enabling environment remains difficult, as for most developing countries this would lead to avoidance of any support in this crucial area. In many cases, the business environment is not particularly conducive and it is clear that changes will happen on the long term; however, the economy and the productive system of these countries will not stay idle, but will continue to evolve. There is therefore a need for parallelism in the support to the various areas which are relevant for the implementation of the wider Aid for Trade agenda. The process of

economic development is progressive and incremental, also in developing countries. In this respect, the capacity building at meso level (intermediary organisations, providers of business service) and at the enterprise level can contribute to increased pressure on the government to improve policies and regulatory frameworks. Donor support may assist in that. However, this should not distract from the keeping of high priority for macro level support, also to enhance the sustainability of other projects and programmes. It is therefore important that EU Delegations in third countries and HQ services, when participating in the programming, identifying and designing of interventions, make sure that such macro level initiatives are included in the action or take place through other support programmes, be they funded by EU or other donors.

A final observation is that attention should be paid also to enhance potential synergies between support provided

by grant donors and the non-grant support provided by development financing institutions as well as investments by commercial private sector, be it financial or other. This refers to the blending of grants and loans or equity. The blending may be beneficial in terms of the combined effect of both interventions, but also in terms of leverage of further private sector participation in the financing of operations in developing countries, be it from commercial

banks, investment funds or other types of companies. It is about enhancing the outreach of the financial sector and/or promote greater participation of the productive sector in development. Some further details on this can be found in the TRs Doing business with the poor and Access to Finance. The Communication on the role of private sector in development, announced for 2011, can be expected to further elaborate on these issues.





## **PART II.**

## **THEMATIC REVIEWS**



## **Thematic Review 1**

### **Trade Policy and Trade-related Adjustment**

# 1. What does the theme cover?

## 1.1 Definition and terminology

This thematic review focuses on technical co-operation to assist beneficiaries to effectively manage trade policy formulation, trade negotiations and integration of trade into a country's overall development strategy.

Trade policy constitutes a plan of action entailing the formulation of measures, rules and regulations that govern the sale of goods and services and the movement of capital and labour across international borders (e.g. tariffs and quotas, restrictions on foreign investments, limitations on the provision of services). Trade policy also includes, inter alia, the reduction of rules and regulations which are unduly restricting trade and which are part of the rules and regulations set for example in the areas of consumer and health protection, or in the areas of recognition of professional qualifications.

The ability to negotiate rules governing international trade implies a capacity to understand systems, issues, rules, rights and obligations with a view to effectively engage in the World Trade Organisation (WTO) and participate effectively in regional or bilateral trade agreements (e.g. the Economic Partnership Agreements, Association Agreements). WTO accession falls equally within this category. A capacity for negotiation may require the institutional development of an adequate (domestic or regional) trade negotiation machinery.

Trade policy formulation, negotiations and implementation in a wide sense may cover many issues including also customs and transit arrangements, issues relating to the effects of standards and conformity assessment requirements on trade, and common policies in areas such as competition. For the purpose of the present thematic review, we will however not proceed on the basis of such a wide definition. On customs and transit arrangements, we refer to the thematic review on Trade facilitation, on issues relating to standards and conformity assessment requirements to the thematic review on Quality infrastructure.

However, the review examines trade related adjustment which temporarily aims to compensate for the transitional negative effects of changes and reforms in trade policies and regulations. The OECD/DAC defines trade-related adjustment as follows: "Contributions to the government budget to assist the implementation of recipients' own trade reforms and adjustments to trade policy measures by other countries; assistance to manage shortfalls in the balance of payments due to changes in the world trading environment". This definition is used for classification of aid and is not to be confused with the broader concept of trade-related adjustment encompassing

not only such budget support but also other temporary support to the changes that the economy and society have to make in order to benefit fully from a changed trade regime (e.g. improving national competitiveness) and to offset the transitional negative effects resulting from changes in a country's trade regime.

## 1.2 Rationale for intervention in developing countries

The linkages between trade, trade policy and poverty are complex, and operate at both the macroeconomic and the microeconomic levels. There has been much debate as to whether growth has driven exports in the successful developing countries or whether trade has been fundamental to growth. But it has been observed that developing countries that have successfully integrated in the world economy have been amongst the most successful in alleviating poverty; while regions, such as sub-Saharan Africa, whose share in world exports has fallen, have struggled to grow their economies faster than their populations.

At the macroeconomic level, trade and trade policy generally have an indirect impact on poverty. Through trade negotiations, governments can reduce or eliminate barriers to foreign markets, thereby creating opportunities for exporters to increase sales and employment. Integrating in global supply chains, through foreign direct investment (FDI), can bring with it access to international technology, and new ways of doing business that can increase productivity and the ability to compete internationally. By facilitating the inflow of foreign capital and skills, the trade framework increases the resources available for production and can unblock bottlenecks in the economy that raise prices and reduce competitiveness. Finally, openness to competition can be a crucial factor in ensuring that potential gains in productivity and efficiency are realised by pushing domestic producers to adopt new technology and business practices.

However, trade liberalization can also increase the vulnerability of the poor to global shocks in supply and demand and lead to changes in the structure of economic production that the poor may find difficult to adjust to, or take advantage of. Opening up domestic markets to greater competition or the adoption of higher technology could displace production out of uncompetitive sectors leading to unemployment and income loss in the short run in those sectors as the economy adjusts to new conditions.

The impact on poverty will depend on the extent to which opportunities for increased production and greater

efficiency are realised, and how these gains translate into higher employment and higher income amongst the poor.

The net macroeconomic impact of trade on poverty alleviation depends in large part on a wide range of factors. Firstly, the macroeconomic situation has to be stable in order to implement trade arrangements and to attract the investment necessary to take advantage of new export opportunities. Further, good governance is required to ensure that policy is not driven by the interests of the elite and to reduce corruption. Also, health and education will enable the poor to participate in economic activity, benefit from new activities and seize opportunities. Extension services and direct support for poorer producers can also be important. Finally, social safety nets contribute to cushioning the impact of volatility and smooth adjustment to changing economic conditions.

### 1.3 Legal and regulatory framework

The legal framework that rules the management of foreign trade is defined at multilateral, regional and national levels. Key principles for trade policy – such as most favoured nation, special and differential treatment<sup>38</sup>, and

transparency – are defined and agreed at the multilateral level within the framework of the WTO.

While the WTO provides a legal framework and forum for liberalisation that allows countries to enhance overall access to export markets, regional and bilateral agreements provide for better market access – at least in goods if not in services – than that offered under the WTO. In addition, a country does not need to wait for the outcome of negotiations to facilitate investment or liberalise tariffs (unless it is party to a customs union which requires a common external tariff for its members). It can take unilateral action.

WTO agreements cover goods, services and intellectual property and spell out the principles of liberalisation, and the permitted exceptions. They include individual countries' commitments to lower tariffs and relating to non-tariff barriers to trade (NTBs), and to open and keep open services markets. The agreements prescribe special treatment for developing countries. They also set out procedures for settling disputes on which the WTO adjudicates. Table 1 provides an overview of WTO agreements, with a brief description.

**Table 1. Overview of existing WTO agreements<sup>39</sup>**

	<b>Goods</b>	<b>Services</b>	<b>Intellectual Property</b>	<b>Disputes</b>	<b>Transparency</b>
<b>Basic Principles</b>	GATT (General Agreement on Tariffs and Trade)	GATS (General Agreement on Trade in Services)	TRIPS (Trade Related aspects of Intellectual Property Rights)	Dispute Settlement	Trade Policy Reviews
<b>Additional agreements and annexes</b>	<ul style="list-style-type: none"> <li>• Agriculture</li> <li>• Sanitary and Phytosanitary Measures (SPS)</li> <li>• Agreement on Textiles and Clothing (ATC)</li> <li>• Technical Barriers to Trade (TBT)</li> <li>• Trade Related Investment Measures (TRIMS)</li> <li>• Anti-dumping measures</li> <li>• Customs valuation</li> <li>• Rules of Origin</li> <li>• Pre-shipment inspection</li> <li>• Import licensing</li> <li>• Subsidies and counter-measures</li> <li>• Safeguards</li> </ul>	<ul style="list-style-type: none"> <li>• Movement of natural persons</li> <li>• Air Transport</li> <li>• Financial services</li> <li>• Shipping</li> <li>• Telecommunications</li> </ul>			
<b>Plurilateral agreements (not signed by everybody)</b>	<ul style="list-style-type: none"> <li>• Civil aircraft</li> <li>• Government procurement</li> </ul>				

<sup>38</sup> Special and Differential Treatment is the principle in WTO that developing countries be accorded special privileges, among which exempting them from some WTO rules, granting them preferential treatment in the application of WTO rules, or granting them longer time periods for implementing agreements and commitments.

<sup>39</sup> Link [www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/agrm1\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm1_e.htm)

The *SPS agreement* deals with rules related to health issues and concerns in traded food products. The *TBT agreement* covers issues related to the general use of technical standards related to trade. The main principle of the TBT and SPS agreements is that international standards should be used where possible to ensure non discrimination and that any measures to reduce trade should be duly justified by the reasons mentioned in these agreements. Issues of interest to developing countries include in particular the setting up of quality standards and conformity assessment procedures and systems. (See thematic review on Quality infrastructure).

The *TRIMS agreement* deals with trade-related international investment issues and oblige members not to require investors to abide by certain performance requirements such as levels of local procurement or import and export targets. (See also the thematic review on Investment promotion).

The *TRIPS agreement* provides a framework requiring all WTO member countries to have minimum legislation in order to give protection to the main categories of intellectual property (See thematic review on Intellectual property rights).

The *GATS* – The General Agreement on Trade in Services covers regulations related to the trade in services. Services account for over 20% of world trade and is growing in importance.

In November 2001, the WTO Ministerial meeting launched the Doha Development Round, in which WTO members agreed to continue negotiations on Agriculture and Services and to consider other areas, including the ‘Singapore issues’, which encompass investment in general (not just trade-related), competition, transparency in government procurement and trade facilitation.<sup>40</sup>

In addition to the WTO’s multilateral negotiations, countries also conclude bilateral and regional trade agreements, which may go beyond what has been agreed in the WTO. In several regions across the world, developing countries are part of regional trade and cooperation agreements, some of which aim for stronger economic integration in the form of customs unions and also monetary unions. This is the case for some of the regional groupings in Africa.

On its side, the EU has set itself as final goal to conclude agreements within a regional framework. More and more bilateral trade agreements are concluded as a first step and are considered as building blocks towards more comprehensive regional treaties. In its negotiations on these bilateral and regional agreements, the EU aims to include issues other than provisions on market access, such as services, intellectual property rights, investment, public procurement, labour and decent work standards, environmental protection, etc. This is the case both for the Economic Partnership Agreements (EPAs) the EU

is negotiating with ACP regions and other regional and bilateral trade and cooperation agreements. The WTO however also sets criteria for what regional integration agreements must achieve in terms of e.g. trade liberalisation in order for such agreements to be acceptable to all members of the WTO. These criteria differ according to whether the countries involved are developing or developed, and allow for a margin of negotiations over the interpretation of what these criteria mean in practice.

## 1.4 Key issues and actors

### 1.4.1 Key Issues

A number of key issues can be mentioned in relation to both national and regional levels.

- **Knowledge and information gaps:** (a) Knowledge of multilateral and regional trade agreements, policies and institutions is limited in most LDCs and many middle income countries – though in the ACP the EPA process has served to raise awareness. (b) Data deficiencies and statistical weaknesses. Challenges in this area will only grow as the trade agenda becomes ever more complex – with an increasing focus on regulatory as well as tariff issues. (c) Constraints on access to information on changes and latest developments in international trade issues result from limited participation by most LDCs in e.g. Geneva (WTO meetings) and poor domestic telecommunications affecting both access and dissemination of this information to stakeholders.
- **Many developing countries lack a coherent and comprehensive assessment of the role and consequences of trade and trade policy in national development strategies.** Such an assessment is key not only to effective identification and prioritization of trade and trade-related assistance needs, but also to ownership amongst stakeholders by clarifying how trade affects different stakeholders and explaining the need for the involvement of e.g. regulatory authorities in negotiations.
- **Trade policy co-ordination within government is often weak.** Responsibility is often dispersed widely across different Ministries and government authorities. Ministries can be given responsibilities without having, or being given resources to acquire the appropriate expertise. Co-ordination of positions on the same issue in different fora (multilateral, regional and bilateral) is also often poor. And many countries find it difficult to effectively pursue multilateral, regional and bilateral policies simultaneously.
- **Effective consultation mechanisms with the private sector and civil society on trade policy are weak or non-existent** though there are more concerted efforts in several countries and regions to enhance consultations. Even where consultation

is institutionalized, results are often poor because of limited capacity of stakeholders to understand the implications of proposed trade policy options and to identify and articulate interests to government.

- **Regulatory gaps.** Increasingly, the trade policy agenda covers issues that address behind the border measures, such as trade in services and investment. Negotiations relate to regulations and increased trade will require regulatory reform. In LDCs in particular, regulation of key sectors (such as non-banking financial services) is rudimentary and often outdated; in some sectors they are missing.
- **Skills gaps:** lack of technical skills to assess potential impact and to define offensive and defensive interests in negotiations. Deficiencies in trade-related expertise, analytical and negotiating skills are generally the result of overstretched staff, limited resources to hire or contract in expertise, limited experience and insufficient training, coupled with high turnover. This applies to the government as well as to private sector stakeholders. Many countries do not have research institutions capable of carrying out the volume and range of analysis on trade policy matters required for effective engagement. Poor data or lack of data further constrain the ability for quality analysis.
- **Human resource constraints.** Ministerial staff is limited. Though the awareness of the importance of trade policy has increased in recent years, it is unclear the extent to which this has led to an increase in staff dedicated to trade policy formulation and negotiation. Constraints are at national level. Skills are highly marketable – including internationally and to donors – making recruiting and retaining appropriate staff a significant problem.

The problems listed above, faced in the implementation of trade policy and regulations at national level, affect also trade policy options for developing countries within the **framework of regional integration** processes. Moreover, further obstacles turn up when dealing with regional integration. These difficulties encompass:

- **The need for open regionalism.** Unlike unilateral liberalisation, regional free trade arrangements can divert as well as create trade. Trade diversion occurs when a lower cost, more efficient source of imports – that does not belong to the regional trade arrangement – is replaced by a less efficient one within the region. The money that was previously raised as import tariffs now disappears. The importing country loses government revenue without a substantial reduction in prices of its imports. High external tariffs of regional groupings encourage trade diversion. “Open regionalism”, a strategy pursued by the EU, aims to remove barriers to trade and encourage co-operation at the regional level, without discriminating against outsiders.

- **Overlapping membership** of different regional economic integration initiatives, generally with similar mandates, is widespread and has created what is often termed a “spaghetti bowl” of trade arrangements. The extent to which this is the cause of limited progress in deeper integration amongst developing countries and/or reflects a lack of commitment to regional integration is the subject of much debate and will vary by region.
- **Political commitment** but lack of implementation of regional commitments by countries: countries sign up to regional commitments without being able or sometimes willing to implement them timely and effectively at national level. They commit for various reasons (sometimes purely political) and they don't implement for other reasons.
- **Institutional structures.** Decision-taking by consensus and the absence of supranational bodies can constrain progress and the enforcing of agreements. Structures often do not explicitly incorporate monitoring mechanisms for implementation at member state level.
- **Under-resourced regional secretariats.** Secretariats to regional economic communities are often weak. Financial and human resources are generally not sufficient to address often very broad agendas and the technical skills required to play a co-ordination and think tank role are often absent. Links with the private sector and civil society at regional level are generally weak.
- **National – Regional co-ordination.** Regional integration has implications for national policy and institutions that are sometimes not effectively taken into account nor implemented. For example, the Southern African Customs Union (SACU) agreement of 2002 requires national bodies to be established in all member states to monitor trade flows and the impact of tariff and other duties, yet this has still not been achieved as of mid 2010.

Trade agreements and trade policy reforms may generate impacts that require the adoption of **trade-related adjustment** programmes, which temporarily aim to compensate governments for the transitional negative effects of changes and reforms in trade policies and regulations. Key issues in this connection are:

- Considering compensation measures would encompass firstly an accurate assessment of the government's net loss of fiscal revenues as a result of such reforms.
- Secondly, trade related adjustment requires the definition of a strategy for fiscal reform in order to offset the negative effects on fiscal revenues e.g. expanding and diversifying the tax base. It is worth keeping in mind that while tariffs are relatively easy to collect,



tax collection is time-consuming and has high costs of compliance. Nevertheless, tax reforms need to be part of the policy measures to be considered in order to ensure a more stable and broader basis for government's revenues. Tax reforms may also be needed to improve the business environment in order to better cope with the changes in competitiveness of the productive system.

- Third, structural impediments to factor market efficiency, namely the reallocation of workers in the labour markets following changes in the trade regime may also need to be considered as key issue of trade-related adjustment in a wider sense. As mentioned in section 1, however, such adjustments are not the subject of the present thematic review. They may relate to policies interfering with the labour market or other policies important for the productive capacity of an economy.
- A final key issue relates to the **difference between trade in goods and trade in services**. While trade in services and goods are similar in that benefits emerge from comparative advantage, specialisation and efficiency gains, there are some important differences. Indeed, restrictions on trade in services are the result of regulation – not of tariffs or quotas. This means that: (1) trade in services liberalisation has no direct tariff revenue impact, (2) but also that liberalizing trade in services can often be very challenging because of the complexity of the issues involved. For many developing countries, the discriminatory aspects of their regulation are not known – in some cases the regulation of many services does not exist or is under review. Developing countries are then confronted with trade negotiations where issues cannot be appreciated on the basis of and with reference to an existing and functioning framework.

#### 1.4.2 Key actors

Trade policy negotiations and implementation cover many issues. In identifying key actors it is therefore important to distinguish between those who are responsible for overall national trade policy formulation and those that are key for specific issues, e.g. negotiations in services or implementation of trade facilitation measures, and to include them in the process as appropriate.

The trade policy process should bring key actors together in order to ensure that the trade policy embodies the national development strategy guiding the country, that trade agreements are effectively negotiated and implemented, and that accompanying measures (such as fiscal reform) are budgeted and implemented (see example in Box 1).

Key actors involved are firstly government ministries, namely the Ministries of Trade and Industry which are usually responsible for trade policy formulation and implementation, the Ministry of Finance which is in charge

of fiscal policy and customs management, the Ministry of Agriculture and possible other ministries. However, the lead responsibility for trade negotiations varies country by country. Even within the same country, different trade agreements can be the main responsibility of different Ministries. In some cases the Ministry of Foreign Affairs may have the lead for one regional trade agreement (e.g. SADC), while the Ministry of Finance leads on another regional trade agreement (e.g. SACU) and the Ministry of Trade and Industry on the WTO. In addition, some countries have ministries specifically in charge of coordinating the development and implementation of a regional integration initiative; for example all Member States of the East African Community (EAC) have EAC Ministries. Depending on the political and economic importance of a particular sector, sector specific ministries – such as the Ministry of Agriculture in particular – can also have a key role in national trade policy formulation and implementation. That also includes ministries in charge of specific sectors of services. Trade in services is, in large part, facilitated by changing regulation to allow foreign participation in service delivery and to remove regulation that discriminates against foreign service suppliers. Therefore, regulators in each sector – such as the Telecommunications Authority or the Central Bank – are key actors, as is the Attorney General's Chamber.

Investment and export promotion agencies can also contribute significantly to national trade policy development. Involvement will depend on whether they have been given responsibility for policy issues and, in that event, on their effective capacity.

Business organisations, such as national chambers of commerce, are increasingly included in the overall development of national trade policy formulation. In relation to trade in services, professional associations, such as the Law Society or the Institute of Accountants, are also key actors. They are central not only because of their role in representing the profession, but also because trade in professional services in particular requires the mutual recognition of qualifications – which is often the responsibility of the professional associations or at least strongly involve them. However the extent to which all these organisations actively and effectively participate, and are listened to, varies widely – in part reflecting political considerations, in part reflecting their capacity to offer representative views and effectively develop policy proposals.

Involvement of other non-state actors, such as trade unions and other civil society organisations, in trade policy formulation differs also greatly from country to country. While consumer associations are very important in many developed countries, they have minimal policy influence in many developing countries. The role of think tanks and academic researchers also varies, depending on a range of factors including capacity and experience (often limited) and the political environment.



**Box 1. Inter-ministerial coordination and private sector involvement in Cambodia**

Cambodia has succeeded in implementing an effective mechanism for consultation and dialogue in support of the identification and implementation of its trade development strategy. In March 2007, the government created a Sub-Steering Committee on Trade Development and Trade-Related Investment. The Sub-Steering Committee is chaired by the Senior Minister of Commerce and vice-chaired by a Secretary of State from the Ministry of Economy and Finance. Key line ministries concerned with trade development are represented, including Industry, Mines and Energy, Agriculture, Forestry and Fisheries and Public Health. The Sub-Steering Committee can make proposals for review and/or approval, either by the Prime Minister or by the full Council of Ministers as appropriate. The Committee also regularly calls for dialogue meetings – at present every two months – with development partners.

In addition, consultation with the private sector is assured through a Government-Private Sector Forum mechanism chaired by the Prime Minister, which meets twice a year. This Forum is itself organised in eight working groups, several of which address issues relating to trade development. Inter-Ministerial coordination is emphasized throughout, with the Ministry of Commerce taking a lead role.

Finally, as international trade agreements generally need to be ratified, Parliament has a potentially key role in shaping international trade arrangements. This is a role that is still developing in many countries.

## 2. What can be done?

### 2.1 Problem identification and diagnostic tools

#### 2.1.1 Questions to consider in programme identification and design

When preparing a support programme in the trade policy area, it is essential to verify if a trade policy process exists, and if so to analyse its contents and dynamics. The trade policy process is an important element of trade policy development. Experience has shown that an effective and functioning trade policy process is critical if an effective trade strategy is to be developed and the true gains from trade are to be realised. In developing an effective trade strategy and negotiating this strategy in international fora, it is important that the government has a good understanding of varying trade-offs that it faces, the likely impact of reform and any obstacles to implementation. The analysis of the trade policy process should include an analysis of key stakeholders, their responsibilities and capabilities and the effectiveness of communication and consultation.

For ease of reference the questions/issues that need to be considered when developing a support programme in the trade policy area could be divided into two groups. The two groups of questions are related to (a) the trade policy process, and (b) trade policy and strategy development.

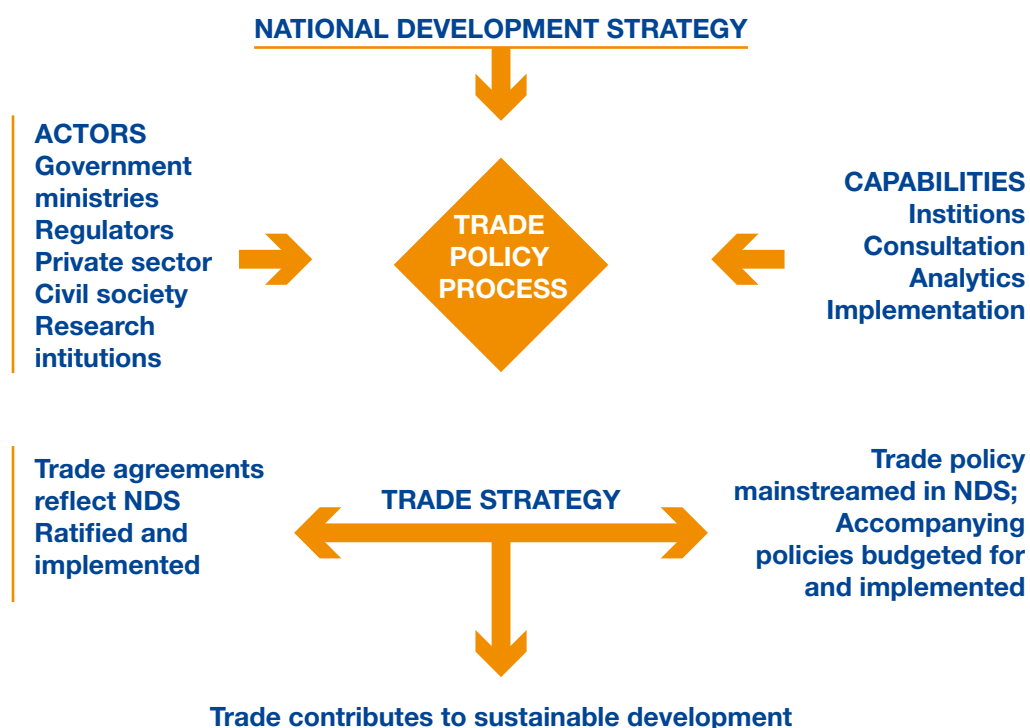
#### a. Trade policy process

Ideally government, private sector and civil society should be involved in an ongoing and constructive dialogue on trade policy. Where this process exists, there is less risk that trade policy will be hijacked by minority interest groups. Similarly, if policy development has been inclusive and transparent, implementation will be much easier with less risk of delay. By running systematically through these questions it will be possible to determine the broad needs of the partner country and to identify key interlocutors. These can then be taken on through the programme identification and design phases.

#### Within government

- Who is in charge of the trade policy process and what are the decision-making processes?

**Figure 1. National development strategy and the trade policy process**



- How are the roles divided within government and what co-ordination mechanisms exist?
- What are the links between trade policy development and national development? What analysis has/is being undertaken?
- How important are regional institutions in the trade area?
- Is the country able to participate effectively in the WTO?
- How effective are the links between country delegations to the WTO and their capitals? Is there regular feedback and discussion?
- Is there sufficient capacity within government to deal with trade issues? Where are the bottlenecks? Have extra resources been identified to address these?

#### *Consultation process*

- How are consultations undertaken with the private sector and civil society?
- Is there a systematic process for doing this? Who is involved?
- Who leads for civil society and the private sector? Are they representative and do they have capacity?
- What policy research and analysis is undertaken outside of government and by whom?
- Is the consultation process broadly inclusive and appropriate?

#### *The international environment*

- How much awareness is there of the WTO and the multilateral trading system and regional trade agreements?
- Is the country having difficulty negotiating and/or implementing WTO and regional trade agreements?
- Is the country involved in international standards-setting bodies?

#### *b. The trade policy and strategy development*

In simple terms a trade strategy is a vision of how an economy, given its particular characteristics, should be seeking to link itself with the global economy. Ideally this strategy should be an integral part of the country's overall development objectives and strategy. It should be coherent with national development priorities, create an enabling environment and contribute to sustainable poverty reduction. Without this mainstreamed approach there is a risk that trade policy will not maximise the opportunities while minimising the costs of adjustment. This mainstreaming approach should help to identify the appropriate emphasis on trade and in turn the resource envelope that should be allocated according to its priority. The types of questions/issues that need

to be considered and addressed when developing the strategy are detailed below.

#### *The importance of trade*

- How important is trade and investment to the country?
- What are the key products and markets? Are these national, regional or international?
- Are there upcoming new products and/or markets with a trade potential?
- What are the principal barriers (domestic and external) to trade development and how can they be addressed?
- What are the country's priority objectives in regional and multilateral trade negotiations?
- How much government revenue comes from trade taxes?

#### *Implications of trade reform*

- Does the country have a national development strategy? Is trade integrated in this strategy?
- What macroeconomic or other policy adjustments will be needed to support trade development?
- What are the likely impacts of trade reform on relative prices (tradables and non-tradables), different sectors, household expenditure and poverty levels?
- What are the likely adverse social and economic consequences of reform? How will the main sectors/industries be affected? What complementary policies should be considered? How can we ensure the poor benefit? Are there short term/long term issues that we should consider?
- What are the implications of trade reform on complementary policies? What domestic policy reform is needed to maximise the benefits and minimise the costs of reform?
- Will the country need to undergo fiscal reform as a result of liberalisation – i.e. how dependent is the country on tariffs? What adjustment period is needed? What analysis has been undertaken?
- Where will the additional resources for trade development come from? What role should donors play?

#### *2.1.2 Diagnostic tools*

A widely used analytical review of country trade policy (or aspects thereof) is the WTO Trade Policy Review (TPR). Further relevant needs assessments include in particular the Diagnostic Trade Integration Studies and the World Bank's Poverty and Social Impact Analysis (PSIA) of Trade Reforms (the latter two applying for LDCs). Additional relevant information may also be drawn from the World Bank's Tariff Reform Impact Simulation Tool (TRIST).

*WTO Trade Policy Review*<sup>41</sup>

The WTO TPRs are conducted for all members of the WTO, though the regularity of review varies. In preparing the report, the WTO Secretariat seeks the cooperation of the government, but has the sole responsibility for the facts presented and views expressed. The reports consist of detailed chapters examining the trade policies and practices of the WTO Member country and describing trade policy making institutions and the macroeconomic situation. They therefore provide relevant information for analysing the country's trade situation.

*Diagnostic Trade Integration Studies (Enhanced Integrated Framework)*

The DTIS is a complementary tool focused on the identification of areas and problems on which action is needed. The DTIS is an analytical tool, financed through the Enhanced Integrated Framework (EIF).<sup>42</sup> In the past, the World Bank and UNDP have been the main implementers of these studies. This may change in the coming years, LDCs aiming at ensuring better ownership and control of the study. DTISs are to be the basis for discussions on mainstreaming trade between partner Government and donors in National Development Programmes or Poverty Reduction Strategy Papers and through partner government policies focusing more specifically on trade and private sector development.

The issues examined in the DTIS cover a wide range of subjects:

- Macroeconomic environment – as a stable macroeconomic situation is a prerequisite to improve trade performance;
- Business environment, standards and trade facilitation issues;
- Structure and pattern of trade and investment (origin and destination of trade and investment flows and trends);
- Trade policy and institutions e.g. trade regime in terms of tariffs and other conditions, institutional capacity and coordination of a country's trade policy;
- Infrastructure, including transport and communications;
- Trade agreements and market access;
- WTO accession (if applicable);
- Trade policy and poverty.

Sectoral studies are to be conducted in order to analyse constraints in the agriculture, manufacturing, and services sectors. In the majority of cases, the DTIS should be a good starting point to have an overview of the main constraints to trade and private sector, and to identify the strategic objectives and key actions to be prioritized.

According to the 2009 OECD/WTO Aid for Trade report, over 50% of the LDCs included in an OECD-WTO Partner Country Questionnaire reported that the DTIS fully reflects trade related needs and priorities. About 20% were either in the process of the DTIS or unsatisfied with the results. However, the same Aid for Trade Report notes that past DTISs were generally drafted in broad terms, and did not clearly prioritise and cost trade-related needs. The newly reformed EIF offers an opportunity to address these weaknesses and improve the next generation of DTISs.

*World Bank Poverty and Social Impact Analysis (PSIA) of Trade Reforms*

The PSIA provides a systematic impact assessment of policy reforms on the well-being of different stakeholder groups, with particular focus on the poor and vulnerable. Various tools and techniques are used, including economic modelling and other quantitative but also qualitative methods. In particular, tools from the "Toolkit for Evaluating the Poverty and Distributional Impact of Economic Policies" and "Tools for Institutional, Political & Social Analysis (TIPS): sourcebook for PSIA" can be used to assess the impact of trade policy reforms and in particular the estimation of poverty and distributional effects.

The PSIA is carried out in three steps. "The first step is the estimation of the changes in the prices of goods and labour returns resulting from trade liberalization. In the second step, the income sources and consumption baskets of each household are analyzed to construct budget and income shares. During the last step, the changes in the prices of goods and factors are mapped into each household's budget and income shares so as to produce an estimate of the changes in the welfare of the households."

*World Bank Tariff Reform Impact Simulation Tool (TRIST)*<sup>43</sup>

The TRIST is an excel-based tool developed by the World Bank that simulates the impact of tariff reform on total fiscal revenues. Fiscal revenue results are broken down by products; hence it allows identifying the products which are sensitive in terms of revenue losses. When suitable and complete data are available, the TRIST can provide information on the short-term vulnerabilities of the productive areas that will suffer the most in terms of employment and production. The tool is extremely useful for donors and policy makers to measure the adjustment costs following trade reforms. It is worth to keep in mind that this tool is only applicable for assessing the short-term impact of trade reforms and that it is only relevant for partial equilibrium analysis which means that impact is analysed in isolation from the rest of economy and no long-term effects are taken into account.

41 Link on WTO TPR: [www.wto.org/english/tratop\\_e/tptr\\_e/tptr\\_e.htm](http://www.wto.org/english/tratop_e/tptr_e/tptr_e.htm)

42 The EIF is a multi-donor facility that was established as an instrument for joint analysis, to assist LDCs to integrate trade issues into the overall development strategy and to fill gaps in the financing of support to governments of LDCs in trade capacity building.

43 Further information and access to existing country TRISTs: <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/TRADE/0,,contenMDK:21537281~pagePK:210058~piPK:210062~theSitePK:239071,00.html>

## 2.2 Broad areas of intervention and key activities

Support to trade policy and regulation mainly relate to: (a) formulating and mainstreaming trade policy, (b) participating in trade negotiations and (c) implementing trade agreements, including trade-related adjustment.

It is important to keep in mind though, that trade in services is mainly constrained by regulation rather than tariffs. With a poor regulatory framework trade in services is not only unlikely to be effectively opened up through trade agreements, but there is also a danger of premature liberalisation.<sup>44</sup>

Furthermore, it should be noted that adjustment support is aimed at off-setting net revenue losses arising from the reduction or removal of tariff barriers<sup>45</sup> so as to assist governments in undertaking the necessary fiscal adjustments. In a wider sense, key areas of adjustment to trade

liberalisation extend to (1) Fiscal reform; (2) Regulatory reform; (3) The flexibility of the factor markets (labour, financial) and (4) Support to the private sector (through the strengthening of productive capacity). The present thematic review however focuses on the fiscal aspects of tariff reforms only. Some of the other aspects are being covered in other thematic reviews such as the one on competitiveness (which includes aspects of strengthening of productive capacities). Again others are subject of policies outside the immediate scope of trade related assistance or private sector development. That includes also fiscal reform which is a wider process in and of itself and cannot be subsumed with trade policy. However, trade negotiations and fiscal revenue and reform issues are of course linked.

Table 2 presents broad areas of intervention and key activities within the framework of the present thematic review.

<sup>44</sup> For the banking sector for instance, liberalisation can jeopardise existing banks and entail risks creating financial instability unless properly sequenced with the prior introduction of required regulation and sector reform.

<sup>45</sup> Tariff revenue is an important source of government revenue for many developing countries, but this varies widely – from 3% in Brazil to 40% in Uganda (OECD 2005).

**Table 2. Broad areas of intervention and key activities**

Broad areas of intervention	Key activities
<b>Mainstreaming and Formulation of Trade Policy</b>	<p><i>Institutional setup</i></p> <ul style="list-style-type: none"> <li>• Institutional review to examine inter-Ministerial responsibilities and co-ordination on trade-related issues and recommended improvements</li> <li>• Establishment of a trade policy research and advocacy unit within the Ministry of Trade in co-ordination with other government bodies</li> <li>• Support to local and independent “think tank” and development of “north – south” and “south – south” research networks</li> <li>• Training for Government officials in policy analysis skills</li> <li>• Support specific to mainstreaming trade policy in national development, with sensitisation of the linkages identified in the diagnostic studies and establishing operational strategies with budgeted action plans</li> <li>• Assessment of strengths and weaknesses of the legal and regulatory framework of different subsectors and the institutional structure responsible for the provision of the respective services</li> </ul> <p><i>Research &amp; analysis</i></p> <ul style="list-style-type: none"> <li>• Support for strategy development, identifying key issues, impact assessment, diagnostics</li> <li>• Diagnostic study of trade and poverty linkages with recommendations on a pro-poor trade policy</li> <li>• Provision of technical expertise for policy research and training to key stakeholders (government and non-government)</li> <li>• Support to Central Statistical Office, Customs etc. to strengthen capacity to produce and access coherent and sound local statistics</li> <li>• Support to non-government stakeholders to undertake their own analysis and prepare position papers</li> <li>• Study on the impact of liberalization on trade in services</li> <li>• Conduct a comprehensive exercise identifying the sensitive areas and main constraints in the services sector of the country/region</li> <li>• Conduct a “regulatory audit” of the domestic regulatory framework administering trade in services in order to identify discriminatory measures and regulatory gaps</li> </ul> <p><i>Policy formulation process</i></p> <ul style="list-style-type: none"> <li>• Communication strategy to raise awareness and develop policy dialogue with business sector and civil society stakeholders – implementation involves workshop etc.</li> <li>• Support in establishment of public-private sector dialogue (e.g. trade policy working groups)</li> <li>• High level workshops to promote a higher profile for trade policy and proactive identification of how trade policy can contribute to reaching sector specific objectives</li> <li>• Facilitate and capacitate a network for dialogue between Trade Negotiators, the regulators and regulated service providers and services users to understand the regulatory baselines and the potential impact of trade policy negotiations</li> </ul>
<b>Participation in trade negotiations</b>	<ul style="list-style-type: none"> <li>• Capacity building, including training, to better represent and defend country interests</li> <li>• Assistance to negotiations of accession to e.g. WTO, regional agreements; this mostly applies to LDCs e.g. EPA). For developing countries, the WTO holds a trust fund (to which the EU is contributing) for training</li> <li>• Direct support to governments through specific technical experts to assist negotiators on particular issues (legal, technical, economic) of trade in services</li> <li>• Assistance with national co-ordination on trade agreements – possibly with establishment of co-ordinating unit in Ministry of Trade for e.g. WTO</li> </ul>
<b>Implementation of trade agreements; including Trade-related adjustment</b>	<ul style="list-style-type: none"> <li>• Support to trade reforms and drafting of new national legislation consistent with international trade commitments</li> <li>• Compensation for net tariff revenues losses resulting from trade agreements /reforms and to fiscal reforms to be implemented in that context</li> <li>• Establishment of national institutions and bodies required for implementation of international trade agreements e.g. WTO National Enquiry Point, the National Tariff Bodies which may be required by regional agreements</li> <li>• Training of officials in key areas – such as when to invoke trade defence mechanisms</li> <li>• Provision of advisory services, long term and short term to support regulators in the reform process</li> <li>• Provision of legal advice on trade dispute settlement</li> </ul>



### 3. How can it be done?

#### 3.1 Methods and levels of intervention

Support to trade policy formulation and implementation can take the form of technical assistance as well as budget support. The adoption and implementation of trade and related fiscal reforms lend themselves to budget support mode, which may be accompanied by complementary technical assistance. Various other results may be better obtained by providing more extensive technical assistance through project mode.

#### 3.2 Sequencing of activities

In terms of sequencing trade liberalisation there are key and relatively well established rules of thumb which vary widely according to the nature of the sector (or sub sector) under consideration. For example, tariff liberalisation for a country heavily dependent on trade taxes should be accompanied by fiscal reform to broaden the tax base and lessen the impact of tariff reduction on government revenue. In the case of trade in services, the strengthening of regulation should be prior to liberalisation reforms, as shown above in the financial sector in order to avoid the risks relying on the combined effect of increased competition and deregulation.

#### 3.3 Expected results and results measurements

Table 3 provides an overview of expected results and indicators – corresponding to the areas of intervention mentioned in section 2.2 above.

#### 3.4 Cross cutting issues

##### *Trade policy and the environment*

Economic development, in its multiple forms, is the primary cause of anthropogenic greenhouse gas (GHG) emissions. International trade can generate significant GHG emissions and other environmental nuisance, but it can also play an important role in the development of markets for low-carbon goods and services and the dissemination of solutions needed to achieve low-carbon growth by countries around the world.

At the international level, the transport sector will increasingly be targeted by and included in schemes aimed at controlling and reducing GHG emissions. In the context of national and regional trade support programmes, climate mitigation efforts can be supported by stepping up efforts to make export-oriented and domestic production more efficient (notably with regard to energy consumption) and environmentally more sustainable. Growth in trade is also often accompanied by the adoption of

less polluting standards and greater demand for higher environmental standards that reduces environmental degradation.

Trade policy measures can also directly influence environmental sustainability. In the Doha round the EU and US have proposed to create free trade in environmentally friendly goods and services, in particular those directly linked to clean energy and climate change. Measures put forward included tariff reduction on 43 climate friendly products, such as solar panels and wind turbines, to be followed by an Environmental Goods and Services Agreement which would eliminate non-tariff barriers in green products and increase market access for climate-related services – including environmental services. Several WTO members rejected the proposal, considering it an attempt to gain market access in products and services of interest to the US and EU. Brazil cited the fact that biofuel was not included as evidence to support the claim.

The complexities and challenges for effectively linking trade and environment at the multilateral level are substantial. However it is obvious that high tariffs on e.g. clean energy technology will reduce adoption, and that restrictions on trade in environmental services need to be taken into account in environmental and climate change programmes.

##### *Trade policy and gender*

The link between trade policy and gender is complex and highly context specific. The gender impact of trade policy needs to be assessed at a country and sector specific level. In several cases international trade has contributed to greater income equality between men and women (e.g. greater trade in manufacturing and services has generally increased employment opportunities for women), leading to greater empowerment of women as their incomes rise and greater entry of women into the labour market. However, there are also cases where women are made worse off. Poor women are also particularly vulnerable to shocks in income and are therefore more at risk from the volatility that often accompanies greater liberalisation and market integration. Barriers to finance and education also make it harder for women to adjust to new prices through e.g. retraining.

The response to the challenge of gender in trade policy in practical terms includes a gender disaggregation of trade flows and production and the inclusion of women's networks in trade policy consultations. Further tracing the linkages between trade policy and gender requires an assessment of intra-household distribution of income,



**Table 3. Selection of results and indicators for measurement**

Results	Indicators	Source of Verification
<b>Trade policy mainstreamed and formulated</b>	<p><i>Institutional setup</i></p> <ul style="list-style-type: none"> <li>Number of internal consultations within the government among line ministries</li> <li>Trade policy research and advocacy unit established within Ministry of Trade</li> <li>Number of consultations and discussion forums set up between government bodies, institutes, private sector organisations and civil society representatives</li> <li>Number of government officials trained in policy analysis skills</li> <li>Adoption of an operational strategy with budgeted action plan for mainstreaming trade policy in national development</li> </ul> <p><i>Research &amp; analysis</i></p> <ul style="list-style-type: none"> <li>Diagnostic study of trade and poverty linkages in the country is established</li> <li>Number of trade policy papers, commissioned and produced by national trade research centres</li> <li>Number of trade policy networks and degree of co-operation between different national and regional centres</li> <li>Number of University courses on trade policy</li> <li>Number of trainings in place</li> <li>Quantity and quality of statistical data available</li> <li>Degree of use of local statistics and research in policy making</li> </ul> <p><i>Policy formulation process</i></p> <ul style="list-style-type: none"> <li>Adoption of a national trade policy that is integrated within country's national development objective</li> <li>Trade policy incorporates co-ordinated input of Ministries concerned</li> <li>Number of high profile sensitization workshop on trade</li> <li>Number of publications/ studies/ statistics disseminated to key stakeholders</li> <li>Dissemination of trade policy reforms amongst stakeholders</li> </ul>	<ul style="list-style-type: none"> <li>Survey and interview</li> <li>Project reporting</li> <li>Review of national budget</li> <li>World Bank, Aid for Trade at a Glance</li> </ul>
<b>Trade negotiations have been undertaken</b>	<ul style="list-style-type: none"> <li>Degree of participation in negotiations (e.g. number of proposals at the WTO)</li> <li>Number of trainings on WTO/EPA/ Regional trade agreements for key stakeholders</li> <li>Timeframe and progress in accession to trade agreement</li> <li>Regularity and involvement in national co-ordinating body</li> <li>Attendance and participation in negotiations</li> <li>Number of cases brought to arbitration or dispute settlement</li> </ul>	<ul style="list-style-type: none"> <li>Survey and Interview</li> <li>Submissions to WTO</li> <li>WTO Trade Policy Review</li> <li>WTO Reports on disputes</li> </ul>
<b>Trade agreements; including Trade-Related Adjustment implemented</b>	<ul style="list-style-type: none"> <li>Number of WTO and other trade agreements implemented</li> <li>Number, scope and quality of WTO or other agreements regulations/ legislation adopted</li> <li>Timeframe of implementation and adoption of related domestic legislation</li> <li>Number of required institutions established</li> <li>Number of trainings on e.g. trade defence mechanisms</li> <li>Impact on tariff revenue assessed and quantified</li> <li>Fiscal reform adopted</li> </ul>	<ul style="list-style-type: none"> <li>Survey and Interview</li> <li>WTO Trade Policy Review</li> <li>Government Gazette</li> <li>Project reporting</li> <li>Number of disputes filed in WTO</li> </ul>
<b>Outcome</b>		
<b>Improved access to export markets</b>	Market Access Trade Restrictiveness Index (MATRI)	World Trade Indicator (World Bank)
<b>Trade liberalisation</b>	Trade restrictiveness Index (tariffs only)	World Trade Indicator (World Bank)
	Share of tariff lines with domestic peaks	World Trade Indicator (World Bank)
	Enabling Trade Index; Market Access Tariff and Non Tariff Barriers Pillar	World Economic Forum, Global Enabling Trade Report

though often sectoral analyses (starting from an identification of sectors where women are disproportionately economically active) can give a fair approximation of the impact of trade policy changes on gender.

### *Trade policy and governance*

Recent studies provide some evidence of the influence of trade policy on good governance<sup>46</sup>, although they do not allow for an assessment of causality. On the one hand, trade liberalisation can lead to better governance for both developing and developed countries, but the impact is limited. On the other, the impact of trade liberalisation is conditional on the initial level of governance: a

poorly governed country is unlikely to see any improvement as a result of liberalisation. For example, for Mexico with NAFTA and for various EU accession countries, regional integration had a very positive impact on the quality of governance.

### **3.5 Risks**

Main risks are linked to the absence of political will to adopt and implement reforms, including fiscal reforms to balance tariff changes. Therefore, it will be important to link any compensation support funded by donors to the effective adoption and implementation of the fiscal reforms.

46 See for example a literature review on empirical linkages between institutions, governance and growth in: Prabir De (2010). "Governance, Institutions and Regional Infrastructure in Asia", ADBI Working Paper Series, No.183, January 2010. [www.adbi.org/files/2010.01.04\\_wp183.gov.institutions.region.infrastructure.asia.pdf](http://www.adbi.org/files/2010.01.04_wp183.gov.institutions.region.infrastructure.asia.pdf)

## 4. Where to find out more?

### 4.1 Baseline assessment of Trade Policy and Institutions

#### *WTO Trade Policy Review Mechanism*

A key reference document is the WTO Trade Policy Review conducted for all members of the WTO, though the regularity of review varies. Reviews are conducted by the Trade Policy Review Body (TPRB) in collaboration with the WTO Member and a report is prepared by economists in the Secretariat. The report examines the trade policies and practices of the Member and describes trade policymaking institutions and the macroeconomic situation. [www.wto.org/english/tratop\\_e/tpr\\_e/tpr\\_e.htm](http://www.wto.org/english/tratop_e/tpr_e/tpr_e.htm)

#### *Benchmarking trade policy and institutions*

The World Trade Indicators (WTI), an interactive tool launched in June 2008, was designed to benchmark a country's trade policy and institutions and help policy makers, advisors, and analysts identify the main border and behind-the border constraints to trade integration. The WTI 2008 database and the country Trade-At-A-Glance (TAAG) tables (last updated in December 2008) are organized in five thematic categories, namely Trade Policy, External Environment, Institutional Environment, Trade Facilitation and Trade Outcome. Country reports can be found at: <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/TRADE/0,,contentMDK:22421950~pagePK:148956~piPK:216618~theSitePK:239071,00.html>

#### *Regional Agreements*

A good place to start to understand the regional and bilateral web of agreements in which a country or regional integration organisation may be involved is [www.bilaterals.org](http://www.bilaterals.org). This also provides updates of the status of negotiations. With regards to Economic Partnership Agreements (EPA) and the status of negotiations go to <http://ec.europa.eu/trade/wider-agenda/development/economic-partnerships/>

### 4.2 Impact analysis

#### *Sustainability Impact Assessments (SIAs)*

Sustainability Impact Assessments (SIAs) seek to identify the potential economic, social and environmental impacts of trade agreements. Their main purposes are: (1) to provide a better basis for EC institutions to ensure that ongoing trade negotiations take the sustainable development dimension fully into account, and to provide a Trade SIA-based assessment of the outcome of negotiations; (2) to provide inputs to the definition of a full package of policies

at EU level and in the domestic context of trade partners, which will produce the optimal outcome in terms of trade liberalisation and economic growth but also of other components of sustainable development; and (3) to create a basis for the discussion with European stakeholders about sustainability implications of the negotiations. [http://ec.europa.eu/trade/issues/global/sia/studies\\_geo.htm](http://ec.europa.eu/trade/issues/global/sia/studies_geo.htm)

#### *Poverty and Social Impact Assessments*

The World Bank also undertakes poverty and social impacts of a range of issues, including trade policy. They also provide handbooks of key issues involved in PSIAs, one of them being "Tools for Institutional, Political & Social Analysis (TIPS): sourcebook for PSIA". <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTPOVERTY/EXTPSIA/0,,contentMDK:20466271~menuPK:1108016~pagePK:148956~piPK:216618~theSitePK:490130,00.html>

#### *Trade policy reform impact assessment*

<http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTPOVERTY/EXTPSIA/0,,contentMDK:20503374~menuPK:1107994~pagePK:210058~piPK:210062~theSitePK:490130~isCURL:Y,00.html>

McCulloch, Winters and Cirera (2004) "Trade Liberalisation and Poverty: A Handbook", Key reference document offering an overview of the linkages between trade liberalisation and poverty. It also includes a guide to the different techniques for analysis.

The OECD has undertaken substantial research in the area of trade-related adjustment, providing theoretical and empirical studies and also guidelines for supporting adjustment programmes. Key documents include:

OECD (2006) "Case Studies on Facilitating Adjustment"

OECD (2005) "Trade and Structural Adjustment: Embracing Globalisation".

#### *Trade and gender*

AIDCO Gender toolkit:

[www.cc.cec/dgintranet/europeaid/activities/thematic/e4/gender/index\\_en.htm](http://www.cc.cec/dgintranet/europeaid/activities/thematic/e4/gender/index_en.htm)

#### *Trade and the environment*

Guidelines on the Integration of Environment and Climate Change in Development Cooperation, EuropeAid, November 2009. [www.cc.cec/dgintranet/europeaid/activities/thematic/e6/documents/environmental\\_integration/environmental\\_handbook\\_en.pdf](http://www.cc.cec/dgintranet/europeaid/activities/thematic/e6/documents/environmental_integration/environmental_handbook_en.pdf)

### **4.3 Evaluations and good practice reports**

ADE 2004: "Evaluation of Trade Related Assistance by the European Commission in Third Countries".

European Commission 2006: "The Joint Evaluation of Co-ordination of Trade Capacity Building in Partner Countries".

Inter-American Development Bank 2005 : "Trade Related Capacity Building: An Overview in the Context of Latin American Trade Policy and the Mercosur-EU Association Agreement".

OECD 2007: "Trade Related Assistance: What Do Recent Evaluations Tell Us?".

DFID 2004: "Building Trade Policy Capacity in Developing Countries and Transition Economies: A Practical Guide to Planning Technical Co-operation Programmes".



## **Thematic Review 2**

### **Trade Facilitation**

# 1. What does the theme cover?

## 1.1 Definition and terminology

The overall goal of Trade Facilitation is that trade transactions become easier, quicker and more economical than before. The focus of trade facilitation, generally, is the introduction of simplified procedures and new techniques designed to reduce the time and cost it takes for imported and exported goods, and goods in transit, to be released<sup>47</sup>. Beyond Customs, Trade Facilitation involves other areas and government agencies, such as veterinary, phyto-sanitary, immigration, port management and security services concerned with the management of imports and exports. Harmonising and rationalising the rules and regulations applied by these agencies, and coordinating their border related activities (e.g. opening hours and inspections), are also important aspects of trade facilitation.

More recently, trade facilitation practitioners tend to also include a wider perspective which looks beyond mere trade procedures and controls governing the movement of goods and services to address the whole trade chain from the seller to the buyer, including the development of transport corridors and logistics chains, other non-tariff trade barriers, rapid legal redress, business mobility, elements of fiscal policy and trade finance.

This is relevant from an economic point of view and for donors from a programming point of view in order to plan the support for a coherent set of measures in a national or regional geographic area. However, though from a project and program perspective, a wider scope such as this could lend itself to an all-encompassing programme, it would be composed of several individual projects each focusing on individual components. For example, a Trade Facilitation programme might include components relating to Customs Procedures, Transport Policy, Trade Policy and Trade Standards.

This thematic review concentrates on import and export procedures and customs formalities that must be accomplished when moving goods across national borders. It should however be noted that some elements of trade facilitation (e.g. SPS and TBT) are addressed more specifically in other thematic reviews.

## 1.2 Background and rationale for supporting trade facilitation

World trade has expanded rapidly over the past decades. This has been partly driven by the changing nature of production and increased competition in international commerce. Moreover, the considerable reductions in the tariffs on goods crossing national borders arising from

the multilateral, regional and bilateral trade negotiations have significantly contributed to the growth of trade. In line with these developments, the focus of trade policy has prominently involved the elimination of non-tariff barriers to trade, including trade facilitation, as means for increasing competitiveness and trade volumes.

Trade facilitation looks at how procedures and controls governing the movement of goods across international borders can be improved to reduce associated cost and administrative burden while pursuing legitimate public objectives. Its importance relates to the context in which trade is conducted. Businesses work within a supply chain, that is to say the chain of processes that involves the movement of goods from their original manufacture to the eventual consumer. The many links in the chain (for example the extraction of raw materials, construction and assembly, merging, processing, storage and inventory, picking and packing, wholesale and retail) all involve some form of distribution/transport, occurring increasingly across borders.

A study by the OECD in 2009<sup>48</sup> indicates that trade transaction costs can amount to up to 15 percent of the value of traded goods globally and that trade transactions costs are higher on agricultural and food products, fish, and forest and wood products, because such products are subject to additional border procedures due to sanitary and phyto-sanitary requirements. These are products traded by many developing countries.

Experience shows that developing countries that have successfully simplified and modernised their official trade procedures have increased their overall trade flows, enjoyed higher revenue collection, higher detection rates of fraud, rapidly amortised any initial capital costs involved in modernising procedures and improved the overall morale and efficiency of their Customs administrations and their trading communities.

Furthermore, countries that have adopted a co-operative approach or that have forged themselves into regional economic groupings have done even better and for this there is probably no better example than that of the EU's achievements with the introduction of the Single Market in 1992 supported by a very efficient Customs Union. Goods, services and people now move effortlessly throughout Europe.

However the development cost has been high and many hard lessons have been learned, not least that lightening the administrative load must be accompanied by technical modernisation that provides the tools to secure the supply chain for both the public and private sectors

47 The definition of Trade facilitation on the Commission's DG TAXUD website is "the simplification and harmonisation of international trade procedures including import and export procedures, the latter being the activities (practices and formalities) involved in collecting, presenting, communicating and processing the data required for movement of goods in international trade". Other international definitions (WTO, World Bank, UN/CEFACT, OECD) also include all these aspects.

48 OECD publication: OECD, (2009) "Overcoming Border Bottlenecks. The cost and benefits of Trade Facilitation- OECD Trade Policy Studies. <http://puck.sourceoecd.org/vl=1971243/cl=38/nw=1/rpsv/-6678/v2009n2/s1/p11>



alike. For example, moving goods in international transit is now a very efficient process for European traders but, to reach this level, the Member States and the Commission put in place a highly sophisticated computerised system that monitors traffic from departure to destination so as to reduce fraud to practically nothing. This computerised system is underpinned by modern risk management systems that aim to maximise benefits for compliant traders.

As a result, the introduction of the EU's Single Market and Customs Union has provided it with perhaps the largest pool of information and operational experience of handling international trade - at both national and regional level.

In summary, the implementation of Trade Facilitation programmes and projects can offer very significant, tangible results in terms of contributing to expanding trade, reducing the costs of trading, as well as improving revenue collection which is of key importance for sustainable and increased government revenues for the financing of national policies and service delivery.

### 1.3 Legal and regulatory context

#### 1.3.1 Introduction

At first sight, the plethora of texts that cover Trade Facilitation seems a complicated tangle – difficult to get to grips with in practical terms. However, these can be grouped and organised according to three different levels:

- First, Agreements and Conventions at multilateral level generally lay out high-level principles that are, for the most part, agreed at the WTO and to some extent at the WCO. The UNECE also has taken responsibility for many years for very detailed work in terms of trade data elements and telecommunication standards and, more surprisingly, Customs Transit systems - where it has responsibility for TIR.
- Second, individual countries and/or groups of countries enter into political, economic and technical Agreements such as Free Trade Agreements, Single Market and Customs Union arrangements, Trade and Transport Protocols and so on.
- Third, there are the more detailed national rules: both those adopted by countries autonomously and the specific implementing rules and regulations that apply as a consequence of the signature of political, economic and technical agreements. In fact, substantial pieces of law and implementing regulations are required at the operational level to make new procedures and systems function in the trade facilitation context. These may be implemented directly

at regional level (for example the Common Customs Code in the EU) but also at national level where a regional implementation cannot be managed for any reason. TF programmes and projects very much aim to ensure such operational rules and systems are put in place in line with broad WTO principles.

It is crucial in the development of Trade Facilitation programmes and projects that the legal framework and impact of the texts, and how they are handled, are understood in their specific context.

The main multilateral agreements, conventions and declarations are summarised below.

#### 1.3.2 Multilateral framework

##### a. World Trade Organization (WTO)<sup>49</sup>

In the WTO, Trade Facilitation is the subject of several provisions and obligations under the GATT Articles V (Freedom of Transit), VIII (Fees and Formalities relating to Importation and Exportation) and X (Publication and Administration of Trade Regulations), which focus on general trade principles such as the need to create an environment in which transit of goods is free from barriers to transport and discrimination, customs clearance procedures, transparency in fees and rules applied to goods crossing the borders and ensuring timely publication and regulations regarding imports and customs valuation procedures.

Since 2001, WTO members have been engaged in negotiations on trade facilitation as part of the Doha Development Agenda (DDA) negotiation process.<sup>50</sup> One of the objectives of these negotiations has been to clarify and improve WTO rules in relation to transparency of trade regulations, import and export procedures, and transit.

The outline of a future possible agreement includes, inter alia (a) new obligations to promote electronic distribution and transmission of government trade regulations on imports and exports, (b) standardisation of certain basic fees for imports, and (c) stronger rules to help ensure freedom of transit for goods crossing national borders. More controversial changes to current obligations have also been considered, such as the establishment of a single window for exporters and importers at Customs, and accepting copies of documents for import and export in lieu of originals.

However, the content of the WTO texts will certainly remain at a high level of principle. Thus in designing TF programmes or projects, law and implementing regulations are still very much required at the operational level to make new procedures and systems function in the facilitation context.

49 [www.wto.org/english/tratop\\_e/tradfa\\_e/tradfa\\_e.htm](http://www.wto.org/english/tratop_e/tradfa_e/tradfa_e.htm)

50 In particular, paragraph 27 of the Doha Ministerial Decision states that "... the Council for Trade in Goods shall review and as appropriate clarify and improve relevant aspects of Articles V (Freedom of Transit), VIII (Fees and Formalities connected with imports and exports) and X (Publication and Administration of Trade Regulation) of the GATT 1994 and identify the trade facilitation needs and priorities of Members, in particular developing and least-developed countries. In addition, article 24 refers to the arrangements and effect of Customs Unions and Free-trade Areas."

### b. World Customs Organization (WCO)<sup>51</sup>

Within the WCO framework, the Revised Kyoto Convention (RKC) is an international agreement that provides a set of comprehensive customs procedures to facilitate legitimate international trade while effecting customs controls.<sup>52</sup> It is widely considered as the “blueprint” for customs modernisation and thus facilitating legitimate trade, with key principles of simplified and harmonised customs procedures, such as predictability, transparency, due process, maximum use of information technology, and modern customs techniques (e.g. risk management, pre-arrival information and post-clearance audit).

The RKC sets operational standards for facilitating trade. Thus in terms of Customs Transit, for example, the Annex E and its specific guidelines in the RKC refer to the need to secure duty and tax charges (the Customs guarantee), the Simplifications of controls to be provided for business designated as Authorised Economic Operators, basic physical security, the importance of using IT as the basis for a secure system to prevent fraud and so on. However, for Customs Transit to work on the ground, the standards set in the RKC need to be further detailed in legal texts so that operational systems can be implemented (see also below).

Another crucial WCO instrument is the ‘SAFE Framework of Standards to Secure and Facilitate Global Trade’. It provides a consolidated platform which aims to protect against international terrorism, to secure revenue collections, and to promote trade facilitation worldwide. It is based on four core elements<sup>53</sup>, aiming to provide a balanced approach between supply chain security and trade facilitation.

The SAFE Framework rests on the twin pillars of Customs-to-Customs network arrangements and Customs-to-Business partnerships. The main aim of the Customs-to-Customs network arrangements is to provide for the exchange of information between Customs Administrations in order to improve controls, to detect high-risk consignments early in the international trade supply chain and to optimise the allocation of Customs resources. The SAFE Framework also provides for the development of mutual recognition of trade partnership programmes under certain circumstances.

The WCO has developed an Integrity Development Guide and published the Arusha Declaration on Integrity in Customs. The revised Declaration proposes ten elements

on how to develop and implement a programme aimed at reducing corruption and enhancing integrity in customs. The global objectives of the programme being to reduce monopoly of power, control the use of official discretion and increase accountability.<sup>54</sup>

The WCO also manages a number of other Instruments (Conventions, Agreements and Recommendations), for example such as in relation to Valuation and the Harmonised System of Goods Nomenclature (the HS), that require implementation at national level.

### c. The UN Economic Commission for Europe – UNECE

The United Nations Economic Commission for Europe (UNECE) was set up in 1947 as one of five regional commissions of the United Nations. Its major aim is to promote pan-European economic integration. Through its Centre for Trade Facilitation and Electronic Business (UN/CEFACT), the UNECE also sets out and manages detailed data and telecommunications standards to facilitate international commerce both within and outside the region. These standards, and especially the code lists, are vital instruments in the implementation of electronic systems for trade and transport management and Customs clearance.

UNECE also manages the TIR Customs Transit system although day-to-day operations have been put in the hands of the International Road Transport Union (IRU) in terms of issuing the Transit documents (called TIR carnets) and providing a guarantee to cover for potential duty and tax charges. TIR came into being in the 1950s and has certainly been of great benefit to the movement of goods regionally in Europe. However it is now out of step with the principles of a modern Customs Transit system as set out in the RKC and it was for this reason that the EU chose to implement its own Common Transit System which is also now fully computerised (NCTS).

### 1.3.3 Regional economic agreements

Trade Facilitation has its greatest impact through the implementation of regional economic agreements and especially those related to the development of Economic Communities and Single Markets – like the EU.

For a Single Market to function, an integrated Customs environment is required (Customs Union) where the Member States all work to the same set of Customs and Trade rules. Duties and other restrictive regulations of commerce are eliminated between the constituent

51 [http://wcoweb04.wcoomd.org/ie/En/Topics\\_Issues/FacilitationCustomsProcedures/facilitationCustomsprocedures.html](http://wcoweb04.wcoomd.org/ie/En/Topics_Issues/FacilitationCustomsProcedures/facilitationCustomsprocedures.html)

52 The RKC was agreed in 1999 and came into force in 2006 after 40 contracting parties ratified or acceded to the protocol of amendment. As of November 2010, 71 countries out of 172 members of the WCO have ratified the RKC. To be noted also that 6 island states of the Caribbean and 9 in the Pacific are not members of the WCO.

53 The SAFE Framework consists of four core elements: i) It harmonises advance electronic cargo information requirements on inbound, outbound and transit shipments; ii) Each country signing-up to the SAFE Framework commits to employing a consistent risk management approach to address security threats; iii) It requires that, at the reasonable request of the receiving nation, and based upon a comparable risk targeting methodology, the sending nation's Customs administration will perform an outbound inspection of high-risk containers and cargo, preferably using non-intrusive detection equipment such as large-scale X-ray machines and radiation detectors; iv) It defines facilitation benefits that Customs will provide to businesses – designated as Authorised Economic Operators (AEOs) – that meet minimum supply chain security standards and best practices.

54 The 10 elements of the Arusha Declaration on Integrity and Customs are: (1) Leadership and commitment; (2) Regulatory framework; (3) Transparency; (4) Automation; (5) Reform and modernization; (6) Audit and investigation; (7) Code of conduct; (8) Human Resource management; (9) Morale and organizational culture; (10) Relationship with the private sector. For more see [www.wcoomd.org/files/1.%20Public%20files/PDFandDocuments/Declarations/Revised\\_Arusha\\_Declaration\\_EN.pdf](http://www.wcoomd.org/files/1.%20Public%20files/PDFandDocuments/Declarations/Revised_Arusha_Declaration_EN.pdf)

territories of the Customs Union and substantially the same duties and other commercial regulations are applied by each of the members of the Union to trade with third countries (Common External Tariff). A Single Market goes beyond a Customs Union to include common policies that enable the free movement of goods and services, people and capital.

This is different to a Free Trade Area where duties and charges on internal trade are eliminated but countries are free to set their own tariffs and rules on third country trade.

Most, if not all, regional blocs are now in the early stages of implementing Single Markets and Customs Unions and they usually draw on the experience of the EU. Trade Facilitation concepts and baseline rules are enshrined in documents which require further implementing rules (see example in Box 1).

Trade facilitation and other issues (e.g. services; investment; government procurement; SPS; intellectual property rights; competition; labour and environment) are also at the core of the Economic Partnership Agreements (EPAs) concluded or being negotiated between the EU and the member countries of regional Economic Communities. Similar regional agreements are under negotiation or have been concluded with other regional groupings, such as Central America or Mercosur. The focus has been primarily on rules that govern trade facilitation as well as services and investment, while other trade-related rules are often left to a later stage.

#### 1.3.4 Legal issues at national level

It is crucial that national projects adopt multilateral principles and any detailed regional standards that have been devised by regional groupings and that national legislation and implementing regulations are amended accordingly.

For example, where ASEAN, SADC, COMESA and others have drafted a Single Administrative Declaration Document this must be used within the new systems installed – and not the generic standard document used by, say, the Asycuda system. Such changes are easily made and are important.

## 1.4 Key actors and issues

### 1.4.1 Key actors

Figure 1 depicts the key actors involved in the practice of delivering a facilitated environment for the movement of goods internationally.

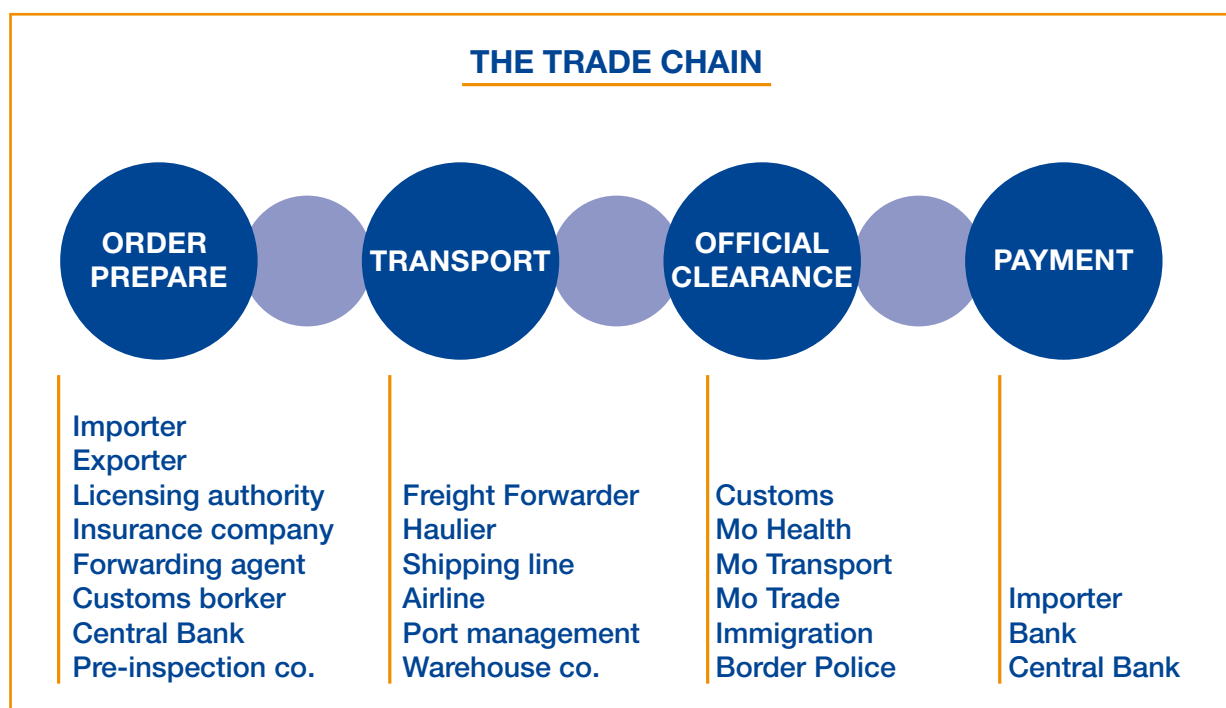
The Customs Administration is always regarded as the key player because it sits at the heart of the clearance process. Customs are involved from the arrival of goods to delivery out of the border gate, and thus have a pivotal role to play in receiving and processing information, assessing and receiving revenue, inspection and final clearance. However, other government agencies are concerned and include veterinary, phytosanitary, technical standards, immigration and police, trade and transport, port management and security.

Where the supply chain crosses international borders, importers, exporters, port authorities, transporters, banks, freight forwarders and shipping agents will also be involved on the trade side of the process.

Each of the other actors in the diagram will have their part to play in the clearance process in accordance with the nature of an individual consignment, or group of consignments, whether this is the provision of an import licence, the presentation of a shipping manifest, a Customs declaration and so on.

### Box 1. ASEAN Framework Agreement for the Facilitation of Goods in Transit

For example, ASEAN sets out its high-level rules for the ASEAN Economic Community (AEC) in its Blueprint signed in Singapore in 2007 and more detailed rules to provide freedom for the movement of goods in the ASEAN Framework Agreement for the Facilitation of Goods in Transit (AFAFGT). The EU financed ASEAN programme for Regional Integration Support (APRIS) has spent some eighteen months working to obtain the approval of the Member States regarding detailed law and implementing regulations under the AFAFGT to make the ASEAN Customs Transit System (ACTS) happen on the ground. These were based naturally on the principles of the RKC Annex E but drew more specifically on the texts underpinning the EU's New Computerised Transit System (NCTS) which fits all international standards and works well on the ground in terms of managing movements of goods and trucks. Similarly, to concur with the SAFE standards, within the same EC/ASEAN ACTS project the Transit system itself and IT networks that will be installed provide for risk management of consignments through an Authorised Operators scheme and the movement of standard data on consignments over a Customs to Customs network; advanced cargo information will be provided and a write-off facility from destination to departure.

**Figure 1. The trade chain**

Source of the original figure (adapted): Marcus Hellqwist, (2003) «Trade facilitation from a developing country perspective», Kommers, Swedish National Board of Trade.

#### 1.4.2 Key issues

Key issues include in particular the following:

##### a. Complexity of procedures

The functions implemented at the border are often complex and involve a variety of different Government Agencies who may be collecting or securing duties and taxes, preventing illegal imports, protecting the consumer and securing the supply chain.

Numerous, complex and non-transparent procedures unnecessarily delay clearance of goods, cause inefficiencies at all levels of the systems and result in high compliance costs and uncertainty for the trade. Common problems faced by businesses in carrying out their day-to-day activities relate to the complexity of regulations, inconsistent application of procedures, lack of up to date information on law, regulations, guidelines and rulings, problems with appealing decisions, an absence of simplified procedures for reliable traders with proven records, lack of harmonisation of customs procedures on either side of the borders at regional level, inadequate infrastructure, lack of an international transit system, problems with classification and valuation and failure to protect IPR.

Complicated processes permit discretionary decision-making by customs officials to flourish and create opportunities for corruption from traders/agents to offer/accept bribes to expedite customs procedures and formalities, to ignore illegal practices aimed at reducing taxation liability or to permit smuggling to take place. These

activities have a direct impact on businesses in terms of time (delay for clearing customs), cost (both official and unofficial) and uncertainty. The cost of trade rises. So the delivery of transparency of policy, regulations, and procedures relating to importation and exportation, simplifying the processes and administrative requirements, limiting contacts between customers and customs officers will have a major impact on the cost of Trade and economic development of countries and regions.

Thus, in the facilitation context, the following concepts are fundamental and need due consideration when identifying and designing a trade facilitation project.

- Simplification: the process of eliminating all unnecessary elements and duplication in data requirements, formalities, processes and procedures;
- Harmonisation: the alignment of national data requirements, formalities, procedures, operations and documents with international conventions, standards and practices;
- Standardisation: the process of developing internationally agreed formats for data requirements, practices and procedures, documents and information;
- Modernisation: through the use of information and communication technologies that rely on standardised and harmonised data to function efficiently; and finally
- Co-operation and co-ordination: this is the process that links the various actors into an active, operational

“community” either at the administrative level through, say, shared risk management information within an integrated Customs environment, or a public/private port community in which information about consignments is shared to facilitate official clearance or a Single Window environment which widens the community beyond the port, airport or land border post perimeters.

#### b. Vested interests and political economy

For Delegations looking towards the implementation of successful programmes and projects (deliverables in time and on budget), getting the “governance” right is a major factor, and in particular getting the understanding, determination and commitment from the actors all the way down the line.<sup>55</sup>

In facilitation projects, vested interests can be difficult to deal with in making fundamental change to procedures and systems.

Regional groupings like ASEAN, SADC and COMESA may have set their political and economic goals in terms of their Single Markets but the technical requirements to support the implementations of the harmonized and simplified environments is an assumption which often gets little further than a nod from the Customs, Transport and Trade establishment.

#### c. Limited institutional capacity

Trade Facilitation interventions are often also constrained by limited institutional capacity amongst beneficiary agencies, and by low levels of technology, particularly IT. The officials tasked with implementation too often have no idea of what is required or are not provided with appropriate budgets. Furthermore, the intelligent use of automation is the key to successful Trade Facilitation projects. The availability of automation above all acts as the catalyst to review and implement new rules, procedures and documents as well as substantially speeding up the clearance of goods out of official charge.

#### d. Consultation and communication

Trade consultation mechanisms may not be in place even though the Trading Community is a key player in the process. It is essential to include a communications element within any trade facilitation project between the actors at all levels. The establishment of, and terms of reference for, the Project Steering Committee should cover these issues and include these responsibilities.

55 A useful tool in this respect is the reference document “Analysing and Addressing Governance in Sector Operations”: <http://capacity4dev.ec.europa.eu/analysing-and-addressing-governance-sector-operations>. Governance issues for Customs are also covered fully in the World Bank’s “Customs Modernisation handbook”.



## 2. What can be done?

### 2.1 The regional context

While work may be centred of course on an individual country, the best results occur when the work can be delivered within a regional context. The creation of synergies at national and regional level will maximise, clearly, the benefit to be derived from funds available. Thus, country Delegations considering TF projects and programmes should first examine the strategic policies of beneficiaries at regional level – so as to fully understand the needs at national level – and thereby avoid duplication of effort; the aim must be to co-ordinate activities efficiently on the ground. Thus, Delegations considering a TF project proposal from a national Administration should first consult their colleagues at regional level so that the proposal can be first put into its proper context.

### 2.2 Identifying the institutional and other issues

The questions listed below address the environment in which trade facilitation interventions take place. They are intended to guide the reader considering a request for support in this area. They are general in nature and some will be relevant for a specific intervention while others may not. Indeed, trade facilitation projects may be wide in scope (e.g. supporting Customs reforms, establishing one-stop border posts), or they can be limited to specific actions (e.g. updating the Customs data processing system).

- Is there a genuine (i.e. not donor driven) and politically supported demand from the country/ region for trade facilitation assistance?
- Is there a legal framework and trade legislation covering trade facilitation in place? Has it been revised recently? Does it correspond to current trading needs? Has business been consulted on whether it fits their needs? Is the legislation efficiently implemented? If not, why not? How to ensure that legal changes find the necessary support?

- Does the country have regional or international obligations in trade facilitation as a result of multilateral and/or regional or bilateral agreements? Is there a trade facilitation chapter in the relevant trade agreements? Are there any transitional periods/waivers granted? What is the state of implementation?
- Has an institutional capacity and governance assessment of the Customs service been done? Does this cover Customs integrity and efficiency assessments, vested interests and drivers for change? Does Customs senior management take ownership of the project?
- Which other Government departments are involved with the Customs service, and how do they interact? For the MoF, has an assessment been done of the impact on revenue as part of the business analysis? Have in particular the Ministries of Transport (vehicle standards, admission issues etc.), Trade (TBTs, licensing) and Agriculture (SPS) been specifically consulted if an international Customs Transit project is envisaged?
- Has a supply chain analysis been done in order to assess where Trade Facilitation could be more supportive of economic activities?
- Since there is no point in doing something that nobody wants or will use, has the private sector been fully consulted and does it take ownership of the project along with Government? Is there a 'national trade facilitation body' or similar organisation? Is there a need for such a coordinating body, to include Customs, other governmental agencies, trade interests, consumers, etc?

Box 2 provides an example of a comprehensive trade facilitation needs assessment in which the questions listed above have been taken into account.

#### **Box 2. Study to support CARIFORUM in the implementation of commitments undertaken under the Customs and Trade Facilitation Chapter of the CARIFORUM-EU Economic Partnership Agreement.**

This project used a robust, established, analytical tool (SWOT Analysis), combined with sector research, (i) to make a comprehensive assessment of the level of conformity of Customs administrations with international best practices and standards, and (ii) to identify capacity constraints in relation to the implementation of the specified commitments. The project achieved these objectives analysing the survey forms which were issued widely to national Customs administrations, other government agencies and the private sector. Field visits were conducted as a follow-up to elicit more detailed information from the stakeholders concerned.

Notwithstanding the positive outcome of the project, it's worth mentioning the poor and limited participation of the private sector (very few firms responded to surveys) compared to the good response from custom administrations. The lack of responsiveness from the private sector can be ascribed to lack of understanding about EPA. The final report contains clear recommendations for future support programmes to address CARIFORUM needs.

## 2.3 Diagnostic tools

Diagnostic tools, and their main features, are briefly described below. Further information is contained in the section 'Where to Find out More'.

### 2.3.1 WCO tools

#### a. The Columbus Programme

The central capacity building tool developed by the WCO is the WCO Customs Capacity Building Diagnostic Framework that includes the principles found in the WCO revised Kyoto Convention and the SAFE Framework of Standards to Secure and Facilitate Global Trade. It analyses customs administrations' modernisations needs and guides an analysis in reviewing the effectiveness and efficiency of an administration from strategic perspective.

One of the most effective Capacity Building instrument is the Columbus Programme launched by the WCO in 2006. It comprises three phases: needs assessments (diagnostic studies) implementation and evaluation.

The diagnostic study is a management development tool that looks first and foremost at the structure, geography, and organisation of a Customs Administration. It does not examine technical level issues but is a precursor to such assessments. WCO Diagnostic assessments are relatively short in duration and can be funded from the WCO's TA resources. The outcome of such studies is useful for the development of a full donor-funded project.<sup>56</sup>

#### b. Time release studies

The WCO and other organisations use this tool to measure the average time taken between the arrival of goods in a country and their release from official control. This enables Customs and other agencies to identify problem areas and take corrective actions to increase efficiency. The objective is to address trade concerns about long delays in the clearance of goods and ultimately to meet trade expectations that goods can be moved across borders in line with their production schedules and just-in-time inventory systems.

Such studies are very detailed (although short in duration) and may indeed be undertaken together with a new or improved automation project - for example, where a new module is proposed that will change the way the clearance system works.

#### c. Integrity Development Guide<sup>57</sup>

This Guide is designed as a self-assessment tool for Customs administrations for the implementation of the Revised Arusha Declaration on fighting corruption in customs.

### 2.3.2 EU Customs Blueprints

The EU Customs Blueprints are practical guidelines that set out clear criteria against which Customs administrations in developing countries can measure their own operational capacity, based on EU best practice. The Blueprints can be used as a set of benchmarks against which Customs administrations can determine, and measure, gaps between the existing situation in 22 customs key areas (including transit and movement of goods, risk management, customs valuation, custom enforcement of intellectual property rights, etc) and thus establish a basis for customs reform plans.

The Blueprints are both a functional management and technical gap analysis tool that can be further adapted and broken down to the detailed operational and technical level. The result of the blueprint exercise (gaps and needs analysis) will ensure that any assistance requested or provided is structured, consistent and properly targeted, with clear objectives and measurable results. This work should follow a WCO Diagnostic study - if this being considered or has been carried out. The Blueprints can also be used as self-assessment tool to prepare management decisions (e.g. setting priorities for assistance). They are also very useful within the environment of a regional project where comparisons will be made at national level that feed directly into systems that will operate at regional level (e.g. international transit or risk management).

The Blueprints are well known to most regions of the world and are always to be taken into account when developing a national TF project or a regional Customs Integration programme. They were first developed and used successfully in the EU enlargement process and have recently been updated. They are important to ensure compatibility and alignment with EU policy. For an individual developing country of medium size and complexity, the work can take up to three months for two experts with the involvement of local personnel.

TF projects need to be realistic in terms of what can be achieved in the developing world so a selective use of the EU Blueprints is recommended, depending on the individual situation and priorities of a country.

### 2.3.3 World Bank

The World Bank also proposes some useful diagnostic tools that can be applied in the process of determining the range, scope, and type of assistance that should be provided in the field of trade facilitation. These are:

#### a. Enterprise Survey<sup>58</sup>

This is based upon firm level surveys and measures business perceptions of the investment climate (bureaucracy, corruption, tax burden, crime, courts, infrastructure, trade transactions costs, finance, etc).

<sup>56</sup> The WCO maintains Regional Offices for Capacity Building (ROCBs) that can be accessed to deliver technical assistance and training. It also provides an extensive library of e-learning modules that are available on line to the Members, on the above subjects. When considering technical components in new TF projects, and especially where training is a requirement, Delegations may wish to consider these WCO services.

<sup>57</sup> [www.wcoomd.org/files/1.%20Public%20files/PDFandDocuments/Capacity%20Building/Integrity\\_Development\\_Guide\\_E\\_March\\_2007.pdf](http://www.wcoomd.org/files/1.%20Public%20files/PDFandDocuments/Capacity%20Building/Integrity_Development_Guide_E_March_2007.pdf)

<sup>58</sup> [www.enterprisesurveys.org](http://www.enterprisesurveys.org)



It enables comparison of countries/regions, based on a common set of indicators. Indicators that can be useful in the field of Trade Facilitation are: % of firms expected to give gifts to get an import license, customs efficiency, days to obtain import license, average time to clear direct exports through customs, average time to clear imports from customs (days), etc.<sup>59</sup>

#### b. *Review of Trade Facilitation Barriers*

- Assesses the regulatory barriers and costs to domestic and global economic integration.
- Based either upon a survey of firms or through economic modelling.
- Different types of costs can be covered:
  - Transit — roads, ports and Customs.
  - Compliance with domestic and foreign regulations/ standards.
  - Reduction of regulatory barriers.
  - Mobility of firms and business people.

#### c. *Handbook for Customs Modernisation*

This is an in-depth analysis of the issues and potential solutions in the development of a Customs Modernisation Programme. It covers Trade Facilitation, the actors, their relationship, critical requirements and so on. It can and should be used as a reference tool to develop TF programmes and projects in conjunction with a WCO Diagnostics study or Blueprint exercise.

## 2.4 Broad areas of intervention and key activities

### 2.4.1 Specific areas of intervention at the national level

Where an individual country is not part of a regional economic grouping (and is not intending to be) then the following sets out the main areas to be addressed at national level.

#### a. *Automation*

The Customs automated system provides the backbone for facilitated clearance and is often of itself the catalyst for new procedures, documents and processes to be introduced. As part of any automation project there must be a commitment to review existing procedures, documents and install proper project management and quality assurance methodologies.

A high quality automated system for Customs will process manifest data and enable automatic management of import and export declarations as they arrive from the trade. It will have a finance module to receive and account for duty and tax payment via cash, direct debit, pre-payment systems and also enable risk to be assessed and managed. It will enable national/international

electronic exchange of trade data between traders and other Government Departments (the Single Window concept), regional organisations and Customs partners within a regional grouping especially as regards the submission and management of Transit information. The EU Blueprint is a useful guide to the requirements for any automation programme.

Customs Administrations in the developed world have been processing import and export data electronically since the early 1970s but it has been only from the late 1980s that developing countries have been installing automated systems. These have usually been based on UNCTAD's Asycuda system. Many of these projects also use the software package (Eurotrace) developed by the Statistical Office of the EU for use with Asycuda to produce trade data. The Asycuda system usually fulfils needs and requirements of developing countries (although not for countries that are or may become candidates for EU accession and may have to get connected to EU systems). Some other standard package systems are available for consideration, some of them through co-operative projects between EU Customs Administrations (e.g. Belgium, Denmark, France, Ireland, Luxembourg) and IT companies.

Experience has shown, that there is a tendency to ask assistance for own developments of IT systems, also to replace Asycuda. In most cases this is not necessary (and unlikely to be successful). A full feasibility study should usually be undertaken for customs IT projects, which should include Asycuda as valid option (look at the best Asycuda version).

It is important to ensure that customs IT systems within a region are compatible to each other and, where Single Window is envisaged, compatible with systems of other relevant agencies on national and/or regional level.

#### b. *One-stop shop/single window*

Two trade facilitation measures of increasing importance are the establishment of a 'one-stop-shop' and a 'single window'. The idea of a 'one-stop shop' is to coordinate physical inspections of goods between all border agencies concerned in a way that trader has to present the goods just once.

The single window<sup>60</sup> concept provides for facilitation relating to the fulfilment of customs and non-customs data requirements: there should be one single entry point to which the trader can submit all data/documents necessary for clearance of goods once only.

The key features of this type of single window are as follows:

- Provision for business of a single interface to government, with all regulatory data being submitted through one portal (this is usually automated, but can also be paper-based);

<sup>59</sup> The WB has completed these assessments in 91 countries, based on surveys of more than 58,000 firms worldwide.

<sup>60</sup> UN/CEFACT Recommendation 33 defines a Single Window as "a facility that allows parties involved in trade and transport to lodge standardized information and documents with a single entry point to fulfil all import, export, and transit-related regulatory requirements. If information is electronic, then individual data elements should only be submitted once".

- Coordination of official interventions, under the direction of a 'lead agency' (usually Customs);
- Designation of a lead agency;
- Harmonisation and rationalisation of the regulatory requirements for import and export transactions, where the requirements of each government agency are seen as just one component of the overall goods clearance process;
- Connection of the various government entities involved in import and export processing through electronic information exchange;
- Development of IT systems of entities concerned should ensure compatibility; and
- Improvement in the efficiency of regulatory functions, whilst at the same time reducing overall compliance costs for the trade.

The scope for developing a single window in any country is obviously depending on and somehow limited by the degree of automation – in the trade as well as the official environment. The pre-requisite for the optimal use of the system is the availability of electronic documents coupled with the introduction and decision of a Single-Window concept, with a nominated lead agency and an agreement on exchange, flow and use of information. A Customs Automated system with a sufficiently modern architecture usually permits efficient data interchange between all the actors in the supply chain, representing the hub around which and through which the different actors pass information between them. In modern ports and airports this is usually however arranged by a private sector organisation.

#### c. Single-stop controls

Single-stop border posts (also known as one-stop border posts) are a facilitation measure allowing persons, vehicles and goods to make a single stop for official controls when exiting one country and entering another.

Juxtaposed facilities: Traffic bypasses the facility in the exit country and goes directly to the entry country to carry out both exit and entry procedures.

Straddle facilities: These straddle the border, thereby creating a single facility within which border officials operate on their own territory.

Common facilities: Where cooperation and trust between neighbouring countries is strong, a single building can be constructed in one of the border countries to house border control officials from both countries.

For each of these arrangements, legislative changes are usually required to enable officials to operate on the territory of the adjoining state, for example to conduct joint inspections. Clearly, ensuring that an adequate legal framework is developed, and building the commitment

of governments and their agencies for shared responsibilities, are essential pre-conditions for the construction of these facilities.

#### d. Risk management

In many countries, the combination of a rapid rise in the volume of trade, and the limited resources (especially numbers of suitably qualified staff) of the Customs and other border agencies, increasingly mean that traditional methods of inspecting all consignments upon arrival at the frontier represent a barrier to trade and are no longer practical. A risk-based approach and risk management enables Customs and other agencies to target and select for control high-risk goods/traders/systems/transactions, and allow those that represent a low risk (the vast majority) to move quickly inland, or across the country, without frontier examination.

The development of control practices is part of risk management and a fundamental part of trade facilitation efforts worldwide. The WCO's SAFE programme has been important in moving the different concepts forward including the concept of Authorised Economic Operators that provides benefits to large traders with a history of fiscal and regulatory compliance, allowing them access to benefits such as fast-track clearance, simplified declaration procedures and automatic clearance facilities at the trader's premises.

Assistance with the development of these schemes therefore needs to be approached in parallel with work in two other key areas: an automated risk management environment, since AEO schemes depend upon access to regularly updated data relating to fiscal and regulatory compliance and post-clearance audit, because these schemes are based on official controls at the traders' premises, before and after the clearance or release of goods at the frontier.

Effective risk management depends heavily upon the availability of quality trade data provided to the customs, effective risk information and intelligence sharing among the relevant governmental authorities, IT to automate databases of risk indicators and profiles, and make the relevant information capable of being rapidly accessed and updated. In addition, increasingly, "thinking" software applications are becoming available that can link into Customs import/export processing systems and automatically update risk management profiles without human intervention.

#### e. Post-Clearance Audit

Post-Clearance Audit (PCA) incorporates '**trader-based control**', i.e. Customs controls that take place at traders' premises, and '**systems based audit**', i.e. the examination of companies' systems and procedures, ensuring that these operate so as to match Customs compliance requirements. This is a different and much more effective

tive approach than the checking of individual import/export consignments.

The introduction of PCA responds to requirements in the RKC, and enables Customs authorities to pursue the mutually compatible objectives of (i) achieving enhanced compliance and (ii) providing increased trade facilitation.

PCA techniques can also be used in relation to pre-audits, for example where there is doubt about an applicant's ability to fulfil the requirements of a Customs-related authorisation such as AEO.

#### **2.4.2 Specific areas of intervention within regional groupings**

As we have seen above, Trade Facilitation initiatives best and most often take place now within the development of a regional Single Market and Customs Integration project. This requires effective and coordinated (joined up) Customs systems working from the same base with common rules that are applied consistently. In essence, Customs Administrations will operate as one in this environment – from the same template and offering above all a service-oriented to the trade – even if national borders remain in place for some time and even if the fiscal and services situation takes time to harmonise fully.

In table 1, we set out the seven broad areas that must be addressed when working towards a Single Market and Customs Union and thus when designing a technical assistance project or programme. *Where a specific EU Blueprint exists this is designated with a star.* In addressing each of these points the infrastructure issue will have to be considered separately by programme designers in terms of buildings, equipment, automation, and so on.

Of these key areas, the implementation of an international Customs Transit System is probably the single most important contribution to developing and building the

Customs Union and Single Market since it addresses the fundamental principle of the freedom of movement of goods. As things currently stand in most regions of the world, goods moving from country A to country B through country C require different Customs declarations often in different formats. They also require different securities in the countries for the potential charges on the goods. Each of the countries is thus treated as a single national movement and it may or may not be controlled by the national Customs computer system to reduce the risk of diversion and fraud.

Within the EU, international transit movements are fully controlled from point of departure to point of destination – which indeed may also be the premises of an AEO – through a networked ICT system that is supported by a single customs declaration and a single guarantee valid throughout the transit movement.

This is a highly sophisticated system which can nonetheless be relatively easily introduced into other regions of the world given the advances in technology. For example, the EU is currently involved in developing such a system for the countries of ASEAN.

The further advantage of such an international computerized system is that it requires the implementation of an ICT network that links Customs administrations and the Trade together into the cooperative environment envisaged by the WCO's SAFE system. The same network can then be used to mount the information applications that are also crucial to the Customs Union and Single market environment. In other words the Transit System acts as a catalyst to drive the other essential elements in the process of Customs integration.

However, it is very important to be aware that the production of the automated system for Transit is not something to be undertaken lightly and certainly no project should be envisaged without full feasibility studies.

**Table 1. Broad areas of intervention and key activities**

Broad areas of intervention	Key activities
<b>Strategic planning</b>	<ul style="list-style-type: none"> <li>• Assess current status and capacity of countries and prepare gap analysis</li> <li>• Develop or update modernization strategies</li> <li>• Develop strategic management plans and management framework at regional and national levels</li> <li>• Identify programmes and projects based on gap analysis (EU Blueprints)</li> </ul>
<b>Over-arching Customs Law and Regulations</b>	<ul style="list-style-type: none"> <li>• Draft Framework Law and Regulations based on modern principles (RKC etc.)</li> <li>• Draft appeals and disputes mechanism</li> <li>• Draft procedural manuals</li> <li>• Prepare publication on national and regional website</li> </ul>
<b>Harmonized Systems compatible nomenclature and Common External Tariff</b>	<ul style="list-style-type: none"> <li>• Draft legal texts from WCO Harmonized Systems Convention</li> <li>• Draft explanatory notes</li> <li>• Prepare binding tariff decisions database</li> <li>• Carry out study on the implementation of the common external tariff</li> </ul>
<b>Single Administrative Document (SAD)</b>	<ul style="list-style-type: none"> <li>• Draft format (electronic and paper)</li> <li>• Agree data model and code lists</li> </ul>
<b>Customs transit system</b>	<ul style="list-style-type: none"> <li>• Draft law and regulations prescribing: <ul style="list-style-type: none"> <li>– Single security/guarantee system</li> <li>– Simplifications and risk management rules</li> <li>– Accompanying document and all data</li> <li>– Procedures from departure to destination</li> </ul> </li> <li>• Carry out feasibility study for automated tracking system</li> <li>• Prepare functional specification</li> <li>• Consult with Ministry of Transport on harmonisation of transport rules</li> <li>• Ensure availability of funding for the ICT application and network</li> </ul>
<b>Enforcement and risk</b>	<ul style="list-style-type: none"> <li>• Review enforcement and risk management requirements</li> <li>• Establish legal basis for exchange of information and complete Mutual Assistance Regulations</li> <li>• Establish co-operative working environment for national customs teams</li> <li>• Carry out feasibility study and write functional specifications for IT database</li> </ul>
<b>Regional information system</b>	<ul style="list-style-type: none"> <li>• Establish requirements for a regional information system including interface mechanisms with the trading community</li> <li>• Write functional requirements</li> <li>• Establish information centre at HQ of regional organisation</li> </ul>

## 3. How can it be done?

### 3.1 Methods and levels of intervention

The implementation of projects and programmes in the area of trade facilitation involves substantial efforts of capacity building as well as reforms. As the bulk of these are in the public domain, both project support with technical assistance and sector budget support are options for implementation. Budget support requires however that relevant and measurable indicators can be defined which would form the basis for disbursements. This may not seem to be very complicated when it comes to policy, regulatory and administrative reforms, but may be different for projects which involve a good deal of capacity building, both in terms of staff and systems. A choice will therefore need to be made on the basis of the nature of the specific action to be financed and, for budget support, of course having regard to the eligibility conditions the country must meet for such type of support.

As already mentioned above, actions can take place on the national level and on the regional level (or, in the latter case, on both levels). Reference is made to section 2.4.2 above which specifically deals with actions on the regional level.

### 3.2 Sequencing of activities

It is vital that a country's Parliament, MoT and MoF should commit themselves to the reform endeavour. At the regional level there must be clear commitment from the Ministerial level of an organisation.

Moreover, the introduction of effective legal systems are almost always a prerequisite in terms of offering certainty in the interpretation and implementation of trade policies and, in countries with high levels of corruption, resistance to greater transparency and simplification will inevitably arise. These issues need to be confronted and dealt with very early in the preparatory cycle. Clear commitments are required in these two areas as well as for the use of all possible international Customs and Trade procedures and data standards outlined in the RKC et seq.

Furthermore, studies and diagnostics carried out in the phases of project preparation (whichever tools are used) must take into account the dependencies and relationships between the different actors, their requirements and systems. For example, of special importance to a Customs Transit project is the influence of the Ministries of Transport in the countries of a region. It is hardly useful for Customs to introduce an efficient – but expensive – automated Customs Transit system if the Transport Regulations in the countries of Transit are not aligned and appropriate to the modern world. In particular, Transport rules and regulations must permit foreign vehicles to enter and this means inevitably that technical standards (axle loads, length, width, emissions etc), insurance and driving licence requirements and perhaps even corridors and border posts have to be agreed.

### 3.3 Results and their measurement

Table 2 ascribes generic results and indicators to the most likely set of circumstances that a Delegation is likely to face in assessing a project or programme.

### 3.4 Cross-cutting issues

Governance, including anti-corruption and security issues, is at the heart of trade facilitation and a central feature in this respect. It is dealt with in the key issues section.

A cross-cutting issue that will arise relates to the environment, namely control of trade in hazardous goods, waste, and protection of plant life and fauna (coral reef, ivory, furs, wild animals, etc) through the prevention of smuggling of those products. Part of the formulators' task will be to identify such issues as they relate to a particular country or region. International Conventions exist for the control of trade in these goods (e.g. CITES conventions for the protection of plant and life fauna, Basel Convention regarding Transboundary Movement of Waste,...).

### 3.5 Risks

The following represent the main risks to the successful implementation of trade facilitation projects (other than those discussed) and mitigating measures to be taken:

- **Failure to tie up government fiscal policy with trade facilitation.** Revenue collection, especially of import duties and taxes, remains an important objective of developing countries. This objective can subordinate trade facilitation to a lower order of priority, unless the need for a proper balance between the two objectives is expressly stated. This is particularly true where Governments have introduced Revenue Authorities and have concentrated on revenue enhancement to the detriment of all else. Working with TF in the regional environment assists greatly to provide the requisite balance since there will be political and economic goals to achieve.
- **Taking a strictly legal approach.** Having identified an issue where the law will have to be changed, it is important to balance technical assistance on developing changes to the law with an implementation effort. This may be through capacity building or training or through a technical development or a mix of these things.
- **Failure to co-ordinate and provide quality assurance of both project deliverables and strategic direction.** TF projects often involve considerable numbers of actors and a complex set of deliverables against international law, regulations and standards. IT system deliverables are especially complex to specify, develop and implement. It is essential that a quality assurance mechanism be put in place at the project outset and that a reporting system is established to the very highest level that brings problems to the early attention of senior management and informs any change to strategic direction.



**Table 2. Selection of results and indicators for measurement**

Area of Intervention	Results	Indicators
<b>Strategic planning</b>	<ul style="list-style-type: none"> <li>WCO diagnostic study reports (for management projects)</li> <li>Feasibility studies (for IT projects)</li> <li>EU Customs Blueprint gap analyses</li> </ul> <p>All completed and findings accepted</p>	<ul style="list-style-type: none"> <li>Minutes of DGs meetings where project proposals, plans and documents adopted and resources allocated</li> </ul>
<b>Simplification, standardisation and harmonisation of international trade procedures</b>	<ul style="list-style-type: none"> <li>New over-arching Customs law and regulations</li> <li>New Customs business procedures and documentation (including Single Administrative Document)</li> <li>AEO systems in place</li> </ul>	<ul style="list-style-type: none"> <li>Law and regulations gazetted and published in official journals and the web</li> <li>Procedural manuals published on Customs websites</li> </ul>
<b>Modernisation - for port and airport clearance at national level</b>	<ul style="list-style-type: none"> <li>Automated systems in place for international trade, including Single Window</li> <li>Formal collaborative mechanisms established between Customs and other government departments</li> <li>Post clearance audit system in place</li> <li>Improved revenue collection</li> <li>Clearance times reduced to less than one day from arrival of transport at port or airport given normal physical conditions</li> </ul>	<ul style="list-style-type: none"> <li>Minutes of meetings, discussions, proposals and reports published in journals and the web</li> <li>MoF and Customs annual reports</li> <li>Cargo clearance statistics and trade journals</li> </ul>
<b>Modernisation - for the international movement of goods through an International Customs Transit System</b>	<ul style="list-style-type: none"> <li>New law and regulations agreed and implemented by all countries</li> <li>Transport rules updated and agreed to international standards</li> <li>New Customs procedures with a single declaration and guarantee throughout the Transit journey</li> <li>Simplified procedures and full guarantee management in place</li> <li>Automated systems in place to monitor consignments from departure to destination</li> <li>Clearance reduced to a maximum of 2 hours at land boundaries</li> </ul>	<ul style="list-style-type: none"> <li>Law and regulations gazetted and published in official journals and the web</li> <li>Procedural and training manuals published on Customs websites</li> <li>Cargo clearance statistics and trade journals</li> </ul>
<b>A Framework for co-operative and collaborative enforcement mechanisms at the regional and national levels</b>	<ul style="list-style-type: none"> <li>Customs mutual assistance agreements in force and liaison offices in place</li> <li>MoUs specifying technical collaboration between Customs and other government departments/agencies</li> <li>MoUs between Customs and private sector</li> <li>Enforcement and intelligence databases in place</li> <li>Strategic and tactical intelligence passing between Member States</li> <li>Increased detection rates</li> </ul>	<ul style="list-style-type: none"> <li>Formal agreements available</li> <li>Regional Organisation reports</li> <li>Reports of regular meetings available</li> <li>Reports of fraud, smuggling cases</li> <li>Conviction of perpetrators</li> </ul>
<b>Improvement of efficiency, morale and integrity of customs agencies</b>	<ul style="list-style-type: none"> <li>Training needs analysis carried out</li> <li>Courseware developed and delivered</li> <li>Existing Integrity action plan completed</li> </ul>	<ul style="list-style-type: none"> <li>Customs annual reports</li> <li>Training evaluation reports</li> <li>Reports monitoring the level of implementation of the plan and action taken against individuals</li> </ul>

## 4. Where to find out more?

### *European Commission's DG TAXUD website*

[www.ec.europa.eu/taxation\\_Customs](http://www.ec.europa.eu/taxation_Customs)

[http://ec.europa.eu/taxation\\_Customs/Customs/policy\\_issues/trade\\_facilitation/index\\_en.htm](http://ec.europa.eu/taxation_Customs/Customs/policy_issues/trade_facilitation/index_en.htm)

This website contains a series of useful references to EU strategy looking towards the future and the need to balance the introduction of new security initiatives for the management of international trade with the tools required to ensure that reliable traders are not impacted adversely.

Global Facilitation Partnership for Transportation and Trade: [www.gfptt.org](http://www.gfptt.org)

### *Evaluations, reviews and research*

Trade Facilitation in Developing Countries: Chris Milner, Oliver Morrissey and Eviou Zgovu, CREDIT Research Paper no 08/05:

[www.nottingham.ac.uk/economics/credit/research/papers/CP0805.pdf](http://www.nottingham.ac.uk/economics/credit/research/papers/CP0805.pdf)

World Bank Trade Facilitation Research  
<http://go.worldbank.org/0UNN2IFG50>

Cost and Benefits of Implementing Trade Facilitation Measures under Negotiations at the WTO: an Exploratory Survey Yann Duval: Asia-Pacific Research and Training Network on Trade Working Paper Series, No. 3, January 2006

Informal Cross-Border Trade & Trade Facilitation Reform in Sub-Saharan Africa: OECD Trade Policy Working Paper No. 86 by Caroline Lesser and Evdokia Moisé-Leeman, produced for the Working Party of the OECD Trade Committee, February 2009

### *Diagnostic tools*

World Bank Diagnostic Trade Integration Studies by country  
<http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/TRADE/0,,contentMDK:20615178~menuPK:1574524~pagePK:210058~piPK:210062~theSitePK:239071,00.html>

Customs Blueprints

[http://ec.europa.eu/taxation\\_Customs/resources/documents/common/publications/info\\_docs/Customs/Customs\\_blueprint\\_en.pdf](http://ec.europa.eu/taxation_Customs/resources/documents/common/publications/info_docs/Customs/Customs_blueprint_en.pdf)

### *Automation*

World Bank Customs Modernization Handbook, 2005

WCO handbook on Customs Computer Systems

IEEE recommended practice for software requirements specifications  
[www.ieee.org](http://www.ieee.org)

### *Border management*

Guidelines for Integrated Border Management in the Western Balkans

[http://ec.europa.eu/enlargement/pdf/financial\\_assistance/cards/publications/ibm\\_guidelines\\_en.pdf](http://ec.europa.eu/enlargement/pdf/financial_assistance/cards/publications/ibm_guidelines_en.pdf)

### *Supply chain security*

C-TPAT

[www.cbp.gov/xp/cgov/trade/cargo\\_security/ctpat/](http://www.cbp.gov/xp/cgov/trade/cargo_security/ctpat/)

CSI

[www.cbp.gov/xp/cgov/trade/cargo\\_security/csi/](http://www.cbp.gov/xp/cgov/trade/cargo_security/csi/)

EU Customs Security Programme

[http://ec.europa.eu/taxation\\_Customs/Customs/policy\\_issues/Customs\\_security/index\\_en.htm](http://ec.europa.eu/taxation_Customs/Customs/policy_issues/Customs_security/index_en.htm)

WCO Framework of Standards to Secure and Facilitate Global Trade

### *Single window*

UN/CEFACT Recommendation (33) and Guidelines on establishing a Single Window to enhance the efficient exchange of information between trade and government

Working Document: TAXUD/1241/2005 – Rev. 5; Subject: Single Window at Community Level

APEC Sub-Committee on Customs Procedures: Working Towards the Implementation of Single Window within APEC Economies, June 2007

WCO Single Window Guidelines

[www.wcoomd.org/sw\\_guidelines.htm](http://www.wcoomd.org/sw_guidelines.htm)



## **Thematic Review 3**

### **Quality Infrastructure**

# 1. What does the theme cover?

## 1.1 Introduction

While important tariff reductions of agricultural and manufactured goods over the last decades have lowered international barriers to trade, **the growing number of standards and technical regulations, has emerged as a key concern to many countries.** Product markets in developed countries rely on a broad array of standards and technical regulations covering areas such as food safety (e.g. maximum pesticide residues in food, hygienic requirements for food processing), product safety (e.g. for electrical appliances, labelling requirements), sustainable production and consumption (e.g. organic products, sustainable forest management, fair trade labels, labour standards). Governments make use of these requirements to protect and inform consumers and to ensure overall product quality.

All those requirements are **non-tariff barriers to trade** and their trade effects may become even more important when exporters face different requirements in different markets for the same products, thereby significantly increasing the cost of trading. Moreover, importing countries sometimes deliberately use technical regulations to protect domestic industries from external competition. In this respect, the World Trade Organisation's TBT (Technical Barriers to Trade) and SPS (Sanitary and Phytosanitary measures) agreements (see Box 5) play a crucial role, as they provide for a number of rules which aim to ensure that standards, technical regulations and related conformity assessment procedures do not become unnecessary barriers to trade.

In addition to standards developed by national, regional or international bodies recognised by WTO Members and to technical regulations, **there is a growing volume of private standards.** These are specifications set by private market players, often large supply or distribution chains, in terms of requirements for production processes (for example to guarantee environmentally sustainable production methods), or product characteristics (physical characteristics, labelling etc). Although exporters are free to comply with these requirements, they may have similar effects as mandatory specifications in case the majority of importers require compliance with such standards. Private standards are not covered by the provisions of the WTO SPS or TBT agreement.

As producers need to be able to demonstrate conformity with standards and technical regulations, **countries need to develop a national quality infrastructure** which is capable and internationally recognized to assess conformity. For many products, prior conformity assessment is a key condition for access to domestic and/or foreign markets. In addition, demonstrating compliance

with voluntary international standards can also boost companies' international competitiveness.

The present thematic review (TR) deals with quality infrastructure, covering TBT and SPS measures, private standards and conformity assessment systems.

## 1.2 Definitions and terminology

A **national quality infrastructure (QI)** is the set of laws, functions and institutions which are necessary to ascertain the conformity of a product or production process with technical regulations or standards.

QI is an integrated system based on several components, which are presented in figure 1.

### 1.2.1 Standards, technical regulations and private standards

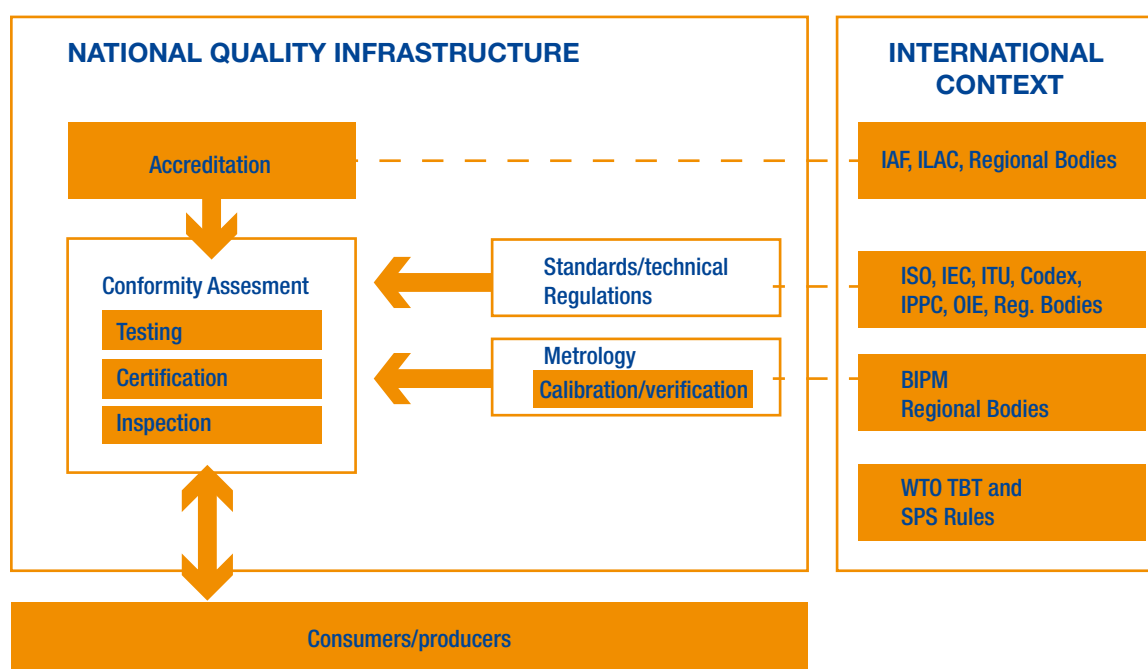
**Standards** provide a set of quality characteristics of a product, process or service. Adherence to standards is voluntary; yet, from the point of view of an enterprise, compliance to international standards facilitates trade and adds value to traded products. In addition, as standards often integrate the latest technical developments in areas such as health, safety and environment, they provide a unique source of technology transfer to developing countries. Furthermore, standardization also plays a crucial role in creating a level playing field for economic operators and allows achieving economies of scale.

Broadly speaking, standards can be sub-divided in three sub-categories:

- product standards, which refer to characteristics of goods or services;
- process standards, which refer to the conditions under which products are produced or packaged (e.g. HACCP<sup>61</sup> for food processing industries);
- management standards, which help the organisation meeting product and process quality standards (well known standards are the ISO9000 series on quality management or the ISO 14000 family on environmental management).

Standards are often the outcome of a long and complex process, involving in particular national standards bodies. These bodies can be public, private or in most cases public-private entities and are as rule not for profit. They prepare and disseminate national standards and harmonise them with international ones. The standardization process involves several rounds of consultations involving national standard bodies and representatives of the concerned industry sector(s), before adoption. Where

61 Hazard Analysis Critical Control Point (HACCP) is a systematic preventive approach to food safety. HACCP can be applied throughout the food chain from primary production to final consumption and is based on critical control points, where actions can be taken to prevent risks from occurring down the food chain.

**Figure 1. Components of the national quality infrastructure**

international standards exist, no new national standards should normally be developed in a country; rather international standards should be adopted.

The most important international standards bodies are the International Organisation for Standardisation (ISO), the IEC (the International Electro-technical Commission) and the ITU (the International Telecommunications Union). Regarding agricultural goods and food products, standards have been developed by the WHO/FAO's Codex Alimentarius Commission (food standards), the World Organisation for Animal Health (OIE), and the International Plant Protection Convention (IPPC).

Within the EU, standards are set by the European Committee for Standardization (CEN), the European Committee for Electrotechnical Standardization

(CENELEC) and the European Telecommunications Standards Institute (ETSI). These organisations provide common sets of standards for all EU member states and are as such a key building block of the EU single market for products.

**Technical regulations** are legally binding texts, which lay down specific characteristics of a product, for example in terms of health and safety requirements (e.g. the maximum residue level of pesticides in food). Technical regulations often use national or international standards as a basis. Products which do not meet the technical regulations may not be sold on the market. The implementation of technical regulations by producers and importers takes place under the surveillance of line Ministries such as the Ministry of Health, Agriculture, Industrial Development or Environment.

It is up to each government to decide up to which level adherence to standards will be made compulsory, through technical regulations, or whether to leave it up to the market to determine in a voluntary manner to which degree products and services should meet certain standards. The decision should be based on an assessment of risk involved in a particular product or service in terms of consumer health, safety, environmental protection etc.

However, in view of the fact that technical regulations constitute mandatory requirements, they are also the most significant and frequent non-tariff barriers to trade. In this context, the WTO TBT and SPS agreements provide for a set of minimum rules to make sure that technical regulations do not become unnecessary barriers to trade.

**Private standards** are based on mutual agreements between buyers and suppliers and are voluntary. Broadly speaking, two types of private standards can be identified:

- (1) Corporate standards : these can be company-specific standards (such as IKEA, Nike, H&M, ...) or standards set by consortia (such as GlobalGap for retail/supply chains)
- (2) Civil society standards (e.g. Forest Stewardship Council, Fair Trade Labelling Organisation).

Private standards have rapidly gained ground in the aftermath of food safety crises such as the BSE crisis in the EU in the 90s, the dioxin crisis in Belgium in 1999 and the foot and mouth disease in the UK in 2001 as food companies became increasingly concerned to preserve their reputation in terms of food quality and safety. They turned to private standards as a way to ensure consumer confidence and reduce their risk, particularly against the background of the new EU Food Law (Regulation EC/178/2002), which pointed to the responsibility of all food business operators along the food chain in ensuring food quality and safety.

Moreover, the globalisation of supply chains and the trend towards vertical integration have raised the need to make specific agreements with suppliers, who want to ensure volumes and quality and do so through the setting of private standards. Especially the high demand for semi-processed food by hotels, restaurants and airlines requires an efficient quality control at all stages of production.

Furthermore, firms may resort to private standards when looking for specific market segments such as fair trade labels (e.g. through the Fair Trade Labelling Organisation), sustainable forest management (e.g. the Forest Stewardship Council) or organic production methods.

### 1.2.2 Conformity assessment

Adherence to standards and technical regulations is confirmed by Conformity Assessment Bodies (CABs). According to the ISO/IEC 17000 international standard, conformity assessment is defined as a “demonstration that specified requirements relating to a product, process or system, person or body are fulfilled”. Conformity assessment is crucial for establishing confidence in trade, since it lowers the risk level and facilitates the free flow of goods across borders. CABs must be independent from external pressure, financially autonomous, and impartial with regard to the origin of the products (domestic or imported).

In practice, conformity assessment can be made either by the supplier (first party) as a self-assessment, by the customer (second party), or by an external (hence neutral) body (third party), depending on the applicable product legislation or private standard.

The principal components of conformity assessment are: testing, inspection and certification.

**Testing** of a product allows determination of compliance or performance in accordance with the requirements set out in standards or technical regulations. All tests are subject to a set of rules defining under which circumstances they should be performed. This implies that also the test procedure itself must be subject to a certain standardization process in order to ensure that the results are universally acceptable.

Testing can serve different purposes. First, it can be done on a voluntary basis for error detection purposes in production processes. Furthermore, testing can be done in the framework of conformity assessment procedures or as a means to determine compliance with the application of technical regulations in a market surveillance context.

Testing laboratories can be either private or public. Skilled staff and appropriate maintenance of equipment are paramount to ensuring accurate and reliable test results.

#### Box 1. Fair Trade label

Companies wishing to use the “Fair Trade” label (private standard) must undergo initial and subsequent assessments of their production and distribution procedures, proving that they comply with the conditions required by the Fair Trade Labelling Organisation FLO. Details on the procedures are available on FLO’s website ([www.fairtrade.net/standards.html](http://www.fairtrade.net/standards.html)).

## Box 2. An example of certification requirements

An Indonesian shrimp company exporting frozen peeled shrimps to USA has been requested by its customers to use the services of an accredited third party certification body based in Singapore for assessing the compliance of their HACCP system, instead of a national accredited certifier. By contrast, a company in Laos has been able to export coffee to USA on the basis of a first party assessment of its HACCP system: this supplier's declaration of conformity was accepted as sufficient by the client given the low level of risk for roasted coffee.

**Certification** confirms the conformity with the requirements of standards or technical regulations. Generally, two different types of certification are distinguished:

- Certification of *products*, for example under EU internal market product legislation providing for the affixing of the CE marking (mainly linked to health and safety objectives), Globalgap (reflecting private standards set by major EU and US food retailers), or fair trade or organic labels;
- Certification of *management systems*, such as quality management systems (e.g. the ISO 9000 series), environmental management systems (e.g. ISO 14000 series or the EMAS management system) or hygienic systems (e.g. HACCP).

Certification bodies can be private or public entities. Similar to testing, certification can be done by the producer, the buyer or an independent third party, depending on the applicable product legislation or private standard.

**Inspection** bodies undertake the examination of ranges of products, materials, services, plants, processes etc. in order to assess their conformity with specific requirements, on the basis of professional judgement. They can be private or public entities.

Inspections are most prevalent in the area of food safety (part of the SPS domain), given the risks involved for public health: in this case, the “competent authorities” (see box 3), belonging to the Ministry of Health, Fisheries or Agriculture<sup>62</sup> are responsible for controls (i.e. market surveillance) along the food chain. They send inspection teams to food companies to verify the existence of quality management systems (e.g. HACCP systems) and compliance with official regulations and standards. If needed, they can take samples at the plant and send them to test laboratories to analyze physical and chemical contaminants. If the Competent Authorities detect lack of compliance or find residues in food products, they have the responsibility to alert potential users of those products to reduce risk of any further injury or damage and eventually to remove the products from the market.

## Box 3. Competent Authorities

The responsibilities of the Competent Authorities in the area of SPS are in particular:

- (1) Establishing a risk-mitigation strategy by:
  - a) Providing secondary legislation which specifies how food business operators (FBO) are expected to apply relevant technical regulations;
  - b) Ensuring preventive control by obliging FBOs to register with them. This includes initial verification whether specific hygiene procedures are in place (e.g. HACCP) and issuing a license to operate;
  - c) Providing certificates for food items sold on the domestic market as a way to reassure consumers; competent authorities may also provide specific export certificates, confirming that products for export match the specific technical regulations of the target markets;
  - d) Doing random inspections of FBOs, checking their license to operate, the validity of certificates for specific products and taking product samples to test-laboratories (e.g. microbiological contamination, labelling and residues). These controls can take place at border inspection points (for imports), on markets or on production sites. Investigations are also conducted if there are complaints or allegations of violation against the law;
  - d) Ensuring traceability, implying that the entire food chain of any item can be tracked, so as to be able to rapidly pinpoint the source of non-compliance (e.g. contamination).
- (2) Applying sanctions in case of non-compliance, including banning or destruction of hazardous food, fining, de-registration of FBOs or legal action.
- (3) Handling of crises: building an early detection system and emergency response capacity; responding rapidly to unexpected outbreaks of food-borne illnesses or situations that put public health at risk.

62 Depending on the distribution of competences in a country

### 1.2.3 Accreditation

According to the ISO/IEC 17000 standard, accreditation is “third party attestation related to a conformity assessment body conveying formal demonstration of its competence to carry-out conformity assessment tasks”. Accreditation bodies must remain independent from political or commercial influences, be neutral, and ensure confidentiality in the execution of their mandate.

From an international trade perspective, it is crucial that accreditation of e.g. testing laboratories or certification bodies is also recognized by trade partners. In practice, the lack of international recognition of test results and certificates can imply the need for double testing and significantly raise the costs for exporters. In the worst case, the lack of certificates may result in containers being rejected at the borders of EU or other markets.

#### Box 4. The Product Certification Office of the Department of Industrial Standards of Cambodia (ISC)

This office was accredited on 11.03.2008 by the Norwegian Accreditation Organisation as a certification body for products. Scope of accreditation: the certification of bottled water.

The international umbrella organizations are the International Laboratory Accreditation Cooperation (ILAC) and the International Accreditation Forum (IAF). The objective of ILAC and IAF is to establish a network of mutual recognition agreements among accreditation bodies. This implies that signatories (accreditation bodies) of the IAF MLA (Multilateral Recognition Agreement) or of the ILAC MRA (Mutual Recognition Agreement) accept the accreditation certificates issued by the partner accreditation bodies. These agreements can form the basis to establish mutual trust between regulators as well as economic actors in different countries and can facilitate the conclusion of international agreements whereby trade partners accept each other's test reports or certificates.

Yet, especially small developing economies may face several difficulties in obtaining membership of the ILAC MRA or IAF MLA for their accreditation bodies because of a lack of skills and (accreditation) practice.

As an alternative, less developed countries often set up a national accreditation body for national testing and certification purposes, while relying on the services of a more developed trade partner for the accreditation of laboratories and certification bodies which are important for international trade.

Regional arrangements are also possible such as the creation of a regional pool of experts from which national

accreditation bodies can draw or the set-up of regional accreditation bodies. Such arrangements could facilitate the mutual recognition of national accreditations in a region. In addition, regional collaboration could also push the elaboration of a common strategy to improve wider international recognition of local accreditation bodies on the longer term.

The main regional bodies are the EA (European Cooperation for Accreditation), APLAC (Asia-Pacific Laboratories Accreditation Cooperation), SADCA (Southern African Development Community Accreditation) and IAAC (Inter-American Accreditation Cooperation).

### 1.2.4 Metrology

Metrology allows for accuracy, reliability, comparability and consistency in measurement. Precise measurements (e.g. of physical dimensions of an object or the concentration of chemical residues in bottled water) are crucial for generating confidence in international trade as well as for consumer protection. In order to ensure correct and universally accepted measurements, a system of units has to be set up including reference units (e.g. the metre) and reference materials (e.g. metals or fossil fuels). At international level, the Metre Convention has created the International Committee on Weights and Measures (CIPM) and the International Bureau of Weights and Measures (BIPM).

National Metrology Institutes are considered the primary calibration laboratory at national level. They **disseminate reference units** to the local industry, often through a network of secondary calibration laboratories, which regularly verify and calibrate the measuring equipment of enterprises. The National Metrology Institute also ensures “**traceability**” of national measurements to the international system through the participation in regular international comparisons of reference units and materials. A **calibration** laboratory verifies the accuracy of weight or volume measuring equipment in companies and in testing laboratories and ensures the traceability of these measurements with the reference materials kept in the National Metrology Institute. Calibration laboratories can be private or public entities.

The CIPM Mutual Recognition Agreement provides for the international recognition of national measurement standards and calibration and measurements certificates issued by signatory National Metrology Institutes. This Mutual Recognition Arrangement is a response to a growing need for an open, transparent and comprehensive scheme to give users reliable quantitative information on the comparability of national metrology services and to provide the technical basis for wider agreements negotiated for international trade, commerce and regulatory affairs.

The speed of technical progress and the need for increased accuracy (hence, increase in costs) raise the relevance of regional cooperation and specialization. The regional metrology organisations are: (i) Asia-Pacific



Metrology Programme, (ii) Euro-Asian Cooperation of National Metrological Institutes (COOMET), (iii) European Collaboration on Measurement and Standards (EUROMET), (iv) Inter-American Metrology System (IAMS); (v) Middle East North–African Cooperation in Metrology (MENAMET), (vi) South-Africa development Community Cooperation in Measurement Traceability (SADC MET).

A specific sub-area of metrology is the so-called “**legal metrology**”, which is related to measurements which directly affect the consumer. Legal metrology aims at making sure that consumers are protected from, for example, weighing or other measuring devices (e.g. gas stations) not being calibrated correctly. This task is often assigned to Trade Ministries, but different national arrangements may exist.

## 1.3 Legal and regulatory context

### 1.3.1 National/regional legal framework

The national legislative framework establishes and organizes the national quality system with a view to promoting trade and ensuring that technical regulations are adhered to.

In terms of **institutional set-up**, national legislation should establish at least the following entities: a national standards body, a national metrology institute and a national accreditation body. Although in practice all entities may operate “under the same roof”, their respective management structures must be fully independent from each other, in order to avoid conflicts of interest. Proper financing and staffing should be ensured. Furthermore,

#### Box 5. What is the difference between SPS and TBT?

It is important to understand the difference between SPS and TBT measures, as they are subject to different WTO rules.

**SPS** measures relate to food safety, animal and plant health. More in particular, SPS measures aim:

- To protect human or animal health from contaminants in food (e.g. regulations setting maximum residue levels for pesticides);
- To protect human health from plant or animal-carried disease (e.g. foot and mouth disease);
- To protect animal or plant health from pests or diseases;
- To protect territory from damage by pests.

The **TBT** agreement covers any other product requirement and is much broader in scope (including e.g. cars, mobile phones, pharmaceuticals, labels of chemical products etc).

A few examples can clarify the difference :

SPS measures	TBT measures
additives in food or drink	labelling of composition or quality of food, drink and drugs
contaminants in food or drink	quality requirements for fresh food
toxic substances in food or drink	volume, shape and appearance of packaging
residues of veterinary drugs or pesticides in food or drink	packaging and labelling for dangerous chemicals and toxic substances, pesticides and fertilizer
certification: food safety, animal or plant health	regulations for electrical appliances
processing methods with implications for food safety	regulations for cordless phones, radio equipment etc.
labeling requirements directly related to food safety	textiles and garments labelling
plant/animal quarantine	testing vehicles and accessories
declaring areas free from pests or disease	regulations for ships and ship equipment
preventing disease or pests spreading to or in a country	safety regulations for toys
other sanitary requirements for imports (e.g. imported pallets used to transport animals)	

Source: WTO, SPS Agreement, Online training module



the roles and responsibilities of different line ministries and/or specific government agencies in terms of issuing technical regulations and ensuring market surveillance should be clear, avoiding gaps or conflicting legislation.

In addition, **technical regulations applying to different products** should be clearly written, unambiguous and accessible to all stakeholders. These regulations should not only specify product (e.g. size or maximum residue levels for pesticides) or process requirements (e.g. HACCP) but should also clarify how conformity should be proved (e.g. through specific certification schemes).

Against the background of rapidly evolving standards and international trade patterns, it seems useful to establish a **National Quality Council**, with representatives from line Ministries, government agencies, the private sector and consumer organisations to discuss the overall quality vision and to address specific concerns and emerging issues in a coordinated and coherent way.

Finally, when drafting national legislation, it is crucial to take into account the **regional dimension**. Regional organisations like EU, ASEAN, NAFTA, SADC, MERCOSUR etc. have trade and development of internal markets as a main objective. One of the main tasks of these regional institutions is to harmonise the national quality legislation and institutional set-up in their member states.

### 1.3.2 WTO Agreements on SPS and TBT

While standards and technical regulations are necessary to protect health of consumers and guarantee product safety and quality, they also create (non-tariff) barriers to trade. Moreover, having different product requirements in different countries for the same product entails additional, often prohibitive, costs to producers. Against this background, the WTO SPS and TBT agreements aim to ensure that different product regulations and conformity assessment procedures do not become unnecessary obstacles to trade.

Both agreements contain the following provisions:

- **Non-discrimination:** treating imported products in the same way as domestic products
- Use of relevant international standards as a preferred option, i.e. **harmonization**<sup>63</sup> of technical regulations and conformity assessment procedures as a key-facilitator of international trade in goods
- **Equivalence:** since harmonisation of technical regulations and conformity assessment procedures can be a long-term process (requiring changes in legislation), WTO Members should pursue “equivalence”, i.e. the recognition that technical regulations and conformity assessment procedures in one country pursue the same objective or level of protection as those in another country, even though they are different
- **Transparency:** each Member country has to set up a **National Notification Authority**, i.e. a national government entity which informs the WTO SPS or TBT secretariat of draft technical regulations and/or related conformity assessment procedures which are likely to significantly affect trade, unless they are substantially the same as international standards. In principle, such changes need to be announced in advance, to allow trade partners to raise questions and send comments. In addition, the WTO requires the setting up of a **National Enquiry Point** where trade partners can obtain all relevant information on applicable technical regulations and conformity assessment procedures in the country. Furthermore, the National Enquiry Point disseminates incoming notifications to national interested parties.
- **Regionalisation** within a country: allowing imports from disease-free areas of an affected country (i.e. avoid the application of product bans to an entire nation in case a particular disease is only concentrated in specific areas and adequate measures are in place to control the spreading of the disease).
- SPS measures can only be applied to the extent that they aim to protect life or health from risks linked to specific causes (as explained in Annex A of the SPS Agreement and box 5), that they are proportional to the health risks involved and based on science. The latter implies that measures are either (i) based on international standards (the three international standards-setting bodies referenced in the SPS agreement are the Codex Alimentarius, the OIE and the IPPC) or (ii) sustained by a scientific risk assessment.
- The TBT agreement prescribes that technical regulations should be necessary to attain so-called “legitimate objectives”, including, *inter alia*: national security, the prevention of deceptive practices, protection of human health or safety, animal or plant life or health, or the environment.

The SPS Agreement also provides for:

The most important difference between the SPS and the TBT agreements relates to the objective pursued by the measure and to the range of acceptable justifications for imposing technical regulations or specific conformity assessment procedures:

Given that two different sets of rules apply, it is important to understand to which agreement a measure is referring (see box 5 for further details). This is also relevant for dispute settlements on SPS or TBT measures adopted by trade partners.

### 1.3.3 The EU framework

EU product requirements may be laid down in EU or in Member State legislation. The EU legislation has been adopted as part of the framework of rules governing

the EU internal market and with a view to ensure an appropriate level of protection of EU consumers and other end-users. It covers both EU produced goods and imports. As such, manufacturers and importers are under the obligation to ensure compliance with the applicable requirements and provide all supporting evidence (e.g. declaration of conformity). Yet, as the EU is also the largest importer of food from developing countries<sup>64</sup>, its legislation has an important impact on third countries. The following paragraphs briefly present the main elements of EU legislation in the area of SPS and TBT.

In the area of **SPS**, the basic legislation is provided in the EU Food Regulation EC/178/2002 and the so-called “Hygiene Package for Food”, which is in force since 2004<sup>65</sup>. In the EU, the prime responsibility for food safety is entrusted to food business operators, meaning that they have to be able to provide evidence of compliance with applicable EU legislation. This implies that they have to keep records of the origin of any batch of incoming products and of the destination of out-going products. This requirement is known as “one back, one forward”.

The Competent Authorities of the EU Member States are responsible for market surveillance from farm to fork, i.e. for enforcing EU laws through their own food control systems (including licensing, certifications, inspections, border control points). They are also responsible for quarantine arrangements when risks are detected.

The EU’s Food and Veterinary Office (FVO), which is part of the Commission’s DG SANCO, has both responsibilities inside and outside the EU. Within the EU it is in charge of verifying, through regular inspection missions, whether Member States have correctly implemented the EU food regulations. Regarding third countries, the FVO carries out missions to verify on the spot compliance with EU import requirements, i.e. verifying the legal framework, the functioning of their competent authorities and selected food business operators. Based on FVO inspection reports, the Commission maintains a [list of countries and food business operators](#) which have been assessed by the third country Competent Authorities as capable of delivering equivalent protection levels as those required in the EU. These inspection reports are of key importance for third countries, as they are the basis for opening market access to the EU. They may represent a relevant source of information for designing EU assistance programmes to developing countries (see also section 2.1). In certain cases, the measures to be taken by the developing country to remedy to deficiencies detected by such inspections have been financed by the EU as part of a technical assistance programme. DG SANCO has been designated as Enquiry point for SPS measures applicable on the EU internal market. Together with DG TRADE, it also represents the Commission (and the EU) at the SPS Committee. DG Sanco is the spokesman on behalf of the 27 Member States of the EU.



### The CE marking attests conformity with applicable EU product requirements

European product legislation<sup>66</sup> in the area of **TBT** is set by legislation using different harmonisation techniques. A full overview of the product areas can be found on the website of the Commission’s DG Enterprise ([http://ec.europa.eu/enterprise/sectors/index\\_en.htm](http://ec.europa.eu/enterprise/sectors/index_en.htm)). A basic distinction can be drawn between the so-called “old approach” (very detailed and prescriptive harmonising legislation, using a standard-like technique, only still applied for motor vehicles) and “new approach” legislation. Since its introduction in the mid-80s, the new approach technique has been widely used and now covers more than 20 industrial sectors, such as electro-technical products, machinery, radio/telecoms equipment, toys, medical devices, pressure vessels, gas appliances, personal protective equipment and construction products. Under the new approach, technical harmonisation is limited to essential requirements for the protection of health, safety or the environment, expressed in terms of performance-based indicators or objectives. Technical solutions to meet these requirements are set out in harmonised standards developed by the European standardisation organisations (CEN, CENELEC and ETSI) based on a mandate from the European Commission. As of publication of their references in the Official Journal of the EU, compliance with harmonised standards confers presumption of conformity with the essential requirements covered by such standards. Applicable conformity assessment procedures are chosen by the legislator from a pre-defined set of modules.

In July 2008 the EU adopted the so-called New Legislative Framework (NLF), i.e. Decision 768/2008 on a common framework for the marketing of products and Regulation 765/2008 setting out the requirements for accreditation and market surveillance relating to the marketing of products.<sup>67</sup> Regulation 765/2008 makes a clear distinction between the liabilities of the manufacturers, importers and distributors. The manufacturer (located in the EU or exporting to the EU) is generally required to carry out a product risk assessment, draw up the required technical documentation (e.g. user manuals), prepare a technical file documenting how all relevant essential (e.g. health and safety) requirements of the applicable EU legislation have been fulfilled, undergo the required conformity assessment procedure (either product or production process related, depending on the modules) and draw up the declaration of conformity. The manufacturer affixes the CE marking whenever required by the applicable directive at the end of the above process as a means to declare that the product is in conformity with all applicable requirements. It should be noted that the definition

64 In 2008, imports from developing countries represented about 28% of total EU imports.

65 Specific legislation exists in the area of feed control and pesticides (containing among others maximum residue levels).

66 A full overview of the product areas can be found on the website of the Commission’s DG Enterprise ([http://ec.europa.eu/enterprise/sectors/index\\_en.htm](http://ec.europa.eu/enterprise/sectors/index_en.htm)).

67 OJEU L 218, 13.8.2008, pp. 30 (Regulation 765/2008) and 82 (Decision 768/2008).

of manufacturer includes also any natural or legal person who has a product designed or manufactured and markets that product under his name or trademark (e.g. for EU legislation, a retail store selling products under its own brand is considered as the manufacturer and carried the related liabilities). Importers are under the obligation to only place compliant products on the EU market. They have in particular to verify that the manufacturer outside the EU has undertaken the necessary steps to ensure conformity, i.e. he has followed the appropriate conformity assessment procedure and drawn up the technical documentation, that the product bears the required conformity marking and is accompanied by the required documents, and that the manufacturer has complied with any applicable traceability requirements. Distributors must act with due care in relation to the applicable requirements and, in particular, verify the presence of both the CE marking and the required accompanying documentation.



**CLP symbol for dangerous  
extremely flammable products**

In addition to the old and new approach directives, additional sector-specific legislation exist, for example in the area of handling and labelling of chemical products (as specified in the Regulation on Registration, Evaluation, Authorisation and Restriction of Chemicals (Reach) and the Regulation on Classification, Labelling and Packaging of substances and mixtures (CLP)), cosmetics, energy efficiency labelling and textile labelling.

Finally, the General Product Safety Directive provides for a general obligation for manufacturers and importers to place only safe consumer products on the market.

Like in the area of SPS, market surveillance is the task of the Member States. With the Rapid Alert System for Non-Food Products (RAPEX), the European Union has an effective and efficient system in place to share information about hazardous products found on the European market. DG Enterprise is the EU notification and enquiry point under the TBT Agreement. It is responsible for overall policy coordination on TBT Agreement-related matters and, together with DG Trade, represents the EU at the meetings of the TBT Committee.

## 1.4 Rationale for intervention with developing countries

As mentioned previously, a number of food safety crises since the 90s has created increasing pressure from consumer groups to ensure products are safe to eat. In addition, consumers are becoming increasingly concerned with the environmental impact of manufacturing processes (e.g. sustainable forest management), product safety (e.g. prohibited chemical substances in toys), labour standards (e.g. ban on the use of child labour) and fairness of price setting (e.g. fair trade initiatives). This has contributed to the proliferation of international and private standards and technical regulations in very diverse areas. Although these standards affect all countries, challenges can be particularly high for less developed countries, which have limited resources to follow-up diverse and changing export market requirements, to upgrade their quality infrastructure and to adapt production systems:

- Compliance is needed with an increasing number of standards and regulations
- Different standards for the same products exist in different countries and within regions which cause diseconomies of scale
- Developing countries' quality systems have only limited or no international recognition, implying additional costs for producers as tests or certificates have to be performed abroad.

A particular challenge is the proliferation of private standards. Contrary to official standards, most often they are not agreed by consensus in the context of an international standards-setting body; they are usually defined by producers and retail groups.

Therefore, the benefits of a fully functioning QI can be significant for all stakeholders in developing countries. First, QI allows **enterprises** to demonstrate compliance with national or international technical regulations, which is a *conditio sine qua non* for launching products on the market. Furthermore, compliance with international standards (in terms of product requirements or management practices) is also a key enabler for SMEs to climb up the value chain, raise productivity per worker and increase their revenue levels. Given that international standards often embody the latest state of technological development, SMEs can adopt them, prove compliance and hook up to national or international value chains. Finally, a broad-based adoption of international standards also allows generating economies of scale. As a result, quality infrastructure is also an important tool to increase international competitiveness. Given the relative importance of food products and the growing share of manufactured goods in developing countries' exports, compliance with standards and regulations can have a very significant impact on export volumes. In particular, the market for fresh fruit and vegetables, in which many developing countries have a comparative advantage, can be very profitable for exporters, given the high premiums paid in industrialized countries.

### Box 6. GLOBALGAP

Globalgap is a private sector body that sets voluntary standards for the certification of agricultural products worldwide. It is a business-to-business label and is therefore not directly visible to consumers. It started in 1997 as an initiative by the Euro-Retailer Produce Working Group (EUREP), working on harmonised standards and procedures for the development of Good Agricultural Practices (GAP). The growing use of the standard led to rename the brand as GLOBALGAP. The standard aims at reassuring consumers about how food is produced on the farm by minimizing detrimental environmental impacts, reducing the use of chemical inputs and ensuring a responsible approach to worker health and safety as well as animal welfare. GLOBALGAP covers the production cycle from farm inputs until the product leaves the farm. The standard has one common base and different product applications covering the whole of range of agricultural activities.

Source: [www.globalgap.org](http://www.globalgap.org)

A well functioning QI and harmonisation with international standards in the area of health and safety also enhance **consumer** protection in the domestic market, through control of locally produced goods and imports and through better and more transparent information.

## 1.5 Key Actors and Issues

### 1.5.1 Key actors

The following table provides a list of the main stakeholders involved in quality and conformity systems and of the related areas where weaknesses tend to appear more frequently. Some of the key issues to address through technical cooperation are presented after the table.

**Table 1. Overview of key actors in QI support programs**

Stakeholders	Typical weaknesses
Public authorities at national and regional level	<ul style="list-style-type: none"> <li>Lack of a quality strategy and its role in the wider competitiveness agenda, gaps in legislation, unclear definition of roles and responsibilities of ministries and agencies in the quality structure, lack of awareness on the need to participate in international fora (WTO, international standards-setting organisations, trade partners), insufficient allocation of human and financial resources to QI;</li> <li>Lack of involvement of the private sector in national quality policy (e.g. when preparing comments on new technical regulations announced by trade partners).</li> </ul>
Market Surveillance Bodies and competent authorities	No effective enforcement of SPS/TBT legislation because of lack of skills, absence of risk-based inspection plans, ill-equipped laboratories, no effective communication with general public on acute health risks, no contingency plans to deal with risks (such as quarantine procedures or the declaration of disease-free areas).
Risk Assessment Bodies (SPS)	No systematic assessment of health risks resulting from specific hazards of diseases, risk assessment function not defined.
National standards institutes	Poor alignment with international/regional standards
Metrology bodies	Lack of competence and demand-orientation
Accreditation bodies	Lack of skills, difficulty to prove equivalence of national systems to key export market requirements
Business associations	Insufficient awareness of international standards and technical regulations, weak capacity for providing services to their members.
Consumer Associations	Weak capacity for defending consumer rights, insufficient awareness of national or international standards
Laboratories	Skill shortages, lack of equipment, poor maintenance
Enterprises/smallholders	Insufficient awareness of national and international standards, technical regulations and conformity assessment requirements; weak capacity to comply with standards and regulations



### 1.5.2 Key issues

#### *At policy (macro-) level*

A frequent constraint at policy level is the lack of a 'quality vision'. This is often revealed by the absence of a national quality policy or of a lead agency (e.g. a national quality council) in charge of its definition. Once quality policies are established, implementation requires a clear action plan and, most importantly, a strong political commitment. Governance also plays an important role in the way the different functions of the QI are distributed, organised and managed. In some cases several ministries/agencies are involved with the same function (which could lead to regulatory overlaps or conflicts of interest), while other important services are not ensured.

Many developing countries also lack institutional capacity to engage in market access negotiations. In particular, they may lack the necessary skills to comment on new technical regulations notified by trade partners in the WTO framework, or find it difficult to demonstrate that their measures in the area of SPS should be considered equivalent to those operated in key export markets. As a result, developed countries often fail to take sufficient account of developing countries' constraints or interests when adopting more stringent SPS/TBT regulations.

#### *At infrastructure (meso-) level*

A major constraint is often skills shortages. Acquiring knowledge demands several years dedicated to the same function, especially for testing. Moreover, accreditation bodies often show poor performance in international peer reviews or are not even in a position to qualify to participate in such reviews. Therefore, developing countries' quality systems often do not enjoy strong international recognition.

Furthermore, the range of tests is often limited to basic levels and testing often does not allow complying with key EU import specifications, for example regarding pollutants in fish or micro-toxins. Frequently, the accuracy of available tests is also low.

Yet, donor assistance may jump to building and equipping new laboratories, without a proper cost/benefit assessment, leading to expensive "white elephant" laboratories. Laboratory equipment for metrology, testing and calibration purposes is often expensive in terms of purchase and maintenance. When market demand is not sufficient or clearly known, gaps in QI may be bridged by other means, e.g. sharing regional facilities or creating partnerships with existing laboratories in private companies or in universities.

A further issue is the division of labour in QI between private and public sectors. In some countries public bodies dominate QI (especially in developing countries), while in others the private sector is more prevalent. A key criterion is to avoid unfair competition from (subsidized) public sector entities in areas where there might be both public and private operators (e.g. laboratories or certification bodies).

#### *At enterprise (micro-) level*

Ultimately, the aim of QI is to help to create the conditions for producers to become compliant with standards and technical regulations of both domestic and key export markets. Yet, the expected supply response crucially hinges on a number of factors, including awareness of quality norms, producers' capacity to adapt production systems and access to affordable conformity assessment services.

In particular, due care should be taken of specific needs of SMEs. Many SMEs are not directly involved in exporting activities but often work through intermediary exporting companies. Since exporters have to make sure the products they trade comply with all international requirements, they have an incentive to work with few larger producers as this reduces transactions costs. Furthermore, international standards often impose a significant burden on smallholders, due to the cost of certification and, in case of food products, the need to keep extensive records of the use of chemicals and in some cases to change production methods. Finally, a specific concern for SMEs is access to information on national and international standards and certification services. Therefore, specific needs of SMEs should be assessed from the start of programme design.

#### **Box 7. Support to accreditation of laboratories in Indonesia**

In Indonesia, the EC funded Trade Support Program had organized, as a training, a blank audit of a laboratory by auditors of the European Accreditation Board. Despite the accreditation certificate granted by the Indonesia Accreditation Board, the audit has revealed 7 non-conformities, of which 3 major ones.

With the support of the EC-funded Trade Support Program, Indonesia's standards institute (BSN) has adopted a solid, computer-based human resources development plan. The system not only describes BSN functions, jobs and necessary skills and knowledge levels, but also links to staff initial level, registers the subsequent training and their impact, registers staff performance against targets/indicators, and allows for assessing the capacity gaps.

### *The importance of the regional dimension*

QI and the alignment to international standards constitute a powerful tool to stimulate regional integration. Uniform product requirements allow producers to take full advantage of regional markets and generate economies of scale.

Regional integration also allows the rationalisation of the design of national quality systems, for example through the exchange of experts or by sharing specialised laboratories. A list of key activities which can be supported at regional level is included in section 2.2.

In practice, fully integrated quality systems at regional level in developing countries are not very common. However, regional objectives can also be implemented through support to national systems (ECOWAS PARI-II programme supported the reinforcement of capacities of laboratory staff), or by developing selected regional functions (e.g. harmonization of food control regulations in SADC and MERCOSUR).

## 2. What can be done

### 2.1 Problem identification and diagnostic tools

QI is an interface between buyers and suppliers. When considering support programmes for QI, it is thus necessary to identify issues pertaining to both sides, in addition to core problems affecting the quality system.

When designing a programme, the main areas of investigation are:

- Domestic (and if applicable regional) requirements regarding consumer protection
- Export market requirements (of key -potential- export products) in terms of technical regulations, voluntary standards (including private standards) and conformity assessment procedures
- Identification of stakeholders in QI and assessment of their involvement and performance levels
- Gap analysis and assessment of different support options, taking into account existing infrastructure and potential synergies at regional level.

The following sources of information can provide useful elements for the initial needs assessment:

- [Diagnostic Trade Integration Studies \(DTIS\)](#). These studies, commissioned by the multi-donor funded Enhanced Integrated Framework, contain an analysis of a country's constraints to increased participation in international trade, covering in particular issues relating to obstacles to trade and the level of alignment with international standards. They tend to be comprehensive but have a long lead time (at least 1 year) and only concern LDCs.
- [WTO Trade Policy reviews](#). The WTO carries out regular reviews of its members' trade policies. They usually contain a description of the institutions involved in trade policy-making and explain the main components (laws, institutions) of the national quality

infrastructure, covering both the areas of SPS and TBT.

- [WTO Members Accession Protocol](#). This document summarizes the commitments, dispositions and benefits adopted for the accessing member. The working party report details the main characteristics, achievements, shortcomings and issues relating to trade. Issues on trade openness and on TBT and SPS compliance are also listed.
- [DG SANCO's Food and Veterinary Office \(FVO\) Inspection Reports](#). They contain a list of country-specific shortcomings in the SPS area, covering both private and public players, which need to be addressed as a condition for exports to the EU.
- [Standards and Trade Development Facility's \(STDF\) "Country Briefings"](#). The STDF is a joint FAO, OIE, World Bank, WHO and WTO initiative aiming at creating a platform contributing to donor coordination at global level and the exchange of good practice in relation to the provision of SPS-related assistance. The EU is also a donor to this initiative. The STDF's Country Briefings present a useful overview of the current SPS situation in selected countries, including key issues and past and recent donor support.

### 2.2 Broad areas of intervention and key activities

Programmes in the area of QI can cover a broad range of intervention areas and activities comprising in particular strengthening the policy framework (macro level) and upgrading the quality infrastructure (meso level).

As a quality system relies on the active participation of both public and private sector, the actions to be undertaken are targeting both the public and private sector capacities and the articulation between them in the area of strategy design, operational aspects and funding.

#### Box 8. Bangladesh Quality Support Programme

**Budget for the Programme:** €13.5 million (of which EU contribution €10 million)

**Period:** 2004–2010

**Description:** The programme aims at broadening international recognition of the national quality system and improving competitiveness of the Bangladesh textile and garment industries. Activities include strengthening key business development service providers such as the National Institute of Textile Training Research and Design (NITTRAD), the Bangladesh Garment Innovation Centre (BGIC) and the Institute of Fashion and Technology (BIFT) of the Bangladesh Garment Manufacturing and Exporters Association (BGMEA).



## Macro level

Support at macro level generally aims at strengthening the overall SPS/TBT policy framework and the core public sector bodies involved in the national quality system. Interventions can include the following areas:

- Strengthen SPS/TBT policy and legislation
  - Develop/strengthen a medium-term SPS/TBT strategy through market research (analysis of competitive advantage, identification of sectors with largest export potential, analysis of export market requirements). This research should be part of a broader strategic analysis of competitiveness issues.
  - Review the legislative framework and bring it in line with international good practice. This includes harmonising technical regulations with international or regional standards and adopting transparent procedures for the assessment of conformity.
  - Improve knowledge on rights and obligations in the framework of the WTO SPS/TBT agreement
  - Support to the national enquiry and notification point (WTO requirements)
  - Setting up a National Quality Council, in charge of defining the medium-term strategy in the area of quality systems, based on broad participation of line ministries and private sector representatives (business associations, consumer organisations)
  - Improve the capacity of business and consumer associations to allow them to:
    - participate in the work of the National Quality Council;
    - participate in the national standards-setting process along international good practice;
- Improve the functioning of the public institutions involved in the national quality system
  - Strengthen human resources at technical and management level and set up human resource management systems
  - Revise legislation to ensure that roles and responsibilities of each entity are clearly defined, that they are politically independent and benefit from financial autonomy
  - Specific support to the standard setting body, including:
    - Build an up-to-date database on relevant national and international standards
    - Review existing national standards and assess the scope for adoption of international standards
  - Specific support to the national metrology institute, including:
    - Strengthen the primary calibration laboratory, establish a network of secondary calibration laboratories
    - Develop legal metrology
  - Specific support to the accreditation board, including:
    - Development of accreditation services aligned with international benchmarks
    - Cooperation with foreign accreditation bodies to obtain international recognition of national conformity assessment bodies

### Box 9. Pesticides Initiative Programme (PIP)

**Budget:** €38.5 million from EDF 9 and €33 million from EDF 10

**Period:** PIP phase 1 for the period 2001–2009, PIP phase 2 for the period 2009–2014

**Description:** The programme aims at preventing negative effects from ongoing changes to the EU food safety regulations on the ACP horticultural export sector. It contains interventions at micro, meso and macro level including: 1) providing support to ACP exporters to overcome obstacles to access EU markets, by helping them install and maintain durable risk management systems; 2) improving the operating environment of ACP companies, by providing capacity building for business development service providers and institutional strengthening; 3) ensuring that the needs of ACP products are taken into account in the harmonization of the EU regulations. In the second phase the scope of the programme was broadened, including also private standards (e.g. commercial, environmental, social and fair trade standards), processed fruits and vegetables and activities to improve the quality of the ACP products on the local and regional markets.

## Box 10. MERCOSUR - Technical Convergence programme in the area of SPS

**Budget for the Programme:** €7,16 million (of which EU contribution €6 million)

**Period:** 2006–2009

**Description:** The purpose of the programme is to facilitate international trade by strengthening regional cooperation in the area of SPS. In particular, the programme supports the regional harmonisation of technical regulations and their alignment with EU requirements. Activities in this area concern skill development for government officials and the elaboration of a regional database containing technical regulations applicable in Mercosur member states. In addition, the programme supports the identification and strengthening of regional reference laboratories, with the aim of obtaining EU accreditation, by providing specialized training and equipment. Finally the programme will elaborate a regional strategy for SPS market surveillance, including a separate risk analysis function.

- Support for participation in regional and international accreditation forums (such as the IAAC, ILAC and IAF)
- Specific support to market surveillance, including:
  - Strengthen enforcement of product safety legislation
  - Strengthen the competent authorities (SPS), prepare inspection plans, set up quarantine procedures and border inspection points, strengthen information systems for e.g. pest control and traceability of products
  - Upgrade infrastructure (e.g. of laboratories involved in inspection)
  - Strengthen risk analysis (SPS).
- Strengthen international linkages
  - Support to influence the work in international fora such as the WTO or international standard setting bodies
  - Support for participation in regional fora.
- terms of clients at enterprise level), establishing partnerships with private players (e.g. with existing laboratories in universities or in larger enterprises) or creating regional arrangements;
  - Facilitate private sector participation in the area of conformity assessment through clear and transparent accreditation procedures for laboratories and certification bodies;
  - Upgrade infrastructure and skill levels of conformity assessment bodies
- Strengthen business and consumer associations
  - Improve awareness of national and international standards and technical regulations in key sectors through training and websites with up-to-date information;
- Support to business development service (BDS) providers in the area of SPS/TBT/private standards
  - They can play a key role in providing training and transferring specific knowledge to producers e.g. on HACCP or ISO22000 (Food safety management systems) or ISO14000 (Environmental management systems).

### Meso level

Interventions at meso level target in particular business and consumer associations as well as the components of the national quality system which can be provided by either private or public players. Activities can also involve strengthening business development service providers which provide technical assistance and training to producers in the area of SPS/TBT/private standards.

- Strengthen conformity assessment bodies
  - Support for making a mapping exercise in terms of the needed versus available conformity assessment bodies (e.g. laboratories, certification bodies);
  - Support for preparing a cost-benefit analysis on how to fill gaps in the quality infrastructure and weighing of alternative options such as: building new laboratories (if sufficient critical mass in

### Micro level

The aim of QI is to stimulate compliance with health, safety, environmental and other regulations and to facilitate external trade through increased compliance with national or international product requirements. This supposes that enterprises, most of which are SMEs, are aware of the relevant requirements, are able to adapt their production process and have access to conformity assessment bodies at reasonable cost. It may be more appropriate to integrate the support at enterprise level into a wider SME support programme. Actions at micro-level include the following activities.

- Access to information on (private or public) standards, technical regulations and conformity assessment procedures

- Access to BDS providers in the area of SPS/TBT/private standards with the aim of upgrading SME production processes or infrastructure (further details on how to support BDS providers can be found in the respective thematic review)
- Access to conformity assessment bodies for testing and certification purposes
- Group certification for smallholders or other small enterprises: certifying producers as a group can allow significant cost savings such as inspection charges and overhead costs. Moreover, acting as a group also facilitates the transfer of knowledge and may result in “peer pressure” to meet specific quality standards
- Identifying opportunities to hook up to international value chains and major trade partners (e.g. leading retail groups, importers, etc.).

### *Regional cooperation (macro and meso level)*

Harmonizing national standards and mutual recognition of conformity assessment procedures is a key step towards the creation of a common market for goods. The benefits can be significant: producers have access to a larger, more homogeneous market, potentially allowing for significant economies of scale. At the same time,

regional cooperation also allows streamlining the national quality infrastructure through the sharing of facilities or the exchange of experts. Concrete actions are in particular:

- Cooperation in standardisation, pushing simultaneous and coordinated action to align national standards with international standards
- Regional cooperation in metrology, allowing specialisation of national institutes (e.g. one metrology institute focuses on physical measurements while another concentrates on chemistry)
- Cooperation in accreditation, facilitating regional and international recognition of national quality systems e.g. by creating a regional pool of accreditation experts in different fields or by organising regular peer reviews among member states
- Regional cooperation on conformity assessment can facilitate the sharing of specialized laboratories, serving producers in different countries
- The functioning of competent authorities is also most effective if coordinated at regional level (i.e. “pests do not stop at the border”)
- Increased cooperation in international fora can strengthen the voice of developing countries.

## 3. How can it be done?

### 3.1 Methods and levels of intervention

In practice, interventions in the area of QI can take different formats: they can be embedded in a broader trade-related or sector support programme or can be targeted on specific components of the QI:

- **SPS/TBT/private standards can be part of a broader trade-related assistance programme**, which also covers assistance to export promotion agencies, strengthening the business enabling environment, support to the business development service providers in the area of export or support to a customs union.
- **SPS/TBT/private standards can be part of a sector-specific support programme**, covering the entire value chain from assistance to producers until export promotion, e.g. in the area of food processing or wood manufacturing. Such interventions can involve training to upgrade skill levels of the specific sectors involved, support for business clusters and support to specific laboratories or certification bodies needed for export.
- **Specific SPS/TBT projects**, targeting specific obstacles in the national or regional quality infrastructure.

*A priori*, there is no preference for one of the above approaches, provided that they are based on a comprehensive needs assessment, correspond to national priorities and are part of a set of complementary measures taken by the government.

The most common intervention method to support QI is the **project approach**, given the emphasis on capacity building and the active involvement of both public and private players:

- Support to QI usually has a significant component of capacity building, i.e.: awareness-raising among government officials and producers, training of laboratory personnel, designing border control procedures etc. In practice, this can be done through different arrangements such as sending national or international experts. Twinning has been successfully used in Phare programmes, in the Western Balkans and in the Southern Mediterranean area. Project support is generally the preferred option to frame this kind of interventions.
- Support to quality systems often requires the involvement of several actors from both the public and private sector. The project approach usually allows a

better articulation between them and is better suited to hold public and private sector bodies accountable.

For the same reasons, **sector or general budget support** programmes are less frequent in this area as they require advanced public sector capacities, a clear national strategy and well functioning core components of the national quality system. Furthermore, sector budget support programmes are usually limited in scope as they will mainly concentrate on public sector reforms.

Regional programmes supporting QI usually also follow the project approach.

### 3.2 Sequencing of activities

Support to QI in developing countries requires an integrated approach which recognizes that the **components of a QI are interdependent**. Metrology provides the basis for accurate measurements, which form the basis for international standards and which in turn can be used as a basis for conformity assessment, which in turn require national or international accreditation.

Yet, there is no “one-size-fits-all” solution in terms of the degree of sophistication of the components or the way the different services can be delivered. The cost of QI in terms of skills and financial resources can be significant for developing countries. It is therefore crucial to start from a clear **needs assessment**, specifying the main goals of the quality system in a particular country in terms of:

- a. the priority areas for domestic consumer protection;
- b. the top 5 (potential) export products and the export market's requirements in terms of technical regulations and standards.

Based on a clear set of priorities, a mapping exercise can be started to ascertain the level of existing QI and the gaps to be filled. A clear **cost-benefit analysis** should be prepared, weighing the benefits of increased trade or of better consumer protection against the cost of upgrading the existing QI. Alternative solutions should also be considered such as partnerships with universities or private laboratories or regional cooperation. In this respect, due attention should also be paid to the financial sustainability of new entities which will eventually be created (i.e. taking into account service fees, government subsidies, recurrent costs etc).

### 3.3 Expected results and results measurement

Table 2 contains a number of key results and indicators to measure them.

### 3.4 Cross cutting issues

#### *Environment*

Quality systems can play a key role in achieving environmental objectives, in particular:

- Implementing SPS/TBT measures can lead to safer production methods:
- The establishment of maximum residue levels limits or bans due to the use of harmful pesticides, protecting human health and the environment.
- Adopting the Globally Harmonized System of Classification and Labelling of Chemicals (GHS) ensures that information on physical hazards and toxicity from chemicals is available, thereby protecting human health and the environment.
- Developing national capacities for detection of heavy metals, pesticides, residues of sanitary products, waste water & air pollution analysis contributes to awareness raising in both public and private entities.

Certification schemes for sustainable forest management can provide an incentive to logging companies and wood exporters to meet environmental standards. Examples in case are the EU's FLEGT programme (see Box 11) and the Forest Stewardship Council (FSC). Many importers in the EU (especially large retail chains) require the FSC label for all wood products. Specific certification

schemes are also available in the area of protecting marine life (e.g. the Marine Stewardship Council).

#### *Governance*

Governance is a key feature of QI. The main principles described in the EU reference document on "Analysing and addressing governance in sector operations" (2008) are important in relation to QI: the participatory approach (e.g. participation of business and consumer organisations in standards setting and in defining the national quality policy), transparency (market surveillance, websites with documentation on national standards, technical regulations and conformity assessment procedures), and accountability (e.g. clear definition of roles and responsibilities of different entities involved in the quality system).

### 3.5 Risks

A key risk is the often limited public sector awareness of SPS/TBT issues as a key enabler for private sector development. It is crucial to ensure a minimum level of political commitment, especially in countries where the basic components of a quality system are still missing. Building up the basics of a quality system implies a very strong public sector involvement, as well as capacities to engage in a constructive dialogue with the private sector representatives to define a vision and to identify efficient implementation methods.

An additional risk is related to the long-term financing of key public institutions involved in quality systems. Operating costs of laboratories or training programmes for experts may be expensive and require minimum budget allocations which are stable over time.

#### **Box 11. EU FLEGT Action Plan**

##### **The EU FLEGT Action Plan: at the crossroads of trade development, good governance and sustainable forest management**

The EU FLEGT Action Plan (Forest Law, Enforcement, Governance and Trade) takes trade as an entry point to support good governance and sustainable forest management in countries selling wood to the EU. It is based on Voluntary Partnership Agreements, in which the authorities of wood exporting countries commit to draw up and implement a sustainable forest management plan, based on a national certification scheme, which demonstrates that all wood products exported to the EU are in line with national legislation. Once a country has entered into an agreement, only licensed timber from that country will be accepted at EU borders. Export licensing is based on national standards for forest management, rooted in national laws and regulations. These cover environmental protection, logging rules, payment of fees, transport and property rights. Partner countries also commit to enable responsible timber companies to more readily achieve certificates. The EU provides capacity building to support developing countries in these efforts.

On the demand side, the EU is in the process of adopting a regulation introducing the "due diligence principle", meaning that timber importers will be obliged to implement procedures that give them reasonable assurance that the wood they trade has been legally harvested, thereby stimulating corporate responsible purchasing. Imports from countries which concluded a FLEGT partnership agreement with the EU would be exonerated from this due diligence requirement, which would act as an additional stimulus to trade.

So far, Ghana (2008) and the Republic of Congo (2009) have concluded a Voluntary Partnership Agreement; discussions are ongoing with Cameroon, Malaysia, Indonesia, Liberia and the Central-African Republic. The FLEGT programme is open to ACP and non-ACP countries.

**Table 2. Selection of results and indicators for measurement**

Areas of intervention	Results	Indicators
<b>Strengthen SPS/TBT policy and legislation</b>	Legislative framework reviewed and in line with international legislation and good practice	<ul style="list-style-type: none"> <li>Strategic analysis of competitiveness based on market research published by Government</li> <li>Official publication of legislation</li> <li>Decrease of cases of overlapping / conflicting legislation</li> </ul>
	Enhanced transparency of SPS/TBT policy and legislation	<ul style="list-style-type: none"> <li>Publication of databases and creation of websites providing information on national technical regulations, standards and conformity assessment procedures</li> </ul>
	Improved knowledge on rights and obligations in the framework of the WTO SPS/TBT agreements at Government level	<ul style="list-style-type: none"> <li>Number of training events organised and attended by officials in charge of SPS/TBT issues</li> </ul>
	National enquiry point and national notification authority established	<ul style="list-style-type: none"> <li>Number of enquiries and notifications received and dealt with</li> </ul>
	National Quality Council established and functioning	<ul style="list-style-type: none"> <li>Decree/decision to create a National Quality Council</li> <li>Number of recommendations made by the National Quality Council</li> </ul>
<b>Improve the functioning of the institutions in the national quality system</b>	Roles and responsibilities of different components of the national quality system defined	<ul style="list-style-type: none"> <li>Publication of the law/decrees providing the set-up of national quality system</li> </ul>
	The institutions are staffed and equipped	<ul style="list-style-type: none"> <li>Approval of organigrams and budget allocations</li> <li>Existence of training plans for staff and number of training events attended by key decision-makers</li> </ul>
	Competent authorities are capable to carry out inspections (i.e. at food business operators; at border inspection points) Quarantine and crisis handling procedures are set and known to main involved parties	<ul style="list-style-type: none"> <li>Number of inspection reports adopted</li> <li>Manuals for crisis handling and quarantine management published and dissemination activities (i.e. training)</li> </ul>
<b>Strengthen national capacity to engage at international level</b>	National bodies are trained and advised in order to participate in regional and international fora, such as the WTO or international standards-setting bodies	<ul style="list-style-type: none"> <li>Number of training sessions on negotiation techniques and technical contents delivered</li> <li>Number of (sectoral) preparatory meetings organised at country level</li> <li>Attendance to meetings at WTO and international standard-setting bodies</li> </ul>
<b>Strengthen conformity assessment bodies (e.g. laboratories, certification bodies)</b>	Conformity assessment bodies deliver certificates and carry out tests, directly or in partnership with private bodies (e.g. universities, larger enterprises)	<ul style="list-style-type: none"> <li>Publication of accreditation procedures for laboratories and certification bodies</li> <li>Increase in investments for infrastructure upgrading</li> <li>Number of certified experts employed</li> <li>Range of tests which can be performed and certificates which can be delivered</li> <li>Number of enterprises accessing their services per year</li> </ul>
<b>Increase awareness of SPS/TBT issues at the level of business and consumer organisations</b>	Business and consumer associations take part and contribute to the consultations on SPS/TBT Specific business sectors are consulted in case of new trade measures notified by trade partners	<ul style="list-style-type: none"> <li>Number of training events for business and consumer associations</li> <li>Publication of consultations via websites</li> <li>Types and activities of fora where business and consumer associations participate (NQC, consultations on SPS/TBT notifications)</li> </ul>
<b>Reinforced skills and capacities of BDS providers in the area of SPS/TBT/private standards</b>	Training and advisory services for BDS providers are in place BDS providers are included in professional networks to keep up to date with new legislation	<ul style="list-style-type: none"> <li>Number of bodies offering services in the area of SPS/TBT and range of services</li> <li>Number of enterprises accessing testing and certification services via BDS providers</li> </ul>
	Enterprises have access to testing and certification services	<ul style="list-style-type: none"> <li>Number of certificates/tests issued (overall and for SMEs)</li> <li>Number of companies involved in trade based on certificates (overall and SMEs)</li> <li>Time and cost to obtain a certificate or to receive the results of a test</li> </ul>



## 4. Where to find out more

### 4.1 Bibliography

- “The answer to the global quality challenge: a national quality infrastructure”, Dr. Clemens Sanetra, Rocío M. Marbán, PTB, OAS, SIN, 2007.

*This publication gives a comprehensive and easy understandable overview of the key problems and considerations related to upgrading and implementation of quality and conformity systems in developing countries.*

[www.ptb.de/en/org/q/q5/index.htm](http://www.ptb.de/en/org/q/q5/index.htm)

- “Private standards in the United States and the European Union markets for fruit and vegetables”, FAO, 2007

*This publication gives a useful overview of the main private standards in terms of requirements and the entities in charge of their administration. Particularly useful is the assessment of their importance in the market.*

[www.fao.org/docrep/010/a1245e/a1245e00.HTM](http://www.fao.org/docrep/010/a1245e/a1245e00.HTM)

- “Quality systems and standards for a competitive edge”, J.L.Guash et al, World Bank, 2007.

*This is a good reference for the design of quality systems and on challenges for developing countries. In addition, it contains several chapters on quality systems and ongoing initiatives in Latin-America.*

[http://siteresources.worldbank.org/EXT/EXPCOMNET/Resources/2463593-1213887855468/69\\_LAC\\_Quality\\_and\\_Standards\\_Pub\\_Nov\\_2007.pdf](http://siteresources.worldbank.org/EXT/EXPCOMNET/Resources/2463593-1213887855468/69_LAC_Quality_and_Standards_Pub_Nov_2007.pdf)

### 4.2 Relevant web links

- DG SANCO: FVO Inspection reports :  
[http://ec.europa.eu/food/fvo/ir\\_search\\_en.cfm](http://ec.europa.eu/food/fvo/ir_search_en.cfm)
- DG SANCO, third country establishments list:  
[http://ec.europa.eu/food/food/biosafety/establishments/third\\_country/index\\_en.htm](http://ec.europa.eu/food/food/biosafety/establishments/third_country/index_en.htm)
- DG TRADE, Market access database; provides an online record of barriers under examination in EU trading partners:  
<http://madb.europa.eu/mkaccdb2/indexPubli.htm>
- DG ENTR, Single Market for Goods - Overview  
[http://ec.europa.eu/enterprise/policies/single-market-goods/index\\_en.htm](http://ec.europa.eu/enterprise/policies/single-market-goods/index_en.htm)

- WTO main reference documents on TBT:  
[www.wto.org/english/tratop\\_e/tbt\\_e/tbt\\_e.htm](http://www.wto.org/english/tratop_e/tbt_e/tbt_e.htm)
- WTO main reference documents on SPS:  
[www.wto.org/english/tratop\\_e/sps\\_e/sps\\_e.htm](http://www.wto.org/english/tratop_e/sps_e/sps_e.htm)
- WTO : interactive course on the SPS agreement:  
[www.wto.org/english/tratop\\_e/sps\\_e/sps\\_agreement\\_cbt\\_e/signin\\_e.htm](http://www.wto.org/english/tratop_e/sps_e/sps_agreement_cbt_e/signin_e.htm)
- World Bank: this site contains the main reference documents on standards, country assessments (for SPS), and case studies on the costs involved in compliance with international standards:  
<http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/TRADE/0,,contentMDK:20629901~menuPK:222955~pagePK:148956~piPK:216618~theSitePK:239071,00.html> .
- PTB – Physikalisch-Technische Bundesanstalt (German Metrology Institute): this site contains the main reference documents on technical cooperation and an overview of ongoing projects :  
[www.ptb.de/en/org/q/q5/index.htm](http://www.ptb.de/en/org/q/q5/index.htm)
- UNIDO publications on standards and conformity assessments:  
[www.unido.org/index.php?id=o72358](http://www.unido.org/index.php?id=o72358)
- World Standards Service Network: this site is a portal with comprehensive list of links towards standardization bodies  
[www.wssn.net/WSSN/index.html](http://www.wssn.net/WSSN/index.html)
- International Trade Centre (ITC) This site provides an overview of the themes covered by ITC, including diagnostic tools and training packages  
[www.intracen.org/eqm/](http://www.intracen.org/eqm/)





## **Thematic Review 4**

### **Intellectual Property Rights**

# 1. What does the theme cover?

## 1.1 Definition and terminology

The concept of Intellectual Property Rights (IPR) refers to the general area of law that encompasses both:

- Industrial property to cover patents for invention, complementary certificates, utility models, topographies of semi-conductor products, trademarks, commercial names, industrial designs, unregistered design rights, plant patents, protected names (Protected Designations of Origin, Protected Geographical Indications, Traditional Specialty Guaranteed);
- Copyright when referring to authors' rights, droit de suite, public lending right, neighbouring rights (performers' rights, technological protection measures, rights management information), database *sui generis* right, computer programmes (software), international registration numbers (ISBN, ISSN, etc.).

Thus, intellectual property law regulates the creation, use, and exploitation of mental or creative labour<sup>68</sup>. While there are a number of important differences between the various forms of assets considered, one common factor is that they establish property protection over intangible things like artistic creations, inventions, signs and information. Rights which did not exist a century ago - like those relating to plant varieties (plant patents) or protected names - belong to industrial property<sup>69</sup>.

It should also be mentioned that issues relating to traditional knowledge may be found in some international conventions pertaining to IPR; however, they are not commonly understood as fully belonging to it. The provision of technical assistance in the area of traditional knowledge (usually covered by cultural exchanges<sup>70</sup>) may not yet have been a priority. However, there may be a shift from the traditional emphasis on the promotion and expansion of the protection of IPR towards a more development-oriented approach.

IPR are of interest to their owners only if they are bestowing a monopoly on their owner. A monopoly on an intangible asset means that the latter is protected against infringements ("counterfeiting" for industrial property and "piracy" for copyright and related rights). Monopoly may be enforced during a limited period of time. Moreover, such a monopoly is geographically confined to the countries where a right has been granted. There is no "international" or "global" monopoly.

## 1.2 Rationale for intervention with developing countries

The present situation is characterized by a "global divide". On one hand, the sub-legal system of developed countries relating to IPR is sophisticated and efforts are made to enforce it. On the other hand, developing countries and least-developed countries have often poorly written laws and do not pay much attention to their enforcement.

In order to understand the divide, orders of magnitude are necessary. A developed country generates about 350 patent applications per million inhabitants, while a least-developed country may only expect 0.5 patent applications per million inhabitants. These numbers are at least partly explained because protecting IPR helps entrepreneurs to protect new endogenous assets. Indeed, IPR can only spring from a relevant industrial base. Therefore, a low number of established rights means that the industrial base is not developed enough to give birth to new assets. For example, if a country does not manufacture cars, it might not develop new products and processes for the automotive industry. It means also that industry is using known processes that may not be outdated.

Similarly, an agricultural LDC importing all of the usual tools (like hoes) will not be leading in applications for patents for inventions, but perhaps for plant patents. As a result, countries have an interest to provide a minimal protection of IPR consistent with their level of development and with the structure of their industrial base (see also § 1.4.2).

Also, in order to be member of the World Trade Organisation (WTO), a country needs to pass laws and regulations pertaining to the protection of IPR in line with the minimal standards defined by the TRIPS agreement; this includes trade-related aspects of intellectual property rights and obliges all countries which are a party to the agreement to organise the protection of their IPR, including through relevant enforcement measures, and to organise their judiciary in such a way that these laws and regulations may be enforced.

## 1.3 Legal and regulatory context

The legal and regulatory context is complex and several layers of conventions may be identified (see figure 1). The TRIPS agreement (Agreement on Trade-Related aspects of Intellectual Property Rights) together with the

68 This definition is close to that given by the 1967 WIPO (World Intellectual Property Office) Convention that states that industrial property includes "the rights relating to literary and artistic, and scientific works – performances and performing artists, photographs and broadcasts – inventions in all fields of human endeavour – scientific discoveries – industrial designs – trademarks, service marks, and commercial names and designations – protection against unfair competition and all other rights resulting from intellectual activity in the industrial, scientific, literary or artistic fields".

69 A proof can be given by the AIPO – African Industrial Property Organisation that delivers plant patents.

70 An introduction to the need for protection of traditional creativity and cultural expressions is given by H.-Ph. Sambuc, La protection internationale des savoirs traditionnels, La nouvelle frontière de la propriété intellectuelle, L'Harmattan, Paris, 2003 (with a foreword of K. Idris, then Director-General of WIPO).

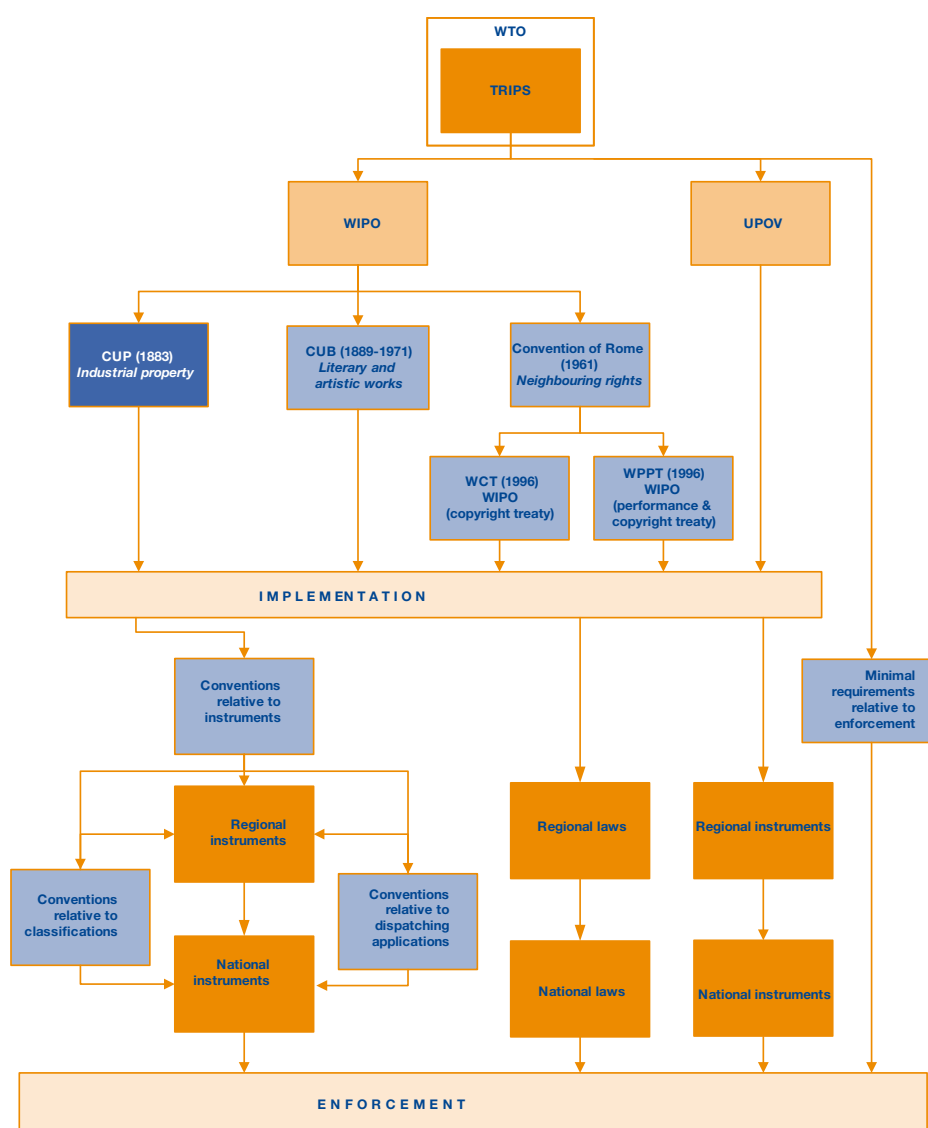
1968 Stockholm Conference, that adopted the revised Berne and Paris Conventions and created the World Intellectual Property Organisation (WIPO), is undoubtedly the most significant milestone in the development of intangible asset protection in the 20th century. Its scope is in fact much broader than any previous international agreement, covering not only all areas already (sometimes only partly) protected under existing agreements, but also giving new life to treaties that failed<sup>71</sup> and protecting for the first time rights that did not benefit from any multilateral protection. In addition, more importantly than this broad coverage, TRIPS enshrined detailed rules on enforcement.

TRIPS lays down minimal standards that are to be implemented by all WTO members and all countries candidate to WTO membership. Developed countries had to meet these requirements as of 1<sup>st</sup> January 1996, whilst developing countries had until 1<sup>st</sup> January 2000.

Least-developed countries were granted facilities until 1st January 2006 (lately extended to July 2013), with specific facilities for pharmaceutical patents and data protection until 2016.

WIPO administers two fundamental covenants: the Paris Convention (CUP) relative to industrial property and the Berne Convention (CUB) relative to intellectual property. It also provides administrative assistance to the International Union for the Protection of new Varieties of Plants (UPOV). Also, WIPO administers a number of agreements, conventions and treaties (25) designed to facilitate the acquisition of multi-country protection for industrial property rights, both as regards classification of subject matters and application/registration procedures, but none on enforcement, contrary to TRIPS. Jointly with UNESCO and ILO, it also administers the Rome Convention on the rights of performers, broadcasters and producers of phonograms (the so-called

Figure 1. Hierarchy of norms relative to IPR<sup>72</sup>



71 For example, the Washington treaty on topologies of semi-conductor products (IPIC).

72 The set of laws and regulations relative to a single intangible asset is often called "instrument". Instruments can be international, regional (i.e. the Community trademark) or national (i.e. national patent law). There are also "dispatching agreements" like the Patent Cooperation Treaty for patents, The Hague agreement for industrial designs, and the Madrid agreement and protocol for trademarks.

*neighbouring rights*). UPOV shares the same level as the Berne Convention and the Paris Convention. It is worth noticing that while the above mentioned Conventions create the instruments, enforcement is taken care by the TRThe four founding treaties (Paris Convention, Berne Convention, Rome Convention, UPOV) usually require implementing authorities (i.e. “Offices” or “Bureaux”<sup>73</sup>) supervised by the Ministries of Culture (intellectual property), of Industry (industrial property), or of Agriculture (plant patents, breeders’ right, and indications of origin), although this may obviously vary from one country to the other. Implementing authorities according to the Paris Convention, Rome Convention, and UPOV must register the right applied for, while this is not necessary under the Berne Convention.

Where registration of a right is not necessary, it may, however, be appropriate to organise a system providing IPR following the Berne convention with an indisputable date, like the “i-depot” in Belgium<sup>74</sup>. This successfully applies to computer programmes and unregistered community design rights. Moreover, copyright and neighbouring rights often request works to be listed into *repertoires* in order to facilitate the collection of fees and royalties.

In such cases, no office or bureau is involved in enforcement because of the generally accepted rule which states that the authority that grants a right cannot decide on the validity of this right<sup>75</sup>.

An overview of the legal sub-system of IPR is provided in Figure 2.

**Figure 2. The legal sub-system of IPR**



<sup>73</sup> Bureau is used where the implementing authority is a ministerial department while offices are independent.

<sup>74</sup> For more details on this <http://www.boip.int/en/ideeen/what.html>

<sup>75</sup> For example, the German patent court was severed from the German patent office in 1961. Cf O. Busse, Patentgesetz, de Gruyter, Berlin, 1972, pp 543-544.

With regard to enforcement, WTO members have committed themselves (TRIPS art. 51-1 and 61-1) to provide border procedures for checking transactions relating to all kinds of protectable IPR<sup>76</sup> and to entrust to Customs the authority to determine whether the importation of a product is an infringement. The WTO members also subscribe to the principle that criminal procedures are obligatory for all kinds of protectable IPR. Whilst IPR are “private rights”<sup>77</sup> and right holders are therefore in the first place responsible for enforcing their rights (i.e. they have to set their case before a Court with the assistance of professionals), it is also clear that they could not fight alone against counterfeiting and piracy. They go to court in order to make up for the damages; they need also the assistance of the customs and police to secure proofs (perpetuation of evidence) of the infringement; but other means might also be used (i.e. collective management societies may offer the services of sworn agents).

Enforcement is needed when certain goods infringe the monopoly of a right holder. Accordingly, intellectual property laws define what an infringement deed is, while magistrates ascertain the infringement and the damage suffered by the right holder.

According to article 67 of TRIPS, developed countries should provide technical assistance to developing countries for the preparation of laws and implementing regulations in the following areas:

- (1) Protection and enforcement intellectual property rights;
- (2) Prevention of their abuse (fight against counterfeiting and piracy); and
- (3) Support to the establishment or reinforcement of domestic offices and agencies relevant to this matter (offices and bureaux according to the Paris Convention), including training of personnel.

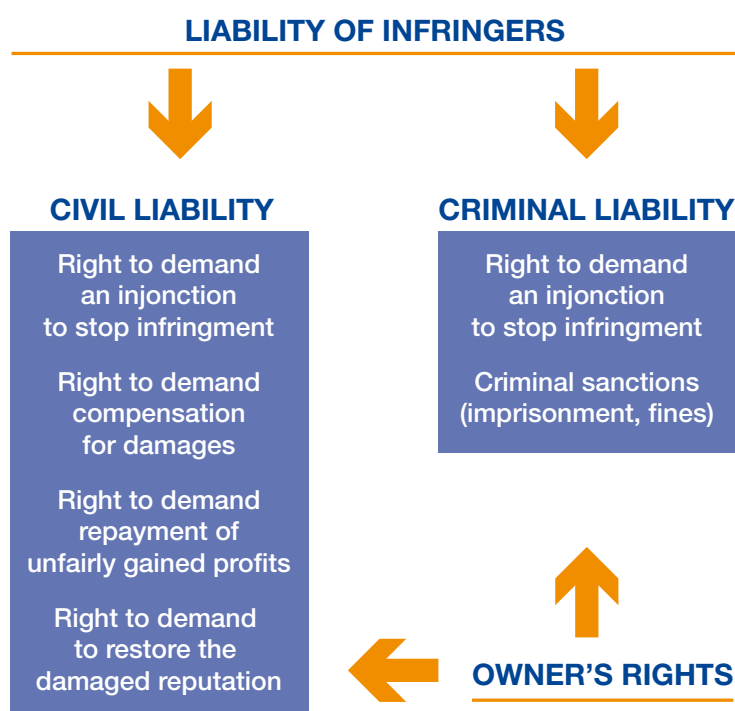
Article 67 does not refer to collective management societies and enterprises<sup>79</sup>. However, it might be relevant to include them in technical assistance programmes and to train their staff.

## 1.4 Key actors and issues

### 1.4.1 Key actors

The main actors at the international level are international organisations like the WTO, the WIPO and the WCO (World Customs Organization). At the country level, the main actors are the legislators, the national offices or bureaux<sup>80</sup>, the magistrates in charge of the enforcement of rights pertaining to IPR, the customs and the police

Figure 3. Liability of infringers<sup>78</sup>



76 TRIPS 51(1): “Members shall (...) adopt procedures to enable a right holder, who has valid grounds for suspecting that the importation of counterfeit trademark or pirated copyright goods may take place, to lodge an application in writing with competent authorities, administrative or judicial, for the suspension by the customs authorities of the release into free circulation of such goods. [...]”

77 Please refer to the preamble of TRIPS indicating that the agreement was adopted by WTO members recognizing that intangible assets (intellectual property) rights are private rights.

78 According to TRIPS 61, criminal liability is mandatory for intellectual property (copyright and neighbouring rights) and trademarks.

79 Collective management societies are bodies created by private agreements to collect royalty payments from various individuals and groups for copyright or neighbouring right holders. They are organisations handling the outsourced function of right management.

80 Regional or national offices or bureaux register applications for the grant of monopolies on technical intangible assets. Copyrights and neighbouring rights are not to be registered but the proof of ownership may be made easy through a non mandatory registration system.

(market surveillance body). These are actors at the macro level. Collective management societies, business associations and other service providers intervene at the meso level. At the micro level there are the ultimate users: creators, artists, entrepreneurs, national and foreign entrepreneurs, and customers.

In agricultural or pastoral societies, the use of protected names (Protected Designation of Origin, Protected Geographical Indication, Traditional Speciality Guaranteed) entails additional actors to support the right to protection. Producers have to conform to the standards in order for their products to be eligible for a protected name. This requires the existence of a conformity assessment system for geographic indications. Credible conformity assessments to standards must be made by independent private bodies supervised by the national accreditation body.

**Figure 4. Key actors**



### 1.4.2 Key issues

- The lack of awareness of IPR-related issues at the various levels of the public administration and the private sector is a recurrent issue in developing countries. Lack of information and public awareness of IPR-related activities may also be the cause of missed opportunities. For example, the attribution of a geographical indication to a product not only enhances its economic value on the market, but it also contributes to the branding of the region/country of origin, which is furthermore an asset when it comes to promoting tourist destinations. Counterfeiting and piracy can cause harm to a population (i.e. counterfeited medicines or vehicle spare parts). Awareness of the issues related to counterfeiting and piracy needs to be mainstreamed by technical cooperation programmes on IPR.
- One of the weaknesses to address as a priority is the lack of national capacity to formulate policy and modernise legislation to take into account the relevant international standards, so as to set up a predictable and transparent legal framework of IPR, in line with the WTO agreements, thus supporting also the integration of the country into the world trading system.
- The lack of knowledge at the level of the judiciary system can be a major obstacle to enforcement, as magistrates may not have the necessary experience to decide upon a case, since cases may not be very frequent, due to the small number of protected IPR. Furthermore, precedents may not be enough to build a reliable basis, which explains the reason why it may be difficult to obtain the publication of the grounds on which a judgment has been delivered as well as the judgment itself. If counterfeiting is allowed to continue, right holders may lose interest in making investment in a jurisdiction that is not protecting their rights. This shows the crucial role of magistrates.
- Protecting IPR has a cost that should be borne by the creators, artists, entrepreneurs, etc. owning the assets. This is an issue of good governance. However, in the case of least-developed countries, the costs may be out of the reach of the applicants. Since there are not many applications for registration (for example, around 50 endogenous patent applications with the ARIPO<sup>81</sup> per year), in such cases a possible option could be to get at least part of these costs covered by the State for some groups of applicants; the burden for the public budget would be minor.
- The aim of technical assistance in the field of IPR should not be solely increasing the number of applications. In fact, teaching creators, artists and entrepreneurs how to use specialised documentation may promote the use of patent documentation (databases) for acquiring free technologies<sup>82</sup>. Such assistance may help small enterprises to develop and acquire royalty-free technologies. In other words, technical assistance in the field of IPR may be either “creator-centred” (main aim being the protection of the creators’ right) or “user-centred” (to enhance access to public domain technologies). Depending on the level of development of a country receiving technical assistance, the most appropriate approach to IPR should be sought, through a balanced support to creators’ and users’ respective issues.
- Collective licensing may be beneficial to right owners and users, but right owners often face the lack of alternatives to joining a certain society, which can impose restrictive terms.
- In the field of IPR, the existence of vested interests must be taken into account when identifying beneficiaries and stakeholders of technical assistance programmes; for instance, bodies to be represented in steering committees should be carefully identified and their potential impartiality assessed.

81 African Industrial Property Organisation

82 WIPO is coordinating a programme called “aRDI – Access to Research for Development and Innovation” aimed at reinforcing the capacity of developing countries to participate in the global knowledge economy and supporting researchers in developing countries in creating and developing new solutions to technical challenges faced on a local and global level. [www.wipo.int/ardi/en](http://www.wipo.int/ardi/en). In 2009, 12 publishers provided access to over 50 journals to 107 developing countries through the aRDI programme.



## 2. What can be done?

### 2.1 Problem identification and diagnostic tools available

Identifying the difficulties of third countries concerning the protection of IPR should begin by assessing the importance of the inventing activity in the region and/or the country. This is relatively easy with the official gazettes / databases that often provide a list of protected IPR sorted by classes of the relevant classification convention. It is then necessary to check the consistency of the existing legal sub-system with the needs and expectations of the country (including also the country's commitments) and its human and financial resources.

Conformity analysis of existing laws and regulations is often the only diagnostic tool available to assess the needs of support at regulatory level. It supposes that laws and regulations are well identified.

### 2.2 Broad areas of intervention and key activities

IPR protection is a large area of intervention. As per Article 67 of the TRIPS, developed countries have agreed to provide technical and financial assistance to developing and least-developed countries, on request, and on

mutually agreed terms and conditions. EU-funded interventions have been limited in number so far and they mainly concerned Asia.

Technical assistance should focus on three main areas:

- a. **Policy and legal frameworks**, including implementation of TRIPS and related laws and implementing regulations (see §1.2). Example of a project in this area is presented in Box 1.
- b. **Capacity building** of the institutions in charge of the implementation of the laws and of the enforcement. Training and advice must be provided to avoid the risk that laws and regulations are not understood according to international standards by magistrates, market surveillance authorities and customs. In some cases this may lead to new laws and regulations providing better means for securing proofs. The EU enforcement directive<sup>83</sup> may be used as a reference text showing what should be done. Offices and bureaux<sup>84</sup> also need to improve their capabilities, mainly in relation to upgraded laws and regulations. This can be done through training of their staff and upgrading of their equipments. In the case of industrial property and of UPOV, registration with the competent offices or bureaux plays a key role

#### Box 1. Intellectual Property Rights Project - Bangladesh (2007-2011), €1,5 million

This project aims at strengthening the national capacity in formulating policy and modernising legislation taking into account the relevant international standards. Legal advice is one of the important areas of support. The project promotes the setting up of advisory missions to review and update existing IP legislation in the field of industrial property and copyright, and to provide for new areas for protection in conformity with international norms and standards. Some areas identified for further legislative assistance are the protection of layout design of integrated circuits, GIs and protection of plant varieties. In addition, the project includes sub-regional workshops and consultations to raise awareness among policy-makers of the advantages of accession to international IP Treaties, such as the Patent Cooperation Treaty, the Madrid System for International Registration of Marks, the WIPO Copyright Treaty.

#### Box 2. EU-China Project on the Protection of Intellectual Property Rights II (2007-2011), €16 million

The aim of this project is to improve the effectiveness of IPR enforcement in China through the provision of technical assistance (TA) to Chinese legislative, judicial, administrative and enforcement agencies and institutions. In fact, while the Chinese IP legal framework is generally in line with international standards, there are many concerns on the high levels of infringements of these rights for a wide range of products. The project provides meeting and training opportunities for judges, prosecutors, public security bureau officers, customs officials and other staff of key government agencies. Training events are based on best practices from Europe and involve Chinese counterparts at various levels. Exchanges and study trips to EU and EU Member States organisations are also included. The actions not only aim at strengthening the capacities of the officials, but also at improving intra-regional and inter-agency cooperation, reducing formality requirements and differences in enforcement practices. Website of the project: [www.ipr2.org](http://www.ipr2.org)

83 Directive 2004/48 (Enforcement directive).

84 Repertoires and catalogues are set up and maintained by collective management societies while databases are often set up and maintained by offices or bureaux.

**Box 3. EU-Sri Lanka Trade Development Project (2004-2007), €1.6 million**

This project aimed at improving the efficiency of the National Intellectual Property Office (NIPO) to manage large amounts of data and to process requests for copyrights and trademarks. One of the main results was the modernisation and automation of NIPO through the upgrading of its databases and the installation of modern IT infrastructure. This reduced the backlog by speeding up IP processing that was initially done manually. The IPAS system was installed (WIPO's Industrial Property Automation System). All trademark data migrated from the old system to the new. IPAS automatically generates the English version of the IP section of the Gazette and keeps track of the three-month deadline for opposition to an application. Other activities to boost NIPO's capacity included the upgrading of the IT infrastructure, the set-up of a single network, the upgrading of the internet connectivity and the increase of the functionality of the website, to enable it to deliver web-based services. Office staff were trained to develop their computer skills and learn how to use the IPAS. Website of the project: [www.dellka.ec.europa.eu/en/eu\\_and\\_srilanka/trade/eu-sl\\_trade.htm#sltrade](http://www.dellka.ec.europa.eu/en/eu_and_srilanka/trade/eu-sl_trade.htm#sltrade)

because it initiates the process leading to the grant of the monopoly by those offices or bureaux. The use of repertoires (copyright and neighbouring rights), databases (industrial property), or catalogues (plant patents) is necessary to identify protected or unprotected IPR. Institution building should be provided to collective management societies, as they organise repertoires of works and authors. Two examples of project in this area are presented in Boxes 2 and 3.

- c. **Enhancement of IPR-related economic opportunities**, awareness-raising initiatives, training and education contribute to make creators, artists and entrepreneurs aware of the outcomes of IPR protection and to create a demand for its use. Cooperation programmes focusing on business development services and/or SME competitiveness<sup>85</sup> may include components on IPR-related assistance, in particular with regard to innovation and product development (including protected designation of origin and geographical indication). Awareness of the opportunities linked to the life cycle of IPR can be of great interest to SMEs:

after the expiry of the monopoly on the intangible asset (at least 50 years after the death of the authors in the case of copyright, 20 years after the registration in the case of patents for inventions or plant patents), this latter asset may be freely used by any third party, as it belongs to the public domain.

In case of technological IPR, knowledge of the state-of-the-art on a given subject is readily available and allows manufacturing without license. This is another window of opportunity for business development in developing countries. As mentioned above, it is about how to use specialised documentation and the use of patent documentation (databases) for acquiring free technologies. It has also the advantage of attracting professionals and staff of offices and bureaux to a same venue with an increase of specific knowledge and awareness at the same time. Moreover, it may lead offices and bureaux to change their performance indicators: their aim should be to increase not only the number of protections applied for, but also the use of the IPR legal sub-system in their jurisdictions.

**Box 4. Creation of Geographical Indications in Mongolia (2006-2006), €114,000**

The Asia Trust Fund (ATF) was set up by the European Commission and the International Trade Centre to deliver TRTA to Asian countries. In Mongolia, one of the interventions focused on building capacity and enhancing the legal framework to enable Mongolian exporters to take advantage of geographical indications (GIs). International experts on GI consulted the main stakeholders, conducted trainings on GIs, and prepared a proposal for draft legislation on GIs. In parallel, a comprehensive study was carried out to identify priority sectors for export promotion. The main result was the identification of the potential benefits of GIs application to "Gobi camel wool" products. Consequently, the 'product specifications', which are the legal basis for a GI application, were prepared and Gobi Camel Wool has been officially registered as a GI. Mongolia has truly embraced GIs as a means to develop typical local products. The increasing number of applications for GIs submitted by producers is the evidence of the success of the initiative. Website of the project: [www.intracen.org/atf/mongolia/](http://www.intracen.org/atf/mongolia/)

## 3. How can it be done?

### 3.1 Methods and levels of intervention

Usually protection for IPR is granted by each country. It may also be done at the regional level (Example in Box 5) if several countries transfer part of their sovereignty to a regional organisation empowered to grant protection of IPR (e.g. to the European Patent Office in the EU).

### 3.2 Expected results and results measurement

Table 1 provides a selection of indicators for measurement of results, along with reference to sources of verification.

### 3.3 Cross-cutting issues

Environment and IPR-related issues draw the attention of developing countries and international donors, especially with regard to access to technologies that can help developing countries address climate change issues. In this respect, intellectual property rights can be seen as

a barrier to access such technologies. In designing development programmes with IPR components, it may be possible to identify concrete measures to leverage the IP regime so as to promote awareness and access to climate-friendly technologies, thus facilitating demonstration, diffusion and transfer of technologies to the beneficiary country. Studies and consultations between development partners are growing in this area, as innovative solutions need to be found. They build ideas such as preferential pricing for environmentally sound technologies, patents with limited or reduced time, financial support through technology funds that would cover IPR-related costs for developing countries or the creation of technology excellence centres in developing countries.

### 3.4 Risks

The lack of political will to implement laws and regulations and the required set of measures to ensure the enforcement represent the main risks in this area of intervention.

#### Box 5. ASEAN Project on the Protection of Intellectual Property Rights—ECAP III (2010–2014), €5 million

This project focuses on the challenges of furthering regional harmonisation and long-term capacity building of the IP policy, legal, administrative and enforcement infrastructure in ASEAN Member States, in support of the objectives of ASEAN's IPR Action Plan and Economic Community Blueprint, and in line with their commitments to international IP agreements. Actions are divided into 5 areas: 1) **Capacity building and regional cooperation for IP enforcement and regulation in ASEAN;** 2) Improving the legal context and administration of IPRs in ASEAN countries harmonised with international and regional IP standards; 3) Accelerating the pace and scope of IP asset creation and commercialisation inside ASEAN and promoting greater public awareness of the role of IP in this context; 4) Supporting structured expansion of IP education, training and research institutions and programmes within a common ASEAN-wide regional network; and 5) Enhancing capacity of ASEC to support, monitor and coordinate regional policies and work-streams on IP including support to ASEAN institution building. Website of the project: [www.ecap-project.org/ecap3.html](http://www.ecap-project.org/ecap3.html)

Table 1. Selection of results and indicators for measurement

Key indicators for projects on Intellectual Property		
Results	Indicators	Sources of verification
<b>Legal framework and enforcement of IPR are more predictable, transparent, coherent and in line with the WTO agreements</b>	<ul style="list-style-type: none"> <li>Number of new priority IP laws and implementing regulations drafted covering industrial property, copyright and related areas</li> <li>Publication of decisions with deterring penalties and administrative fines</li> <li>Increase of IPR cases handled by the civil and criminal judges, prosecutors and police officers</li> <li>Number of IP cases resulting in criminal convictions and sanctions applied</li> <li>% decrease in number and trend of IPR infringements reported by enforcement authorities</li> <li>Online publication of Court decisions</li> <li>Number/value of seizures of counterfeit and pirated products</li> </ul>	<p>Published Government legislation and regulation</p> <p>Infringements Statistics</p> <p>Reports from multilateral and bilateral monitoring bodies</p> <p>Feedback from law firms, industry and judges</p> <p>Customs, police and court statistics</p> <p>Web-forum and statistics about visitors of webpage</p> <p>Feedback from concerned stakeholders</p> <p>Feedback from chambers of commerce</p>
<b>Institutional capacity building</b>	<ul style="list-style-type: none"> <li>Number of IP teaching programmes established in target universities</li> <li>Number of IP research programmes operational and delivering quality research outputs for publication</li> <li>Number of officials trained in search and examination techniques and provided with automation tools</li> <li>Increase in registrations in Trademark, Industrial Designs and other Databases</li> </ul>	<p>University faculty graduate and post-graduate student statistics</p> <p>Reviews of training curricula, pedagogical material and exams</p> <p>University websites and academic journals</p> <p>Copyright Office</p>
<b>Awareness and use of IP as a tool for economic development increased (opportunities)</b>	<ul style="list-style-type: none"> <li>Number of IP offices providing Business Development Services (BDS) and patent information services to assist to select appropriate technologies at reasonable costs</li> <li>Number of targeted enterprises, business associations, universities, research institutes that have undertaken IP audits and IP asset valuations</li> <li>Number of universities and tertiary research institutes with IP policies and protocols put in place</li> <li>% increase in the registration of industrial property rights</li> <li>% increase in acquisition and absorption (IPR registration and development of licence agreements) of foreign owned IP protected technologies in target sectors</li> <li>% increase in number of sampled companies introducing IPR in their business strategy</li> </ul>	<p>National IP Office annual reports and statistics</p> <p>IP Awareness surveys of target enterprises, business associations, universities and research institutes</p> <p>Survey through interviews with sample private companies</p> <p>WIPO and IP Office statistics</p> <p>EU IPR enforcement surveys</p> <p>Government Ministries and IP Offices</p> <p>Reports of international organisations</p>

## 4. Where to find out more?

Many books and papers are published every year on the protection of IPR. But publications rapidly become obsolete because WIPO conventions, treaties, and agreements are continuously changing, and because regional laws and regulations have to be upgraded in order to keep with these conventions, treaties, and agreements. For this reason, it is recommended to check the most recent developments through the websites of the main organisations dealing with IPR (see below).

Care should be given also to the origin of the literature; theories and principles applied in the USA may not be consistent with the ones which apply in Europe.

### *European Commission – DG TRADE*

The webpage on IPR of DG TRADE provides links to supporting information, including legislation, reports and texts on IPR-related activities and programmes.

[http://ec.europa.eu/trade/issues/sectoral/intell\\_property](http://ec.europa.eu/trade/issues/sectoral/intell_property)

### *European Patent Office*

The website provides information on the patent system, overviews of recent innovations and other technological developments in the context of the European patent system. It includes links to the patent offices of the EU member states and to databases of legislation.

[www.epo.org/about-us/office/international-relations.html](http://www.epo.org/about-us/office/international-relations.html)

### *WIPO*

WIPO is the main source of information on the international intellectual property system. The website provides information on the main IP-related services offered by WIPO, including International Patent Protection; International Trademark Registration (Madrid System); International Design Registration (Hague System); International Registration of Appellations of Origin (Lisbon System); Alternative Dispute Resolution; Domain Name Dispute Resolution; International Classifications

[www.wipo.int/ip-development/en/](http://www.wipo.int/ip-development/en/)

### *WTO*

For more information about the trade-related aspects of Intellectual Property Rights, as per Uruguay round agreement, TRIPS

[www.wto.org/english/docs\\_e/legal\\_e/27-trips\\_01\\_e.htm](http://www.wto.org/english/docs_e/legal_e/27-trips_01_e.htm)

### *UNCTAD*

The development dimensions of Intellectual Property Rights are analysed in this website and links to international and other events in this area are provided as well.

[www.unctad.org/Templates/StartPage.asp?intlItemID=3423&lang=1](http://www.unctad.org/Templates/StartPage.asp?intlItemID=3423&lang=1)





## **Thematic Review 5**

### **Business Enabling Environment**

# 1. What does the theme cover?

## 1.1 Definition and terminology

There is no single accepted definition of the concept of *business enabling environment*, the environment in which the economic development of a country occurs. In the context of this Thematic Review we refer to the one adopted by the Donor Committee for Enterprise Development: *the enabling environment is a complex of policy, legal, institutional, and regulatory conditions that govern business activities. It is a sub-set of the investment climate and includes the administration and enforcement mechanisms established to implement government policy, as well as the institutional arrangements that influence the way key actors (e.g. government agencies, regulatory authorities, business membership organizations) operate*<sup>86</sup>.

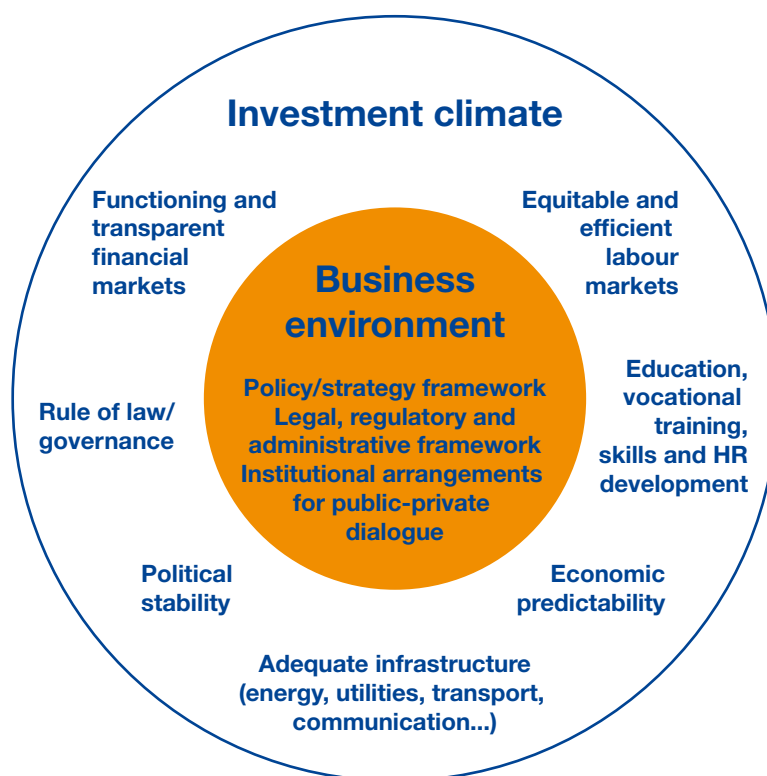
A visual representation of the link between the broader concept of investment climate and the specific area of business environment is provided in Figure 1.

Policy framework: *this refers to the policies that are used to address the issues of enterprises (e.g. SMEs policies), as well as broader macroeconomic policies, sector policies, employment policies.*

Legal and regulatory framework: *it encompasses the full range of legal and regulatory instruments that governments introduce for enterprises and for the economy as a whole, for example, rules and regulations to set up and run a business, to register a property, to protect investors and ensure tax collection.*

Institutional arrangements for public-private dialogue: *an institutional arrangement brings together a group of actors from the public and private sectors in order to carry out a joint problem analysis and identify policies and institutional reforms that contribute to a more conducive environment for private sector development. Through an equitable dialogue, governments avoid the risk of following the most powerful voices, which rarely speak in the best interest of broad-based private sector growth*<sup>87</sup>.

**Figure 1. The business environment as a part of the investment climate**



86 Donor Committee on Enterprise Development (DCED), 'Supporting Business Environment Reforms – Practical Guide for Development Agencies', 2008 Edition.

87 More detailed analysis of this element in "OECD, Promoting pro-poor growth: private sector development-2006"

## 1.2 Rationale for intervention with developing countries

A *healthy business environment* is necessary to promote growth, and international donors support developing countries in their efforts to improve the business environment through the reduction of factors which restrict investment and the development of markets, stifle entrepreneurship and confine many businesses to the informal economy. This is mainly done through reforms which address issues like inappropriate regulations, disproportionate taxation, unfair competition, unstable policy environment. The objectives of the reforms are in particular to enable businesses to operate formally, increase the level of investment, and encourage the creation of more and better jobs through:

- Reduced business costs: to increase profits (that may lead to increased investment) or market share (and thereby output and employment).
- Reduced risks: poor or frequently changing government policies, laws and regulations pose a risk for business, thus reducing the value of capital and the number of attractive investments in the market.
- Increased competitive pressures through new market entry: to stimulate the efficiency and innovating incentives of the market.

Reforming the enabling environment is a process, thus support to this area should ensure the long-term sustainability of the reforms by building the capacity of key public and private sector stakeholders.

## 1.3 Legal and regulatory context

The legal framework that governs the business environment is defined essentially at national level, so domestic regulation and legislation are the most important. A country can thus act unilaterally to set-up a more conducive environment for enterprises and any international agreement must as a rule- be implemented at national level for it to take effect.

## 1.4 Key actors and issues

### 1.4.1 Key actors

The key actors in enabling environment support or reform programs are parliamentary and policy making institutions together with government line ministries (Economic Development; Trade and Industry; Economy and Finances; Employment, Labour and Social Affairs), as they set the basis and steer specific policies (SMEs, taxation, labour policies). In addition to central government, regulatory authorities, local and district government bodies have a say in this area, as they implement the law through regulations and administrative activities, with distinctive degrees of autonomy from the central

government. As a result, and depending on the level of decentralisation, local public authorities may also become key actors of projects aimed at supporting business enabling environment initiatives.

Private sector organisations, such as chambers of commerce, small enterprises associations, other business service providers and informal sector organisations constitute the connective tissue between the public actors and businesses. In fact, they undertake advocacy and lobbying activities and provide advice and info to SMEs on the legal framework, their legal obligations and potential opportunities. As a result, they represent important stakeholders which are indispensable actors in consultations when assessing the soundness of policy and legal framework and designing reforms.

Trade unions, community-based organisations, civil society and universities /academic research institutions should be consulted as well, as they can provide advice on the reforming process and help identify the needs and expectations of potential vulnerable populations (workers and small entrepreneurs are both likely to be affected by the effects of reforms).

The final beneficiaries of business enabling environment support are businesses, namely MSMEs, but also multinational companies who can increase their competitiveness thanks to improvements of the legal and regulatory framework.

### 1.4.2 Key issues

Two issues are particularly important to highlight when addressing the business enabling environment:

- *Business environment reform is complex*, operating on many levels and involving a wide range of stakeholders. Development agencies should therefore ensure a *thorough diagnostic analysis* and maintain, as far as possible, a *systematic approach* and understanding of the broader causal picture. More specifically, their analysis should focus on reforms to reduce major obstacles to economic growth.
- *Business environment reform is always political* and development agencies should therefore take care to analyse the political context. They should have strategies to build coalitions of support and to engage with those who wish to protect the status quo: vested interest could be at the origin of situations which represent actual obstacles to growth.

For these reasons, one of the main aims of interventions on business enabling environment should be to change attitudes and mind-sets, so that key stakeholders have a greater appetite for reform of the business environment. This includes improving transparency in public administration and enhancing accountability by the government towards key stakeholders.

### Box 1. Stakeholders and donor coordination

In Ghana in January 2004, the government approved the National Medium-Term Private Sector Development Strategy and Action Plan 2005-2009. The goal of the PSD Strategy is: 'sustainable, equitable and widespread private sector-led growth throughout Ghana', while its purpose is to 'enhance the competitiveness of the private sector'. Based on the agreed strategy a number of development partners agreed on a Memorandum of Understanding with the government to establish a framework within which their support for private sector development would be provided. Development partners work through the Development Partners (DP) Group and the PSD Strategy Working Group to assist the government in the implementation of the strategy. The PSD Working Group contains representatives of the private sector and oversees the work of all actors, including 17 ministries, departments and agencies. Progress within the PSD Strategy is reviewed by the PSD Working Group twice a year and a joint meeting and evaluation framework have been established.

## 2. What can be done?

### 2.1 Problem identification and diagnostic tools available

Both bilateral donors and international organisations have developed studies and diagnostic tools in order to help identify constraints and weaknesses of the enabling environment in developing countries.

The selection proposed in this section includes tools which are relevant for various functional areas of intervention.

#### *World Bank: Doing Business and Enterprise Surveys*

The World Bank's Enterprise and Doing Business Surveys are complementary tools, but different in their approach to benchmarking the quality of the business environment across countries.

The Enterprise Survey is a firm-level survey which reports perceptions and experiences of business, based on a representative sample of the private sector companies in an economy. Doing Business focuses on measuring the complexity of business regulations and quantifying the ease of doing business at country level. The survey is administered to local experts (business lawyers and consultants, accountants, freight forwarders and government officials).

The Doing Business Survey reviews the laws and regulations which are most relevant for the life-cycle of an enterprise: starting a business, construction permits, hiring workers, registering property, getting credit, protecting investors, tax payment, enforcing contracts, closing a business.

On the basis of the information collected, doing business indicators provide a good proxy of the business environment. Some shortcomings must however be mentioned: (i) data refer to businesses in the economy's

largest business city, hence they may not be representative of regulation in other parts of the country and different economic sectors; (ii) transactions and regulations examined may not represent the entire range of obstacles enterprises meet, (iii) the survey is based on the assumption that entrepreneurs are knowledgeable of all regulations in place.

The Enterprise Survey provides a sample of an economy's private sector's perceptions of several areas of business environment, including access to finance, infrastructure, land and permits, taxation, informality, business-government relations, corruption. Over 90% of the questions aim to ascertain the characteristics of the business environment in a country; the remaining questions assess the survey respondents' opinions on what are the obstacles to firm growth and performance. Firm-level datasets, the investment climate indicators derived from them, as well as research papers are available on the website ([www.enterprisesurveys.org](http://www.enterprisesurveys.org)).

#### *ILO, Assessing the influence of business environment on the small enterprise employment. An assessment guide*

The guide identifies the three layers of government activity that shape the environment for small enterprises: (i) policies and laws, (ii) regulation and (iii) administration. This diagnostic tool encompasses a set of questions and tables which help structure the analysis and the mapping of each policy and law, through the identification of the key issues affecting small enterprises in the policy and legal framework. Nine policy domains are identified: specific small enterprise policies, taxation, business laws, labour policies laws and regulations, finance and credit, enabling and innovation policies, environment and education.

The diagnostic tool is useful to assist policy makers, researchers and programme managers to determine the effects of business environment on the employment generated by small enterprises. The guide also contains templates of terms of reference for experts and checklists of questions to be administered to the various stakeholders.

## 2.2 Broad areas of intervention and key activities

In most countries, businesses face hundreds of regulatory constraints, which represent a major barrier to business growth and enterprise formalisation. To simplify and streamline business regulations, national governments are increasingly receiving technical and financial assistance from development agencies and donors. The reform of the business environment includes different functional areas, which are often connected and require a holistic approach<sup>88</sup> in order to have a direct impact on performance and competitiveness of the private enterprise:

- Simplifying business registration and licensing procedures. There is empirical evidence that economies with efficient business registration systems have higher entry rate as well as a greater business density<sup>89</sup>. Simplifying procedures includes their standardisation, the elimination of disproportionate and redundant requirements (e.g. company seal, certain capital requirements), reducing and merging registration procedures through creation of “one stop shops” with representatives from all the public and semi-public entities involved in the business registration.
- Improving tax policies and administration. The challenge for governments is to find a way to ensure public revenues while encouraging compliance. A lot of countries have initiated tax reform programmes which focus on lowering tax burden for enterprises, broadening the tax-base and simplifying administrative requirements (electronic filing and payment systems).
- Enabling better access to finance include revising or introducing laws and regulations which strengthen the legal rights of borrowers and lenders. This comprises also reforming secured transaction laws, including the use of movable assets as collateral. Beyond the regulatory framework, improving access to finance necessitates also other measures and mechanisms. For example, to expand and enhance access to credit information by setting up credit bureaus and collateral registry (see the thematic review on Access to finance).

- Improving land titles, registers and administration to encourage investments, since formal land titles can be used as a collateral asset. Reforming land title registration together with simplifying property registration are key steps in improving the business environment. Some of the key activities include computerising property registry and procedures, reducing taxes and fee required to register the property, making optional the involvement of notaries, establishing time limits to register the land, decentralization of tasks.
- Improving labour laws and administration. Employment laws are key to protect workers from arbitrary or unfair treatment. National legislation should include and should be consistent with ILO core labour standards (e.g. collective bargaining, elimination of forced labour, equitable treatment in employment practices). Governments have to find the right balance between worker protection and labour market flexibilities. Stringent and excessive labour restrictions can be an incentive to create informal enterprises.
- Simplifying and speeding up access to commercial courts and to alternative dispute-resolution mechanisms.

Across the board, two further areas of intervention need attention when designing support programmes:

- Improving the overall quality of regulatory governance implies a substantial regulatory reform which is often difficult due to the lack of competence and effectiveness in state administration and to corruption. In addition, mechanisms to ensure that new regulations are in line with the objectives and spirit of regulatory reform should be put in place. Regulatory impact assessment of new regulations, cost-benefit analysis of options for assessing new laws, cost of compliance assessments, and consultations in the process of developing regulations, are all techniques that can be used to assess new pieces of legislation.
- Broadening public-private dialogue processes in monitoring reform implementation. The best way to ensure sustainability in business environment reform is to institutionalize some form of business environment monitoring or watchdog functions that involve representatives from the public and private sectors. Organisations of this kind can regularly assess the business environment, monitor reform outcomes and impacts, identify the demand for future reforms and provide training, advice and information to government agencies and other stakeholders in the design and implementation of reform programs.

88 See also figure 1 of this thematic review, which reproduces two circles, each of them including a subset of areas of intervention. Their boundaries are often difficult to identify, hence the possibility that interventions in this area include some elements of the outer circle.

89 World Bank, (2009) “Doing Business 2010. Reforming through difficult times”.

**Box 2. Ukraine SME Policy Reform and Public Outreach/Information Campaign**

IFC's Ukraine SME Policy Project worked with the Ukrainian government to improve private sector regulations as a means of promoting investment. The project lobbied a reform of the system of business permits in order to bring Ukrainian practice into line with contemporary European standards. By the end of 2004, IFC has assisted the government to draft a law to improve the permits system by abolishing about 1000 unnecessary permits, and leave in place only key permit procedures for potentially hazardous firms and activities. The challenge was to promote adoption of the law and assure implementation of the law by Ukraine's regulatory agencies. The media proved to be an important stakeholder to engage in this process. IFC initiated a national media campaign on the need for business permit reform (e.g. press articles, coverage by national television, radio news stories, and internet). As a result, the awareness of the need for reform of the permits system among both officials and media sources increased.

Table 1 provides an overview of the broad areas of intervention and key activities which could be implemented at various levels (supra-national, macro, meso and micro). The vast majority of activities aimed at creating an

enabling environment for businesses are implemented at national level, but in some cases they may also need a regional framework for harmonisation.



**Table 1. Key activities per area of intervention**

Broad areas of intervention	Key activities
<b>Simplifying business registration and licensing procedures</b>	<ul style="list-style-type: none"> <li>• Developing an inventory of existing permits and procedures to guide reforms</li> <li>• Increasing transparency and simplifying the licensing issuance procedure (publishing licenses requirements and fees), through elimination of duplicative or unnecessary procedures, as well as clarification and streamline of the application and procedure to issue permits. This may include procedures of the type <i>silence means consent</i><sup>90</sup> and self-certification</li> <li>• Creation of one-stop shop</li> <li>• Reduction of minimum capital requirement to start a business</li> </ul>
<b>Improving tax policies and administration (regional and national levels)</b>	<ul style="list-style-type: none"> <li>• Review of the Tax Code (incl. adoption of new tax laws and/or revision of existing ones as/if needed)</li> <li>• Simplification of tax compliance process (incl. reduction of the number of filings per year and per tax, introduction of electronic filing and payment systems)</li> <li>• Review and simplification of corporate income taxes/profit tax, as well as social security contributions</li> </ul>
<b>Coordinating tax regimes</b>	<ul style="list-style-type: none"> <li>• Support to studies on VAT treatment of intra-regional trade and harmonisation of tax incidence</li> <li>• Support to the design/discussion/signature of regional tax agreements, tax incentives and indirect taxes</li> <li>• Creation and enhancement of tax databases</li> </ul>
<b>Improving land titles, registers and administration</b>	<ul style="list-style-type: none"> <li>• Supporting land reforms</li> <li>• Computerisation and modernisation of registering procedures</li> <li>• Introduction and enhancement of on-line procedures</li> <li>• Simplification of registration requirements</li> </ul>
<b>Improving labour laws and administration</b>	<ul style="list-style-type: none"> <li>• Technical advice to the Ministry of Labour and Social in reviewing and updating labour legislation</li> <li>• Set-up training programmes for Ministry of Labour representatives and for administrations both at central and local level</li> <li>• Set-up training programmes for trade union members to enable them to implement the new legal provisions with regard to health and safety at work</li> </ul>
<b>Capacity building of the government to undertake administrative barrier reforms</b>	<ul style="list-style-type: none"> <li>• Establishment of a business regulatory reform unit within the government administration</li> <li>• Organisation of training programmes and study tours for civil servants in regulatory reforms</li> </ul>
<b>Broadening public-private dialogue</b>	<ul style="list-style-type: none"> <li>• Creation/facilitation of a private sector forum with a secretariat within the business regulatory reform unit</li> <li>• Design and implementation of technical assistance to strengthen institutional capacity of intermediary organisations to allow them to engage better in the dialogue with the public sector</li> <li>• Conducting enterprise surveys including face-to-face interviews and focus group to better assess private sector needs</li> <li>• Awareness campaigns targeted to MSMEs to compensate the lack of legal knowledge of many entrepreneurs (i.e. through training on legal issues)</li> </ul>

90 The silence means consent principle means that the administrative body that issues a licence has to make a decision within a set term upon receiving the application; if no notification has been made within the set timeframe, the licence or permit is automatically granted.

### 3. How can it be done?

#### 3.1 Methods and level of interventions specifically related to the theme

The project approach modality has been the most used when implementing business enabling environment programmes. General and sector budget support constitute however an alternative implementation modality for business enabling environment since the reform processes concerning the tax system, permits, licenses, registrations, etc. require a constant and direct commitment from the government and local administration and a great deal of ownership. This requires a coherent private sector development policy included in the overall development strategy. However the promotion of a substantial business regulatory reform is often particularly difficult due to the lack of capacity and effectiveness at the highest level (Ministry and Parliament) and at the local administration level. In such situations, complementary technical assistance is needed in addition to sector budget support.

#### 3.2 Sequencing of activities

In general, in order to address business enabling environment reform in an effective and efficient manner, it is first necessary to assess existing constraints and bottlenecks

on the macro, meso and micro level. The results of this analysis will then form a sound basis for developing, prioritizing and sequencing activities which will address the identified shortcomings. Many business enabling environment reforms can be undertaken in parallel, but some must be sequenced in order to be effective. For example, it might be necessary to establish institutional capacity before giving an agency regulatory authority, or to implement specific laws and regulations. It may be appropriate to start with some of the most important bottlenecks or “quick wins” to trigger reform appetite or sustain reform impetus.

#### 3.3 Expected results and result measurement

Table 2 provides an overview of the expected results and indicators to be used when monitoring and evaluating enabling environment support programmes. The indicators presented in the table should be customised to the specific situation of the country, setting reasonable targets (e.g. maximum number of days to obtain a license) which take into consideration the conclusion of the diagnostic studies and the commitment of the government and the local administration.

#### **Box 3. The Ghana Private Sector and Trade Enabling Programme - PSTEP (2007-2009), €5 million**

The PSTEP is a Sector Budget Support (SBS) programme, which provided budget support to the Government of Ghana. The project purpose was in line with the Private Sector Development Strategy (PSDS) launched by the Government of Ghana in July 2004. The main reasons underlying the provision of a SBS were: private sector development constitutes the centre of the overall Ghana development strategy (first pillar of GPRS II), the Government had explicitly requested to use its own systems in development interventions.

The main objective was to improve the business enabling environment and investment climate in Ghana in order to support the upgrading competitiveness of Ghanaian firms and the growth in exports. This was to be achieved through a series of reforms in the legislative and regulatory framework by building the capacity of civil servants to respond to private sector needs and ensuring a stable macro economic environment that would enable business to grow.

The progress of the programme were measured through a set of five indicators: percentage increase in non traditional tariff exports, reduction in time to import and exports (Time taken to export and import measured by the GoG and WB), reduction in time taken to register a business, budget execution rate for enhanced import procedures and time taken to register a business.

**Table 2. Selection of results and indicators for measurement**

Results	Indicators	Sources of verification
<b>Output / Outcome level</b>		
<b>Processes to register and to close a business shortened and simplified</b>	<ul style="list-style-type: none"> <li>Reduction in no. days required to register/ to close a business</li> <li>Reduction in the no of documents and procedures required to register / to close a business</li> <li>Reduction in costs (fees to be paid) to register/ to close a business</li> <li>Introduction of standardised documents</li> <li>Introduction of on-line procedures</li> <li>Set-up of one-stop shops</li> <li>Reduction of minimum capital requirement</li> <li>Creation of local registration offices</li> </ul>	<ul style="list-style-type: none"> <li>Enterprise Surveys (WB/ IFC Doing business; Chamber of Commerce)</li> <li>National statistics</li> <li>SME Registration records</li> <li>SME survey</li> <li>Relevant laws (e.g. bankruptcy law)</li> </ul>
<b>License and permit process shortened and simplified</b>	<ul style="list-style-type: none"> <li>Reduction in the no. of days required to obtain a license or permit</li> <li>Reduction in the no. of procedures and documents</li> <li>Reduction in costs (fees to be paid)</li> <li>Use of standardised documents</li> <li>Introduction of on-line procedures</li> <li>Set-up of one-stop shops</li> </ul>	<ul style="list-style-type: none"> <li>Enterprise Surveys (WB/ IFC Doing business; Chamber of Commerce)</li> <li>National statistics</li> <li>SME Registration records</li> <li>SME survey</li> </ul>
<b>Tax system simplified and rationalised</b>	<ul style="list-style-type: none"> <li>Revision or introduction of a tax code</li> <li>Reduction in the no. of days (per year) to pay taxes and prepare file returns</li> <li>Increase in the tax-base</li> <li>Introduction of on-line tax filing and payments</li> </ul>	<ul style="list-style-type: none"> <li>Enterprise Surveys (WB/ IFC Doing business; Chamber of Commerce)</li> <li>National statistics (Board of revenues and Minister of Finances)</li> </ul>
<b>Awareness of enterprises about their rights and responsibilities enhanced</b>	<ul style="list-style-type: none"> <li>Publications, brochures on rights and responsibilities, incentives distributed to enterprises</li> </ul>	<ul style="list-style-type: none"> <li>Enterprise Surveys</li> <li>Interviews</li> <li>Average data from firm statements</li> <li>BIOS<sup>91</sup> surveys</li> <li>National and BIOS data</li> <li>Project monitoring reports</li> <li>Public websites and publications</li> </ul>
<b>Institutional set-up improved</b>	<ul style="list-style-type: none"> <li>Establishment of a business regulatory reform strategy</li> <li>Set-up of a business regulatory reform unit</li> <li>Number of reforms designed and implemented</li> <li>Number of training sessions provided to ministries, regulators and administrators</li> <li>Improved dialogue and increased participation of private sector to the reform process (no. of fora, meetings, committees)</li> <li>Enactment of an anti-corruption law</li> <li>Set-up of controls or watch-dogs which monitor the activities of the public administration (central and local)</li> </ul>	<ul style="list-style-type: none"> <li>Enterprise Surveys</li> <li>Interviews</li> <li>Average data from firm statements</li> <li>BIOS survey</li> <li>National and BIOS data</li> <li>Project monitoring reports</li> <li>Watchdog's reports</li> </ul>

<b>Capacity of the government to undertake reform of administrative barriers enhanced</b>	<ul style="list-style-type: none"> <li>• Creation of inter-ministerial committees to coordinate reform process</li> <li>• Creation of a Reform cell within the government</li> <li>• Review of the legal and regulatory system</li> <li>• Number of reforms designed and implemented</li> <li>• Adoption of a competition policy framework</li> <li>• Number of training events provided to ministries, regulators and administrators</li> <li>• Number of civil servants trained</li> </ul>	<ul style="list-style-type: none"> <li>• Official documents establishing the committees</li> <li>• Revised laws and regulations published</li> <li>• Official reports on training events</li> </ul>
<b>Business regulation enhanced</b>	<ul style="list-style-type: none"> <li>• Number of days spent on bureaucratic compliance and waiting /inspection periods by enterprises</li> <li>• Unofficial payments firms paid to “get things done” (% of sales)</li> <li>• Increased number of registered firms/ Reduced number of informal enterprises</li> <li>• Business Entry: new registrations as percentage of total enterprises</li> </ul>	<ul style="list-style-type: none"> <li>• Enterprise Surveys</li> <li>• Interviews</li> <li>• Average data from firm statements</li> <li>• BIOs survey</li> <li>• National and BIOs data</li> <li>• Project monitoring reports</li> </ul>
<b>Participation of the private sector to the reform process enhanced</b>	<ul style="list-style-type: none"> <li>• Number of fora and committees established to allow private sector participation</li> <li>• Proportion of private sector representatives in these fora and committees</li> <li>• Number of training events, seminars, workshops organised for business intermediary organisations and entrepreneurs</li> </ul>	<ul style="list-style-type: none"> <li>• Committees’ official reports</li> <li>• BIOs periodic reports</li> <li>• Project monitoring reports</li> </ul>
<b>Enabling policies and incentives to promote PSD set up</b>	<ul style="list-style-type: none"> <li>• Incentive schemes designed and applied to support entrepreneurship (access to credit facilitations, financing innovative schemes)</li> </ul>	
<b>Impact level</b>		
<b>Competitiveness of the private sector (incl. SMEs) enhanced</b>	<ul style="list-style-type: none"> <li>• Improvement in the international Bureaucratic Quality Index</li> <li>• Increased number of registered firms/ Increased business entry rate</li> <li>• Increased number of firms filing tax returns</li> <li>• Increased domestic private investment</li> <li>• Increased volume of FDI net inflows (% of GDP)</li> <li>• Increased number of loans allocated to enterprises</li> </ul>	<ul style="list-style-type: none"> <li>• National account data</li> <li>• World Bank development indicators</li> <li>• Board of revenues records</li> <li>• Global competitiveness reports</li> </ul>
<b>Poverty reduction through pro-poor growth</b>	<ul style="list-style-type: none"> <li>• Poverty headcount ratio at national poverty line</li> <li>• Increased level of employment</li> <li>• GDP (% of growth)</li> <li>• FDI net inflows (% of GDP)</li> </ul>	<ul style="list-style-type: none"> <li>• National statistics</li> <li>• Household income expenditures</li> <li>• Poverty assessment reports</li> </ul>

### 3.4 Cross-cutting issues

#### Good Governance

Governance is not just a cross-cutting issue in the area of enabling environment reform but is at the core of it. This includes also the transparency of procedures (e.g. licensing and permit issuance) which is key to business environment improvement, since it enhances the trust in institutions and their accountability. Increased transparency reduces unofficial costs faced by enterprises when dealing with bureaucracy, and facilitates effective implementation of reforms.

Local governance and decentralisation are two areas of concern in the reform of the business environment. When a decentralisation process is in place, local governments play a key role in implementing and administering the reform and in the service-delivery.

#### Gender

Gender equality should be integrated into enabling environment programmes since a variety of barriers in the legal and regulatory framework prevent women from creating a business, increasing their volume of affairs, having access to finance. Moreover, there is often a gap between customary law and statutory law above all in the areas of land ownership and property registration which hinder women participation from business activities. Mainstreaming gender issues in the reform process, and the participation of women professional associations in the consultation phase is important to ensure and promote women entrepreneurship.

#### Environment

A number of laws and regulations intend to protect or mitigate risks to the environment. These include: environment permits that are sometimes needed for new

constructions, sustainable or environmental impact assessments for new activities and accompanying remedial plans, land use planning, waste disposal and recycling regulations, regulations applying to hazardous activities, etc. Reform programmes should make sure that these regulations adequately protect the environment and provide space for the development of new businesses in the green sector, without imposing a disproportionate burden on firm's activities (e.g. the idea is indeed not to replace obsolete licenses and permits by environmental ones, but maybe to require such permits for activities posing an environmental risk or conditioning approval to the realisation of an impact assessment).

Working groups within the government could be set up to design and implement viable fiscal and economic incentives aiming to encourage sustainable production practices or business creation in new areas.

### 3.5 Risks

Some of the risks that need to be considered when designing and implementing enabling environment interventions include the following:

- Political stability: the reform of a legislative framework is a long-term process, which can be hindered by political instability due to abrupt or frequent changes in the government, for example. Or the government does not continue to support the review of administrative barriers and the reform process, not having enough leadership and strength to continue the reform process against vested interests, lobbying activities and corruption practices;
- Customary rights may apply in some countries. Top-down reforms have little or in some cases negative effects if they do not fit with local institutions and traditional rules: experiences from land titling

#### **Box 4. Streamlining business permits and licensing procedures at local (city) level, Ormoc City, The Philippines**

In order to improve the business environment in Local Government Units (LGUs), the German Technical Cooperation (GTZ) and the Philippine Department of Trade and Industry through the Small and Medium Enterprise Development for Sustainable Employment Program (SMEDSEP), provided technical assistance to the LGU in Ormoc City to simplify the city's business permits and licensing processes. The main objectives of the project were to: monitor and evaluate the improved business licensing procedures; recommend ways of further improving the current licensing procedures to achieve client satisfaction; and present lessons learned to selected LGUs to encourage similar efforts. The reform reduced the process of business registration from 17 steps to 5, and the time from 17 to 2 days. This led to a 25 percent increase in the number of registered businesses in Ormoc from 2005 to 2006. The Philippine Chamber of Commerce and Industry awarded Ormoc City as the Most Business Friendly City for Visayas in 2006. Other municipal and provincial LGUs in the region were reviewing their business licensing and permit systems guided by the practical Ormoc model. By the end of 2007 around 50 percent or 21 more LGUs had successfully streamlined their procedures.

Source: [www.smedsep.ph](http://www.smedsep.ph)

in Kenya “brought substantial uncertainty into the complex system of customary rights to land, leading to an increase in opportunistic behaviour and weak effects on credit use, land yield and investment”<sup>92</sup>.

In a nutshell, it is necessary to analyse, understand and take into account the local institutions that are embedded in the social norms and traditions before engaging in the design and implementation of regulatory reforms.

#### **Box 5. SWITCH Programme—Asia (2007–2013), €90 million**

Switch Programme aims to promote sustainable production (i.e. development of less polluting and more resource efficient products, processes and services) and sustainable consumption patterns and behaviour in the Asia region. These objectives can be achieved through an improved understanding and strengthened co-operation between Europe and Asia, notably by mobilizing the private sector (i.e. SMEs, retailers, producers, financial institutions and consumer organisations), along with relevant public sector authorities.

The programme entails three components: (i) Grant Projects, (ii) Network Facility, and (iii) Policy Component.

The policy component aims at strengthening the implementation of national and sub-regional policies on sustainable consumption and production in selected countries from the Asia region; mainstreaming SCP-policies not only in the national environmental agenda but also in the overall development policies.

<sup>92</sup> Recent and relevant studies in this area are quoted and referred to in an article published by CESifo Forum 4/2009 “Fostering economic development in Sub-Saharan Africa: what role for reforming business regulations?”



## 4. Where to find out more?

### General bibliography

ADE, 'Evaluation of European Community Support to Private Sector Development in Third Countries', Final Report (incl. Annexes 1-10), December 2005.

Altenburg, Tilman; von Drachenfels, Christian: '**Creating an Enabling Business Environment in Asia: To what Extent is Public Support Warranted?**' German Development Institute, February 2007.

[www.die-gdi.de/CMS-Homepage/openweb-cms3.nsf/\(ynDK\\_contentByKey\)/ADMR-7BRKBB?Open&nav=expand:Publikationen%5CDiscussion%20Paper;active:Publikationen%5CDiscussion%20Paper%5CADMR-7BRKBB](http://www.die-gdi.de/CMS-Homepage/openweb-cms3.nsf/(ynDK_contentByKey)/ADMR-7BRKBB?Open&nav=expand:Publikationen%5CDiscussion%20Paper;active:Publikationen%5CDiscussion%20Paper%5CADMR-7BRKBB)

Development Alternatives (DAI), '**Grounds for Growth – Enhancing the Competitiveness Impacts of Business Environment Reform**', Volume 13, Issue 1, Winter 2009.

The document contains ten articles dealing with initiatives aiming to improve the impact of business environment reforms. Each article identifies different strategies implemented in various geographic and economic regions, and relates of the impact and success of some initiatives like conducting regional 'doing business assessments', establishing public-private coalitions, etc.

[www.dai.com/pdf/developing\\_alternatives/Dev\\_Alts\\_Grounds\\_for\\_Growth.pdf](http://www.dai.com/pdf/developing_alternatives/Dev_Alts_Grounds_for_Growth.pdf)

GTZ and UNIDO, '**Creating a Private Sector Enabling Environment in Sub-Saharan Africa**', Vienna 2008.

The study examines amongst other things the relevance and impact of three regulatory business reforms: easing business registration, providing property rights, and simplifying labour regulations in Sub-Saharan Africa.

[www.unido.org/fileadmin/user\\_media/Publications/documents/creating\\_an\\_enabling\\_environment\\_for\\_private\\_sector\\_development\\_in\\_subSaharan\\_Africa.pdf](http://www.unido.org/fileadmin/user_media/Publications/documents/creating_an_enabling_environment_for_private_sector_development_in_subSaharan_Africa.pdf)

The Donor Committee for Enterprise Development (DCED) has set up the business environment Working Group which deals exclusively with initiatives supporting this sector. It has also elaborated a Guidance on Business Environment Reform and established an inter-agency database containing numerous documents on the subject. Documents are organised according to the phases of the project cycle: assessment, design, implementation, impact assessment, global documents and events.

[www.businessenvironment.org](http://www.businessenvironment.org)

### Diagnostic tools

World Bank Doing Business Indicators:

[www.doingbusiness.org](http://www.doingbusiness.org)

The *Doing Business* project was launched in 2002. It looks at domestic small and medium-size companies and measures the regulations applying to them through their life cycle. The *Doing Business* project encompasses 2 types of data. The first come from readings of laws and regulations. The second are time and motion indicators that measure the efficiency in achieving a regulatory goal (such as granting the legal identity of a business).

World Bank Enterprise Surveys:

[www.enterprisesurveys.org](http://www.enterprisesurveys.org)

*World Bank Enterprise Surveys* cover 114 countries and assess business environment as experienced by firms, performance measures, firm characteristics, and perceptions regarding obstacles to growth. They are complementary to the Doing Business Indicator, being based on surveys of individual firms

ILO Assessment Guide

[www.ilo.org/empent/Whatwedo/Publications/lang--en/docName--WCMS\\_093631/index.htm](http://www.ilo.org/empent/Whatwedo/Publications/lang--en/docName--WCMS_093631/index.htm)

This guide has been prepared to assist policy makers, researchers, evaluators, programme managers to determine the effects that external influences have on employment in small enterprises. It aims to assist and add value to assessment efforts of the business environment, and market conditions affecting the performance of MSMEs.

### Other web links

International Finance Corporation (IFC) Business Enabling Environment Site: [www.ifc.org/bee](http://www.ifc.org/bee)

Business Growth Initiative:

[www.businessgrowthinitiative.org](http://www.businessgrowthinitiative.org)



## **Thematic Review 6**

### **Investment Promotion and Facilitation**

# 1. What does the theme cover?

## 1.1 Definition and terminology

Investment promotion is commonly defined as “activities that disseminate information about, or attempt to create an image of the investment site and provide investment services for the prospective investors”<sup>93</sup>. The objective of investment promotion is to attract potential investors, either national or foreign, whereas investment facilitation supports investors in the process of establishing and running their investment projects.

The activities which fall within the realm of investment promotion and facilitation are diverse and can range from the attempt to create a favourable image of a country in investors’ minds to helping an individual investor through the investment process. It can target foreign direct investment (FDI) as well as domestic investors. Finally, investment promotion can aim at capital injections in existing firms or the establishment of new firms (“greenfield” investment).

Some publications refer to “investment promotion” as a broad concept which covers any initiative aimed at enhancing private investment. The DAC Reference Document “Promoting Private Investment for Development”, for example, deals with donor support ranging from competition policy to financial sector support to the business environment.<sup>94</sup> In this thematic review the concept of *Investment promotion and facilitation* is developed essentially around the marketing initiatives to attract FDI and increase domestic investments; this is done for the purpose of facilitating the preparation of development programmes and projects in this area. Whilst this thematic review thus focuses on the marketing aspects of the investment climate, whose direct purpose is to foster investment, it does not cover support related to public investment activities. This thematic review also addresses the differential treatment of foreign investors when compared to domestic investors in terms of laws and regulations, including those relating to Export Processing Zones (EPZ) – special areas of a country where trade barriers are significantly reduced and bureaucratic requirements are lowered so as to attract new business and foreign investments.

There are close links between investment promotion and facilitation and other areas of donor support which are addressed in other thematic reviews, notably those related to:

- **Access to Finance**, which examines the way donors support the development and strengthening of institutions, instruments and practices to enhance the

opportunities for firms to obtain funding by borrowing (debt financing) or to increase their capital base by expanding ownership (equity financing); and

- **Business Enabling Environment**, which addresses the topic of the enabling environment for private sector development as an essential part of the wider investment climate.

## 1.2 Rationale for intervention in developing countries

There is a clear and positive link between investment (both domestic and foreign) and economic growth. Significant inflows of FDI into a country can generate benefits to the local economy through several effects like the creation of employment, the supplementing of domestic savings, the transfer of know-how and the access to new technologies, and the development of local productive capacity. Through these effects and via a spill-over effect of the investment to the local economy, FDI is thus a catalyst for economic growth, the latter having, via the transmission mechanisms, an impact on poverty reduction. Therefore, the importance of FDI for host countries may be very significant.

Worldwide, the share of net FDI inflows in GDP increased from 0.6% in the 1980s to 2.8% over the period 2005-07, and in developing countries from 0.7% to 3.3% over the same period.<sup>95</sup> The share of FDI inflows in gross fixed capital formation in 2007 reached 35% in developing countries (compared to 15% in 1990) and 24% in LDCs (compared to 7% in 1990).<sup>96</sup>

In recent years, many developing countries have engaged in market friendly economic reforms that aimed at improving the business environment for the private sector. These reforms have included the removal of barriers for foreign companies to establish and expand operations. However, as these reforms have taken place in many countries around the globe, competition among countries to become the destination of investment – both from foreign and domestic investors – has increased. Investment promotion activities are thus an important complement to continuous reforms of the investment climate.

It is important, however, to underline that developing countries, in particular when they compete to attract FDI, will need to take into account the main drivers for investment and carefully consider the impact of investment on the economy of the country. The three main drivers in FDI are to ensure market access, to exploit natural resources or to achieve lower operating costs. While investments in each of these cases may of course

93 Wells Jr., Louis T./Wint, Alvin G. 1990: Marketing a Country: Promotion as a Tool for Attracting Foreign Investment, Washington, DC: IFC and MIGA.

94 OECD 2006: Promoting Private Investment for Development. The Role of ODA, DAC Reference Document, Paris.

95 UNCTAD 2009: The Least Developed Countries Report 2009. The State and Development Governance, New York/Geneva, July 2009.

96 UNCTAD 2008: World Investment Report 2008. Transnational Corporations, and the Infrastructure Challenge, New York/Geneva, September 2008.

be significant, it is important for developing countries to keep in mind other aspects to which attention should be given in order to attract investment on a larger scale and over the longer term:

- The interest of market access will be rather low for those developing countries where the national market is too narrow to allow for appropriate return on investment and where there is no easy access to markets of the neighbouring countries.
- In relation to exploitation of natural resources, it is important to keep in mind that such exploitation may be rather capital intensive (extractive industries) and, though relevant for providing significant revenues to the country, may not in itself generate important employment or spill-over effects. The country should therefore look for opportunities to link such activities to further in-country processing activities in order to retain more significant and sustainable effects in terms of economic development.
- Where cost advantage is the driver, it needs to be kept in mind that this may impact the level of ambition in terms of social, labour and environmental standards.

More in general, the host country policies may, however, not be appropriate (e.g. for investment protection) or the level of development may be too low to guarantee the investor a basic business environment (lack of human resources, finance, infrastructure and physical capital).

The increasing competition between destinations requires countries to continuously work on the quality of their business environment, develop or strengthen their strategies for attracting investment, and strengthen their institutional frameworks to influence investors' location decisions with timely and relevant country and sector information and facilitation efforts. Donor support can play a role in this regard.

### 1.3 Legal and regulatory context

There is no one international organisation administering the full process for international investment rulemaking.

The World Trade Organisation (WTO) has however established certain rules for investment issues. Two agreements are particularly relevant:

- The Agreement on Trade Related Investment Measures (TRIMs): the TRIMs Agreement applies to measures that affect trade in goods. It states that no WTO member shall apply investment measures which are prohibited by the provisions of the GATT on national treatment or quantitative restrictions. Examples of inconsistent measures, as spelled out in the Annex of the TRIMs Agreement<sup>97</sup>, include local content and trade balancing requirements.

All members of the WTO must comply with the provisions of the TRIMs Agreement.<sup>98</sup>

- The General Agreement on Trade in Services (GATS): one of the so-called modes of supply of services as defined in the GATS is Mode 3 – Commercial Presence, which consists of foreign services providers establishing a subsidiary or branch in the target market. Thus, commercial presence is essentially a foreign direct investment. All WTO members must comply with the general principles of the GATS – most-favoured nation treatment, transparency in and objectivity of regulations, free flow of international payments related to the establishment of commercial presence, and progressive liberalisation. Any further liberalisation commitment is negotiated on a sector and/or modal basis; this is currently taking place as part of the trade in services negotiations under the Doha Development Agenda.

For the rest, investment issues are the subject matter of a “spaghetti bowl” of bilateral and multilateral international investment treaties, double taxation treaties and other international agreements with provisions related to investment that have been developed over the years – UNCTAD counts more than 5,700 different international investment agreements (IIAs).<sup>99</sup>

## 1.4 Key actors and issues

### 1.4.1 Key issues

Identifying the key issues to address when dealing with investment promotion and facilitation and the answers to these questions will help design a coherent and comprehensive strategy:

- An effective investment strategy could entail a sector support as opposed to an economy-wide approach. In this context, the cluster approach receives increasing attention as the supporting activities are focused on attractive sectors and are more likely to produce results in the short-term. Conversely, the results of wider, cross-sector approaches are likely to be diluted.
- Investment promotion and facilitation very often target foreign investors, but they should also facilitate domestic investment. In this connection, it is important that in designing strategies to promote investments, governments and donors should ensure that both foreign and domestic investors benefit from the same conditions (national treatment; fair competition). However, foreign and domestic investors constitute most often different target groups, and strategies need to be specifically targeted to the group concerned. This may well entail targeting different economic sectors.

97 The “Illustrative List” is the only annex to the TRIMs Agreement. For a web version, see [www.wto.org/english/docs\\_e/legal\\_e/18-trims\\_e.htm#ann](http://www.wto.org/english/docs_e/legal_e/18-trims_e.htm#ann).

98 A further strengthening of rules on investment was originally planned to be part of the Doha Development Agenda but was dropped from the negotiation agenda in 2004.

99 UNCTAD 2009: International Investment rule-making: stocktaking, challenges and the way forward, UNCTAD Series on International Investment Policies for Development, UNCTAD/ITE/IIT/2007/3, February 2009.

- Domestic investment should be actively promoted in countries where the savings rate is high, whilst investment in productive activities sticks to low levels (i.e. savings stay within the financial sector or are invested in non-productive activities such as real estate). Questions need to be asked as to what are the obstacles that need to be removed in order to enhance investment in productive activities, both at Government and banks level, as well as what are the most needed economic reforms and policies to be promoted in order to enhance domestic investment?
- How can governments of destination countries ensure that investments are “development friendly”, i.e. they generate employment, respect health and safety, labour and social standards, raise the quality of life, and are undertaken in an environmentally sustainable way?
- How can governments keep the treaty network consistent and transparent, and above all how can they formulate the “right” agreements in terms of balancing their own interests and those of foreign investors, as well as strengthening the development dimension?
- At the macro level through the contribution to the design and implementation of investment strategies in close collaboration with the competent ministries;
- At the meso level, where IPAs may play an advocacy role among government bodies on issues affecting the investment climate; and
- At the micro level through the facilitation of investment projects. This includes the provision of information, access to infrastructure, legal advice, and identification of “greenfield” options. Some IPAs also act as a clearing house for submission of necessary documents and applications to the various government departments and institutions.

Outward investment agencies (primarily in developed countries) constitute another set of important actors. They can provide financial solutions, risk management options and professional advice in order to create opportunities for businesses willing to invest abroad. They often provide guarantees against political risks. The World Bank group through the Multilateral Investment Guarantee Agency (MIGA) also provides guarantee facilities for investments in developing countries, thus helping attract FDI i.e. providing insurance to foreign investors for political risk (currency transfer restrictions, expropriation, war and civil disturbance, breach of contract, etc.) in the host countries.<sup>100</sup>

On the international scene, another important actor is UNCTAD. Each year it publishes the World Investment Report which focuses on trends in FDI at the global, regional and country levels, and its contribution to development. Investment Policy Reviews provide an objective evaluation of the country’s legal, regulatory and institutional framework for FDI in order to attract more foreign and direct investment, as well as to maximize the benefits from it.

#### 1.4.2 Key actors

The key actors in the area of investment promotion and facilitation are first of all the Government authorities whose mission includes development and implementation of policies and activities to promote and facilitate investment: these are usually the Ministry of Economy and the Investment promotion authorities (or agencies). Some private sector actors also play an important role in this area: financial institutions, intermediary (membership) organisations and of course the (potential) investors.

Investment Promotion Agencies (IPAs) play a key role in the promotion of FDI and facilitate public-private dialogue, serving as a bridge between investors, local entrepreneurs and the Government. They are usually statutory bodies established through Parliamentary law or Government regulations. Their main objectives entail promoting investment:

#### Box 1. UNCTAD’s International Investment Agreements (IIA) Advisory Services

UNCTAD operates a programme to assist developing countries to participate in negotiations of IIAs, the “IIA advisory services”, ranging from regional, national and Geneva-based seminars, to ad hoc technical assistance advisory work, in the form of missions and reports to requesting countries/regional organizations with legal commentary or draft laws or draft treaties/model treaties, as well as regarding the issue of managing investor–State dispute settlement, and negotiations support, in the form of facilitation of negotiation rounds for bilateral investment treaties. Since 2000, a total of 162 countries have benefited from the programme.



## 2. What can be done?

### 2.1 Problem identification and diagnostic tools available

In order to define a strategy for donor support to investment promotion in a given country, a three step approach should be applied. Firstly it has to be determined if the core conditions for support in this area are appropriate. Secondly, if this is the case, the country system for investment promotion is assessed. Finally, identified weaknesses should be the focus of a support strategy.

#### *Assessing the business environment*

The main questions to be asked in the identification process are: how can the business environment in the country be improved? Does the government have a strategy to improve it and how do investment promotion and facilitation measures fit within this strategy?

The effectiveness of investment promotion interventions is positively related to the overall investment climate. Hence, donor support to investment promotion initiatives should be granted only when the beneficiary government has embarked on reform of the investment climate. Support to investment promotion and facilitation should be combined with initiatives aimed at improving the business environment.<sup>101</sup>

#### *Identifying opportunities and obstacles to investment promotion*

In the second stage, it is useful to analyse the level of FDI in the country (investment amount, investment trend over the years, percentage of GDP, percentage of total investment flows into the region, investment sectors, investors' countries of origin) and to benchmark it to similar, competing countries in the region. The existing infrastructure to promote domestic investment and attract FDI needs also to be assessed.

Issues to be addressed at this stage can be identified through the following questions:

- Does a strategy for the attraction of investment exist, directing the investment promotion activities to specific targets in terms of economic sectors, types of investment and activities, countries of origin, destination regions?
- Is there an appropriate legal framework to support domestic and foreign investment, in line with multi-lateral obligations? Incentives which may be included in such a framework might comprise subsidies, tax exemptions, rules and measures for the protection of investment, existence of special economic zones such as export processing zones (EPZ), existence of a

legal framework for Public-Private Partnerships (PPP), rules that regulate governments and companies, etc.

- Has the partner country concluded International Investment Agreements (IIA), are these actually being applied, and do they contribute to economic development?
- Are investment promotion institutions in place (usually they exist in the form of investment promotion agencies - IPAs)? To what extent has the structure, mission, legal status and functions of the IPA been informed by, and benchmarked against, international good practices (see the diagnostic tools described below)?
- Is the IPA adequately funded and is its performance in terms of attracting investment regularly reviewed? What indicators have been established for monitoring the performance of the agency?
- Are administrative procedures for setting up investments or investing in existing firms transparent, simple, and fast?
- Are adequate structures and capabilities in place (in the government, local authorities and the private sector) to promote investment linkages between businesses or through public private partnerships, especially between foreign affiliates and local enterprises?
- Are there any obstacles specifically related to investment? What are measures put in place by the government in order to address these hindrances? It is especially important to assess the interactions between foreign and local companies so as to ensure that the investments are efficiently channelled. Are the local companies ready to absorb the additional investment (notably if it concerns FDI)? Do they have the human capacity and technology to benefit from the investment effect?

There are some diagnostic tools which can help identify and assess potential problems related to investment promotion and facilitation. The *World Bank's Investment Promotion Toolkit* helps to analyse and develop investment promotion strategies and activities (primarily for FDI). The Toolkit comprises nine modules devoted to understanding FDI; developing and establishing IPAs; creating investment promotion strategies; building effective partnerships; strengthening a location's image; targeting and generating investment opportunities; servicing investors; monitoring and evaluating activities and results; and utilising information technology. The toolkit is available online at: [www.fdipromotion.com](http://www.fdipromotion.com).

101 For more details on the concepts of enabling environment and investment climate, see the thematic review "Business Enabling Environment".



The *OECD Policy Framework for Investment* (PFI) is a tool developed in order to identify obstacles to investment, to formulate sound policies to remove obstacles to investment, and to implement and monitor policy reforms. The PFI toolkit provides a checklist in the form of questions assessing important issues in ten different policy domains (e.g. investment policy, investment promotion and facilitation policy, trade, taxation, etc.). It offers substantial practical guidance on how to address each question within the ten policy chapters. It also highlights how the core principles of the PFI influence investment; how the various chapters of the PFI relate to one another and how the PFI can assist in an on-going and iterative process of reform and in fostering public/private dialogue. The first two chapters (investment policy and investment promotion policy) are particularly relevant when assessing the issues affecting FDI and domestic investment at the macro level (government policy). The toolkit is available online at: [www.oecd.org/investment/pfitoolkit](http://www.oecd.org/investment/pfitoolkit).

These two toolkits are complementary: OECD's is focused on the macro level and policy issues affecting investment flows, whilst the World Bank's addresses key factors at the meso level (e.g. how to set up an IPAs, how to implement effective cooperation between investment promotion intermediaries, identification of the most effective promotional activities).

A third toolkit to be mentioned has been developed by the MIGA. This toolkit addresses IPA core operations only and aims to provide a methodology to measure the performance of IPAs. The methodology is based on the following indicators:

- The extent to which IPA web sites offer a business-support gateway for prospective foreign investors:
  - Information architecture: how easy is it to find country and sector-specific information on the web site?
  - Design: how is information presented to support the online promotion effort?
  - Content: how relevant and accurate is the country and sector information for targeted foreign investors?
  - Promotional effectiveness: how well does the site market the location and IPA services?
- IPA capacity to deliver information directly requested by prospective foreign investors:
  - Availability and accessibility: how easy is it to find the IPA online and contact a knowledgeable project manager?
  - Responsiveness and handling: how skilfully do IPA staff engage with the prospective investor over the telephone and by e-mail?

- Response: how relevant, thorough, and professional is the IPA's response to specific inquiries?
- Customer care: how well does the IPA follow up to convert initial interest of an investor into a firm lead (a further inquiry or site visit)?

Two final observations can be made in relation to this stage of needs and project identification. Firstly, data on current investment levels are usually easy to get at an aggregate level (e.g. from the World Bank, IMF) but might be less easily available – and reliable – at more disaggregated levels (potentially the national statistics body, government, IPA or economic research institutions have such data). Secondly, once the business environment has been assessed and opportunities and obstacles to investment promotion have been determined, extensive stakeholder consultations are important. A joint identification of issues with stakeholders is an important ingredient for ensuring a demand driven approach and creating ownership among beneficiaries. Important stakeholders will typically include the government (Ministry of Economy, Industry, etc.), government bodies in charge of investment promotion, private sector organisations (chambers of commerce and industry, professional associations), current foreign investors in the country or their organisations, financial institutions, academia, civil society, and donors.

## 2.2 Broad areas of intervention and key activities

On the basis of the identified opportunities and obstacles, a strategy for investment promotion can be defined, determining the most appropriate areas and levels of intervention.

Table 1 identifies the most recurrent broad areas of intervention to support investment promotion and facilitation as well as key activities in such areas of intervention.

At the macro level, supporting negotiation of IIAs constitutes a key component of investment promotion strategies. In an IIA, the contracting parties seek to encourage foreign investment through the granting of investment protection; however, “notwithstanding the great importance of a stable and predictable international legal framework for attracting foreign investment, existing IIAs might not live up to their full potential as regards to their investment *promotion* objective”<sup>102</sup>, nor do they always appropriately address the development dimension of investment. This is because IIAs often focus on the *protection* of investment. Technical assistance can be an important element to help partner countries negotiate more balanced IIAs which pay due attention to both promotion and protection issues.

At the macro level, another broad area of activity encompasses support to the development of a legal framework for investment promotion, e.g. in particular drafting of laws and regulations governing the statute, mandate and

Table 1. Investment Promotion intervention areas and key activities by intervention level

Intervention level	Broad areas of intervention	Key activities
<b>Macro level (policy; international instruments)</b>	<ul style="list-style-type: none"> <li>• Definition and design of investment strategies and legal framework</li> <li>• Negotiation of International Investment Agreements (IIAs)</li> <li>• Regional cooperation</li> </ul>	<ul style="list-style-type: none"> <li>• Assistance to policy formulation and strategy</li> <li>• Drafting of laws and regulations governing the statute, mandate and functioning of IPAs</li> <li>• Drafting of investment related laws, incl. tax incentives and EPZ/Free Zone laws</li> <li>• Drafting of PPP laws and regulations</li> <li>• Technical assistance/studies in support of preparation of positions in negotiations</li> <li>• T.A. to formulate agreements and during negotiations</li> <li>• Setting-up or strengthening of regional networks of IPAs</li> </ul>
<b>Meso level (intermediary organisations)</b>	<ul style="list-style-type: none"> <li>• Establishment or strengthening of IPAs</li> </ul>	<ul style="list-style-type: none"> <li>• Technical assistance to set up IPA</li> <li>• Support in preparation of investor guides/ websites to attract investors</li> </ul>
<b>Micro level (enterprises)</b>	<ul style="list-style-type: none"> <li>• Support by IPAs to local firms and international enterprises</li> </ul>	<ul style="list-style-type: none"> <li>• Assistance to brokering activities to identify partners, including the organisation of matchmaking events</li> <li>• Assistance with setting-up an investor-specific framework for partnership, incl. for PPPs</li> </ul>

### Box 2. Support to an investment promotion agency: Swaziland 'Private Sector Support Programme' (2001-2007), €5.9 million

This EC-funded programme provided technical assistance to the government of Swaziland in their efforts to strengthen the Swaziland Investment Promotion Authority (SIPA), created in 1998. The programme included a component of technical assistance in the area of business enabling reforms and SMEs support. SIPA is at present operational thanks to public funds and their services to potential investors target both foreign and domestic business people. The website of SIPA provides details of the various services available to investors: [www.sipa.org.sz](http://www.sipa.org.sz)

functioning of IPAs. Such initiatives are usually of limited scope and could therefore be implemented as components of initiatives related to the business environment.

Projects related to Free Zones/EPZs should be considered as a transitory tool to be implemented in countries where reforms of the business environment are particularly difficult and/or extended over a very long time. Donor support related to EPZs covers all the instruments and methods also used for general investment promotion support. This can range from assistance in establishing the legal basis for EPZ to support of IPAs or EPZ management agencies in their efforts to attract investors.

The design of investment incentives constitutes an important instrument for investment promotion. They include financial instruments (such as tax holidays<sup>103</sup>) and non-financial measures (such as preferential access to certain government or infrastructure services). When conceiving incentive schemes, legal and financial issues have to be taken into consideration. From a legal point of view, they must comply with international obligations, whilst from an economic point of view the benefits of incentives should outweigh their costs.

It should be noted that investment incentives such as tax holidays may be ineffective in a business environment which does not support private sector operations.

### **Box 3. Support to a regional network of investment promotion agencies: MEDA Region, ANIMA (2002-2007), €3.9 million**

In the ENP-South region (Southern Mediterranean and Middle Eastern countries), the Euro-Mediterranean network of Investment Promotion Agencies (ANIMA) project was designed to strengthen skills and capabilities of “Mediterranean” IPAs and to establish a network of EU and Mediterranean IPAs. The project was run by the ‘Invest in France Agency’, the ‘Italian Institute of Foreign Trade’ (ICE) and the ‘Direction des Investissements’ (Morocco). The aim of the initiative was to increase investors’ confidence in the competitiveness of the countries in the region and, as a result, increase regional investment flows. The IPAs’ capabilities had to be strengthened in order to provide investors with useful tools such as an investment climate scoreboard up-dated annually and containing indicators and data assessing the attractiveness of the country in several fields (market, economic performance, rights of investors, quality of human resources, infrastructure and access to technologies, or transparency and governance).

They should therefore be accompanied by measures to improve the investment climate. Another caveat regarding investment incentives stems from the fact that there often is a tendency to create new incentives over time without a clear strategy, thus creating a multitude of uncoordinated incentives. “Each individual incentive granted may make sense at the time, but the cumulative effect of all the incentives offered might, with time, become unaffordable or counter-productive by giving investors an incentive to delay investments until they can obtain concessions”<sup>104</sup>. Furthermore with competition between countries in this field there could be a “race to the bottom” which would be counter-productive. A further aspect to take into account relates to the importance of defining appropriate fiscal policies and laws, which should not be unduly weakened by non-strategic types of tax exemptions or derogations.

Supporting the establishment of IPAs and building their capacity occurs both in regional and national programmes (see Boxes 2 and 3). Technical assistance consisting in the placement of one or two long-term advisers and short-term expertise within the partner institutions is often combined with training, workshops, study tours, and staff exchange initiatives.

#### **Projects related to Public-Private Partnerships:**

PPPs have received significant attention in recent years, often from a public sector perspective, where lack of public funding would have otherwise prevented certain investments in infrastructure or other sectors typically catered for by government (such as public transport, waste collection, etc.). At the same time, PPPs are also interesting from a private sector perspective, because they allow the private sector to invest in sectors hitherto reserved for government operations and they can share the risk with their public partners. Moreover, they contribute to increase the level of national investments. Donor support to PPPs is often provided in the form of project financing with International Financial Institutions (IFIs). Nevertheless, many partner countries lack an appropriate regulatory framework for PPPs, as well as lacking capacity for the management of PPP projects. Technical assistance by the EC – provided both by service providers and Member State institutions– could be a useful complement to the project finance approach applied by IFIs. The target institutions in partner countries typically are both the Ministry of Finance and the IPA. Donor support often has to start with clarifying the competences between them, prior to support in legal drafting and building capacity in PPP project management.

### **Box 4. Support to investment and inter-enterprise co-operation via regional investment promotion agencies: SADC Region, ESIPP (2002–2007), €16 million**

The project was aimed at promoting investment and technology flows to enterprises operating within key growth sectors in the SADC member states. ESIPP was structured around two components:

- Kick-start an investment promotion process in the SADC region through the organisation of high profile co-operation meetings;
- Raise investor awareness and interest to be further sustained by institutional strengthening, capacity building, advocacy and continuing sub-sector/sub-regional business-to-business meetings.

103 A tax holiday is a temporary reduction or elimination of a tax. Governments usually create tax holidays as incentives for business investment; in developing countries, governments sometimes reduce or eliminate corporate taxes to attract FDI or stimulating growth in selected industries.

104 OECD 2008: “Draft User Guidance for the PFI investment promotion and facilitation questions”, [www.oecd.org/dataoecd/36/38/41246119.pdf](http://www.oecd.org/dataoecd/36/38/41246119.pdf). This paper also refers to costs and benefits of investment incentives.

### 3. How can it be done?

#### 3.1 Methods and levels of intervention specifically relevant to the theme

The levels of intervention are referred to in the table in section 2.2, where areas of intervention are structured on three levels: macro, meso and micro.

Concerning aid modalities, support to investment promotion and facilitation can be provided through budget support as well as project approach (technical assistance and capacity building). Budget support could be considered for certain macro level interventions, such as the development of investment laws or conclusion of international investment agreements, preferably in combination with reforms of the investment climate. This can be done through general and sector budget support.

Technical assistance and capacity building are crucial at the meso level, where they focus on strengthening IPAs and supporting the development of their promotion interventions. This requires a project approach.

Twinning, secondment, mentoring and the contracting of service providers are suitable implementation methods for IPA capacity building. The focus on capacity building is necessary to achieve sustainable results. In the past, support was also provided for the preparation of investor guides and similar materials, sometimes without any active involvement of partner IPA staff. This is not considered a good practice, as there is no lasting effect. However, it must be realised that capacity building takes time, and this should be reflected in the project design.

#### 3.2 Sequencing of activities

As previously mentioned, investment promotion and facilitation activities are more effective if combined with reforms of the business environment. However, specific interventions to support investment promotion can be used to spearhead more general reforms of the business environment – e.g. interventions related to EPZ or Free Zones.

When considering support to an investment promotion initiative, it is important to ensure that a comprehensive investment strategy has been conceived by the beneficiary government. This should be prior to the implementation of meso- and micro level support, since it would guarantee greater effectiveness, while minimising potential risks of uncoordinated or incompatible interventions.

#### 3.3 Expected results and result measurement

The definition of well identified and measurable results through verifiable indicators relevant to the specific area of intervention is necessary to monitor the progress and the performance of investment promotion projects.

#### 3.4 Cross-cutting issues

Although many governments consider it inappropriate to encourage investment by lowering health, safety or environmental standards or relaxing core labour standards, increasing competition between investment destinations may erode this position. Donor initiatives for investment promotion and facilitation therefore need to encourage development-friendly investment; the exploitation of natural resources has to be managed sustainably, both in terms of rate of use of the resources and of environmental impact of the exploitation process.

Cross-cutting issues can be addressed both by the choice and design of support programmes:

- Programme choice: by focussing support on sectors where employment effects are high and/or where women are employed above average (e.g. textile industry as opposed to mining) or where working conditions are better.
- Programme design: in many intervention areas, provisions can be built in to ensure that international standards are adhered to or national standards are raised. Examples are the tying of investment incentives to an investor who is complying with certain minimum environmental standards, by requiring environment impact assessments for certain types of projects (e.g. mining) etc. Among the several initiatives aiming at promoting best practices in the field of socio-economic human rights, the UN Global Compact constitutes a comprehensive strategy for businesses that are committed to align their operations with 10 universally accepted principles in the areas of human rights, labour, environment and anti-corruption<sup>105</sup>. National and foreign investors have to comply with the labour standards enshrined in the ILO Declaration of Fundamental Principle at Work<sup>106</sup>.

#### 3.5 Risks

There are hardly any risks which are specific to investment promotion interventions. As mentioned above, an important risk is that the business environment is not conducive for investments and hence investment promotion support could be futile – but this can be addressed by an appropriate sequencing of activities (top-down approach) as indicated in sections 3.1 and 3.2 above. It is also important to ensure there is no “race to the bottom” regarding investment incentives as mentioned in section 2.2.

<sup>105</sup> [www.unglobalcompact.org](http://www.unglobalcompact.org)

<sup>106</sup> [www.ilo.org/declaration/lang--en/index.htm](http://www.ilo.org/declaration/lang--en/index.htm)

**Table 2. Selection of results and indicators for measurement**

<b>Results</b>	<b>Indicators</b>
<b>International Investment Agreements (IIAs) concluded</b>	<ul style="list-style-type: none"> <li>• Number of bilateral investment and double taxation agreements signed</li> </ul>
<b>Investment strategy designed and under implementation</b>	<ul style="list-style-type: none"> <li>• Publication of an investment strategy document, which provides the matching between a country's assets and investors' requirements. Clear targets in terms of investment sectors are set</li> <li>• Adoption of legal framework, incl. overall investment promotion framework and system for investment incentives</li> <li>• Approval of government budget, providing for the funds for the functioning of the investment framework and incentives.</li> </ul>
<b>IPA established and/or its capacity strengthened</b>	<ul style="list-style-type: none"> <li>• Adoption of Act creating the IPA</li> <li>• Adoption of implementation rules for IPA</li> <li>• The IPA is operational (staff, equipments and funds allocated; annual work programme adopted)</li> <li>• IPA website in place</li> <li>• Investment guides published and available to potential investors</li> <li>• Adoption of legal framework instituting a one-stop-shop for investment projects</li> <li>• Numbers and types of services provided by the IPA as one-stop-shop</li> <li>• Number of investor inquiries and investor prospective visits per year</li> <li>• Response times for inquiries</li> <li>• Percentage of inquiries leading to investment</li> <li>• Number of days required for concluding all formalities relating to an investment project realised with IPA assistance</li> <li>• Score of IPA in benchmarking, e.g. according to Global Investment Promotion Benchmarking methodology<sup>107</sup></li> </ul>
<b>EPZ/Free Zones established</b>	<ul style="list-style-type: none"> <li>• Adoption of Act establishing the EPZ/ Free zone</li> <li>• Number and volume of new business projects in zone</li> <li>• Number of jobs generated in zone</li> <li>• Number of subcontracting agreements between enterprises in zone and domestic suppliers</li> <li>• Value of exports produced in zone</li> </ul>
<b>Public-Private Partnerships established and operating</b>	<ul style="list-style-type: none"> <li>• Number of PPP investment projects identified (project pipeline)</li> <li>• Average time required for launching PPP projects</li> <li>• Number and value of PPP projects concluded legally and financially</li> <li>• Number of PPP projects implemented</li> <li>• Value of private investment in PPP projects</li> </ul>
<b>Business environment reforms to support investment promotion implemented</b>	<ul style="list-style-type: none"> <li>• See thematic review "Business Enabling Environment"</li> </ul>
<b>Foreign and domestic investment increased</b>	<ul style="list-style-type: none"> <li>• Number of projects attracted, volume of investment (absolute figures and as % of GDP) per investment sector, employment generation</li> <li>• Evolution of FDI and domestic stock – volume, number of projects; benchmark against neighbour/competing countries in the region</li> <li>• Evidence of technology/knowledge spill-over</li> </ul>



## 4. Where to find out more?

There is extensive literature (documents, materials and websites) dealing with investment promotion issues. The recommendations below provide some key sources which appear to be particularly helpful and/or good starting points for further research in the area.

### *Good websites to start with*

- The **OECD “Investment for Development”** pages provide information and tools intended to mobilise private investment, both domestic and foreign, for achieving the development objectives of the Millennium Declaration. OECD investment policy tools, such as the [Policy Framework for Investment \(PFI\)](#), aim to help any government interested in creating an attractive investment environment and in enhancing the development benefits of investment: [www.oecd.org/daf/investment/development](http://www.oecd.org/daf/investment/development)
- **UNCTAD’s Division on Investment and Enterprise** provides comprehensive information on investment issues in developing countries (studies, policy papers, the annual World Investment Reports – see below, FDI statistics): [www.unctad.org/Templates/StartPage.asp?intlItemID=2983&lang=1](http://www.unctad.org/Templates/StartPage.asp?intlItemID=2983&lang=1)
- The **World Bank** website provides information, at country and level, on investment *climate* issues, and provides useful links to related sites: [www.fias.net](http://www.fias.net)
- The website of the **World Association of Investment Promotion Agencies (WAIPA)** provides a list of members (with links), documents, tools and a comprehensive set of links related to investment promotion: [www.waipa.org](http://www.waipa.org)

### *Key documents on investment promotion*

- **UNCTAD: World Investment Reports**, published annually. Each report has a key topic, which varies each year, and provides important developments and latest FDI statistics. All reports available from: [www.unctad.org/Templates/Page.asp?intlItemID=1465&lang=1](http://www.unctad.org/Templates/Page.asp?intlItemID=1465&lang=1)
- The **World Bank’s Global Investment Promotion Benchmarking** assesses the operational performance of IPAs worldwide. Latest edition: World Bank 2009: Global Investment Promotion Benchmarking 2009. Summary Report, Washington DC, May 2009. Available at: [www.ifc.org/ifcext/fias.nsf/Content/GIPB2009](http://www.ifc.org/ifcext/fias.nsf/Content/GIPB2009)

- **Toolkits for assessing and developing investment promotion (for details see section 2.1 above)**
- FIAS Investment Promotion Toolkit: [www.fdipromotion.com](http://www.fdipromotion.com)
- OECD Policy Framework for Investment Toolkit: [www.oecd.org/investment/pfitoolkit](http://www.oecd.org/investment/pfitoolkit)
- World Bank 2009: Global Investment Promotion Benchmarking 2009. Summary Report, Washington DC, May 2009.

### *Indicators – methodologies, tools and data*

- **ITC/UNCTAD Investment Map** assists IPAs in defining priority sectors for investment promotion, identifying potential investors in a given sector and identifying competitor countries for inward investment. It provides data on international trade, foreign direct investment, tariff and foreign affiliated companies in 80 countries and allows analysis by sector, home and host country. It is produced by the International Trade Centre and UNCTAD in partnership with WAIPA and MIGA: [www.investmentmap.org](http://www.investmentmap.org)
- **UNCTAD Investment Compass** measures the quality of an investment environment based on six key indicators (Resource Assets; Infrastructure; Operating Costs; Economic Performance and Governance; Taxation and Incentives; Regulatory Framework) considered to have an influence on the investment environment. The Compass makes comparisons on a “horizontal” basis (one country compared to another country, or to a region, or to a ‘best performer’), as well as on a “vertical” basis (comparison between indicators for a given country): <http://compass.unctad.org>
- **UNCTAD Investment Policy Reviews** provide an evaluation of a country’s legal, regulatory and institutional framework for FDI to attract increased foreign and direct investment, as well as how to maximize the benefits from it. The review includes FDI entry and establishment, treatment and protection of investment, taxation, the business environment and sectoral regulations. Investment Policy Reviews are so far available for 27 developing countries: [www.unctad.org/Templates/StartPage.asp?intlItemID=2554](http://www.unctad.org/Templates/StartPage.asp?intlItemID=2554)





## **Thematic Review 7**

### **Access to Finance**

# 1. What does the theme cover?

## 1.1 Definition and terminology

*Access to Finance* is not a commonly used concept. For example, the Development Assistance Committee (DAC) Sector classification refers to “Banking and Financial Services” (class 240). When defining the concept of *Access to Finance* from the development perspective, a problem-driven approach may be adopted, to start from the observation that a common problem which hinders economic development in partner countries is limited access to finance. Thus, it would be more appropriate to speak of *Facilitation of Access to Finance* being any measure which improves the availability of finance in an economy. In the context of private sector development, it is then typically about the availability of finance for enterprises (including micro- and unipersonal enterprises).

*Access to Finance* relates in the first place to the provision of capital. It entails, however, more than just provision of capital. It includes a wide range of financial services, i.e. leases, savings, payments and insurance.

As far as the provision of capital is concerned, this comprises both equity and debt financing. The key difference between the two is that with equity financing the sponsor becomes an owner in the company whereas under debt financing the sponsor enters into a contract with the firm to lend money to it in exchange for receiving interest (see Table 1 for a basic comparison between the two types of financing)<sup>108</sup>. Initiatives targeted at attracting investment in general are dealt with in the thematic review *Investment Promotion and Facilitation*.

Microfinance represents one tool to improve access to financial services in particular for the poor. As the end users may be entrepreneurs/producers or simply households, microfinance is only partially related to private sector development and support to entrepreneurial activities. As is the case for *Access to Finance* in general, microfinance entails more than just microcredit. It includes a wide range of financial services, i.e. leases, savings, payments and insurance tailored to the preferences and needs of the poor. This thematic review includes a few sections on microfinance, but does not focus on microfinance as this is the object of dedicated EC Microfinance Guidelines<sup>110</sup>.

## 1.2 Rationale for intervention in developing countries

Access to finance constitutes a key ingredient for a thriving private sector. It is considered as one of the means for building a partner country's productive base which in turn helps them benefit from more open international trade and reduce poverty. For the private sector to have adequate access to finance, a functioning capital market is needed, which will efficiently and effectively allocate resources into those sectors where it can be profitably used. However, capital markets in developing countries are typically characterised by various types of imperfections and market failure which constrain access to finance<sup>111</sup>.

Table 1. Comparison of equity and debt financing

	Equity financing	Debt financing
<b>Relationship between sponsor<sup>109</sup> and firm</b>	Sponsor becomes an owner in the firm	Loan contract
<b>Role of sponsor</b>	Investor	Lender
<b>Financial reward of sponsor</b>	Financial returns from firm's profits	Interest as specified in loan contract
<b>Risk for sponsor</b>	Sponsor's investment fully participates in entrepreneurial risk (full risk sharing)	Risk of firm's default in case of bankruptcy (residual risk)
<b>Typical “securities” available for sponsor</b>	Business idea/concept Quality of management Firm's assets	Collaterals Credit guarantees
<b>End of sponsorship</b>	Sale of sponsor's ownership share; usually an exit strategy is required	Automatic upon full repayment of loan by firm
<b>Typical sponsors</b>	Private investors (individuals and firms), development banks, investment funds (venture capital funds)	Banks Microfinance institutions Loan/credit funds Informal lenders

<sup>108</sup> The distinction between equity and debt financing is not always easy, as there are also mixed forms, usually called quasi-equity. This is a type of debt financing which has some characteristics of equity financing, such as having flexible repayment options (e.g. based on the borrower's performance) or lack of securitisation.

<sup>109</sup> Sponsors as investors / funds providers

<sup>110</sup> More information on the EC approach to microfinance and examples of tools and projects is available from [www.cc.cec/dg/intranet/europeaid/activities/thematic/e2/2\\_microfinance/index\\_en.htm](http://www.cc.cec/dg/intranet/europeaid/activities/thematic/e2/2_microfinance/index_en.htm)

<sup>111</sup> This is not to say that developed country capital markets are free from imperfections and market failure, as shown by the recent financial crisis.

- According to several studies, the lack of access to finance is a critical cause of generating persistent income inequalities as well as lower growth.<sup>112</sup>
- Imperfections in the financial services sector especially affect SMEs. According to the 2005 World Development Report, small firms worldwide obtain only 5% of their financing from banks, whereas large firms meet up to 22% of their financing needs through bank loans<sup>113</sup>. Also, according to the World Bank Enterprise Surveys, SMEs list access to finance as one of the most important obstacles to doing business.

These problems clearly gained in importance with the recent global financial crisis.

### 1.3 Legal and regulatory context

There is no compulsory international legal or regulatory context which would guide access to finance interventions. Nevertheless, access to finance in developing countries is of course affected indirectly by international conventions on accounting standards and risk management, in particular the Basel II Framework on International Convergence of Capital Measurement and Capital Standards (see Box 1). Many developing countries are in the process of adjusting banking supervision to the new framework. The other actors that need to adapt to the consequences of the new financial standards and capital requirements are SMEs themselves in order to comply with stricter bank requirements.

### 1.4 Key actors and issues

#### 1.4.1 Key issues

Key issues are in particular:

- **Restrictive financial sector policies and regulatory framework:** these frequently work against the ability of commercial financial institutions to serve SMEs. Supervisory and capital adequacy requirements often prevent banks from lending to enterprises that lack traditional collateral. Also, in many countries, lack of competition in the banking sector reduces pressure on banks to reach out to SME client segments.

- **Risk perception and management capacity at local bank level:** high risk and high transaction costs – real or perceived – associated with bank lending to SMEs likewise constrain access in the absence of reliable information about SMEs (e.g. financial statements, business plans) and their creditworthiness. Lack of capacity to tailor financial services to specific needs of SMEs is equally an important issue, as is the limited experience of local lenders in new business areas, like those offered by green investments.
- **Lack of experience of SMEs as the potential clients in dealing with financial service providers.**
- **Limited outreach of financial service providers:** access to finance in rural areas and by the poorest strata of the population is often lacking in developing countries, mainly for the same reasons that also limit access to finance by micro, small and medium-sized enterprises (MSMEs); regulatory requirements which induce a bias against lending to the poor for lack of collateral. Comparatively high infrastructure and other costs of doing small scale business in geographically dispersed regions add to that.
- **Microfinance is not a solution for MSEs** (micro and small-scale enterprises): in response to the limited outreach of traditional financial service providers both in rural and urban areas, the microfinance approach was developed as a source of finance for micro-entrepreneurs and some smaller enterprises. However this, in most cases, leaves out the majority of MSEs since generally the size and the terms (e.g. repayment schedule) of micro-loans is inadequate to their financial needs. Microloans may be at times useful for working capital and to help with liquidity management, but they are mostly unsuitable to support investment (e.g. acquiring equipment, for which longer term loans with sufficient grace periods - or other types of financial products like leases - may be necessary).
- **Crowding out of the private sector by the public sector** is a further element which hinders access to finance by SMEs.

#### Box 1. The Basel II Framework<sup>114</sup>

The Basel II Framework which came into force in 2006 describes a more comprehensive measure and minimum standard for capital adequacy that national supervisory authorities are now working to implement through domestic rule-making and adoption procedures. It seeks to improve on the existing rules by aligning regulatory capital requirements more closely to the underlying risks that banks face. In addition, the Basel II Framework is intended to promote a more forward-looking approach to capital supervision that encourages banks to identify the risks they may face, today and in the future, and to develop or improve their ability to manage those risks.

At the time of writing, proposals on Basel III had just been adopted, aimed at adopting a new framework that should gradually enter into force in stages up to 2018<sup>115</sup>.

112 Banerjee, Abhijit V./Newman, Andrew F. 1993: Occupational Choice and the Process of Development, *Journal of Political Economics*, 101 (2, April): 274–98.

113 World Bank 2004: World Development Report 2005. A Better Investment Climate for Everyone, Washington DC, September 2004.

114 Source: Bank for International Settlements, [www.bis.org/publ/bcbsca.htm](http://www.bis.org/publ/bcbsca.htm).

115 [www.basel-iii-accord.com](http://www.basel-iii-accord.com)

- **Trade finance:** the importance of trade finance has been highlighted recently in relation to the contraction of world trade in 2009 and because of its immediate effects on the capability of producers in developing countries to export their goods in times of shrinking supplies of export finance. Contrary to the other key issues mentioned so far, lack of access to trade finance typically affects larger and export-oriented firms.<sup>116</sup>

#### 1.4.2 Key actors

Regardless of the area, type and level of intervention, access to finance interventions typically face a triangle of:

- Government: usually the ministries of finance and economy, as well as the central bank and, if different, the regulator or supervisory authority (for non-banking institutions);
- Financial institutions: banks, specialised companies (leasing, factoring, insurance) and other financial institutions and their organisations, service providers for the industry, e.g. credit bureaux, rating agencies;
- “Users” of finance, i.e. the private sector and its intermediary organisations.

<sup>116</sup> A good summary of trade finance concepts and issues is provided in Humphrey, John 2009: “Are Exporters in Africa Facing Reduced Availability of Trade Finance?” Brighton: IDS, March 2009, available at: [www.ids.ac.uk/index.cfm?objectid=C369D2D2-AEE3-EB77-A7847EA6F6FBF447](http://www.ids.ac.uk/index.cfm?objectid=C369D2D2-AEE3-EB77-A7847EA6F6FBF447)

## 2. What can be done?

### 2.1 Problem identification and diagnostic tools

In order to define a strategy to address *Access to Finance* issues, first it has to be determined if limited access to finance constitutes an important problem. If this is indeed the case, the causes of limited access to finance in the local context need to be identified.

#### *Determine if limited access to finance constitutes an important problem*

Identifying the problem usually does not require comprehensive original research and analysis. Often, sufficient information about the status of the financial sector in a given country or region is readily available from government institutions (such as the central bank), international organisations and donors, and economic research institutes. Whether or not access to finance is perceived as a problem by the private sectors can be determined by looking at investment climate or business environment assessments. Of course, the analysis of these details needs to be complemented by consultations with all relevant stakeholders, including representatives of the private sector (the users of finance), financial institutions (the suppliers of finance), the Government, and donors. These consultations will help prioritising needs and viewing limitations in access to finance in relation to other constraints faced by the private sector.

Two useful tools and data sources to assess the situation at country level are the following:

- World Bank ‘Enterprise Surveys’: these surveys are available for most developing countries, and are updated every three to five years.<sup>117</sup> They capture business perceptions on the biggest obstacles in a given country to enterprise growth, and the relative importance of various constraints to increasing employment and productivity. Access to finance is one of the dimensions studied. The sub-indicators used for assessing the situation with regard to access to finance include the percentage of firms with bank

loans or lines of credit; percentage of firms using banks to finance purchases of fixed assets; percentage of firms using bank loans to finance working capital; value of collateral needed for a loan or line of credit as a percentage of the value of loan or line of credit; percentage of firms identifying access to/cost of finance as a major constraint.

- World Bank ‘Doing Business Indicator’: this indicator is complementary to the Enterprise Survey. Rather than looking at constraints as perceived by the firms in their actual operations, the Doing Business Indicator shows what happens to small and medium enterprises when complying with laws and regulations. It is based on the analysis of local experts in law and accounting who interact with a large number of firms, mainly in the central business district of the country. Access to finance is addressed by the “Getting Credit” sub-indicator which explores two sets of issues: credit information registries and the effectiveness of collateral and bankruptcy laws in facilitating lending. The Doing Business Indicator is available for 175 countries worldwide and updated annually.<sup>118</sup>

#### *Identify the causes of limited access to finance*

While it is relatively easy to determine whether or not limited access to finance constitutes an important impediment for private sector development, it is considerably more difficult to identify and rank the causes for this. If we look at access to finance from a market perspective, the causes can be at the supply side, demand side, or at the match between supply and demand. Mostly, however, they stem from supply and market inefficiencies, whereas demand side problems tend to play a less important role, as described also in section 1.4.1 Key issues. It is essential that institutional mapping and institutional capacity assessment be undertaken as part of the stakeholder consultation process during the problem identification stage.

Table 2 exemplifies a way to systematise the constraints on SME access to finance.

117 For more information and data see [www.enterprisesurveys.org/ExploreTopics/?topicid=7](http://www.enterprisesurveys.org/ExploreTopics/?topicid=7).

118 For more information and data see [www.doingbusiness.org/ExploreTopics/GettingCredit](http://www.doingbusiness.org/ExploreTopics/GettingCredit).

**Table 2. Causes of / constraints on SMEs' access to finance**

<b>Market and institutional context</b>	
<b>Informational asymmetry</b> between small businesses and lenders or investors (leading to market failures and disincentives)	
Adverse <b>institutional factors</b> (unsuitable banking regulations, lack of creditor, investor and loanee protection, poor information infrastructure such as credit bureaux, ineffective payment systems, etc. <sup>119</sup> )	
<b>DEMAND side (SMEs)</b>	<b>SUPPLY side (banks, etc.)</b>
Intrinsic <b>higher risk</b> associated with small-scale activities	Sizeable <b>transaction costs</b> in handling SME financing for involved actors
<b>Lack of collateral</b> and guarantees	Relatively <b>high interest rates</b> (to cover costs and risks)
Limited ability of SMEs to submit suitable <b>business plans</b> to raise finance	<b>Lack of capacity</b> in dealing with SMEs and <b>limited SME lending portfolios</b>

There are different diagnostic tools to assess various aspects of access to finance; however, for a full assessment of the above determinants for the poor/limited access to finance by SMEs it is advisable to engage financial and Business Development Services specialists at an early stage of programme definition, in order to assess and interpret data and stakeholders' perceptions.

General tools for the assessment of access to finance obstacles at the various levels include the following:

- The World Bank's 2007 publication "Expanding Access to Finance: Good Practices and Policies for Micro, Small, and Medium Enterprises"<sup>120</sup>. This presents a policy framework whereby donors and governments can support increased access by microenterprises and SMEs to financial services based on empirical evidence and practices.
- The above mentioned World Bank Enterprise Surveys and Doing Business Indicators also provide useful information as to the particular weaknesses of the financial sector of a given country.

Tools to assess macro level obstacles for access to finance are:

- The website of the Financial Sector Assessment Program of the IMF and the World Bank includes country reports on observance of standards and codes in the financial systems of member countries identifying strengths and weaknesses of the financial system and providing recommendations on how to address shortcomings:  
[www.imf.org/external/np/fsap/fsap.asp](http://www.imf.org/external/np/fsap/fsap.asp)

- The USAID Policy and Programming Tool for Legal and Regulatory Frameworks for Access to Finance (or LRFAF) is designed to assist donors and their country counterparts to identify the conditions under which legal and regulatory reform may be warranted (and the circumstances under which it is not recommended) and to suggest various programmatic options. The tool is available at: [www.iris.umd.edu/download.aspx?ID=e2188a92-b61a-4c86-ba00-f12d8d951a2a](http://www.iris.umd.edu/download.aspx?ID=e2188a92-b61a-4c86-ba00-f12d8d951a2a)
- The IFC has developed a benchmarking tool for banks' SME operations, called "IFC SME Banking CHECK": [www.ifc.org/ifcext/gfm.nsf/Content/SMEBanking](http://www.ifc.org/ifcext/gfm.nsf/Content/SMEBanking)

## 2.2 Broad areas of intervention and key activities

The main areas of intervention are capacity building, the common element of all Commission's interventions to support access to finance, and provision of capital. These are strongly interconnected at the various levels of intervention:

- Macro level: support in formulating or implementing financial service sector policies, legislation and regulations;
- Meso level: support to financial institutions, financial service providers and their associations;
- Micro level: support to (potential) users of finance.

### 2.2.1 Capacity building

Capacity building of financial sector stakeholders is fundamental in order to tackle the obstacles of access to finance for SME in developing countries. In some cases it is necessary to combine interventions at more than one level, as empirical experience shows (see Box 2).

119 Credit bureaux and credit rating agencies provide information on individual borrowers' borrowing and bill paying records, thereby helping lenders to assess credit worthiness and the ability to pay back a loan. By reducing risk for lenders, credit bureaux can positively affect the interest rate and other terms of loans. Payment systems are used to settle financial transactions within and between financial institutions. They typically include the physical or electronic infrastructure and associated procedures and protocols.

120 Malhotra, Mohini/Chen, Yanni/ Crisculo, Alberto 2007: Expanding Access to Finance: Good Practices and Policies for Micro, Small, and Medium Enterprises, Washington DC: World Bank. [http://info.worldbank.org/etools/docs/library/236032/SMEAccessToFinance\\_Final\\_083106.pdf](http://info.worldbank.org/etools/docs/library/236032/SMEAccessToFinance_Final_083106.pdf).



### **Box 2. Donor support to reduce capital market fragmentation and increase financial institution outreach – example of a World Bank project**

In a context where a comprehensive reform of the financial sector would be unfeasible, the Financial Sector Capacity Building Project in Ethiopia (2006-2010, USD 15.6 million) assists in building the foundation for a more transparent, well-governed, well-regulated, and competitive financial sector that allocates resources to the private sector more effectively and efficiently, and helps to ensure better access to finance for all. The project has four technical components:

- Component 1 primarily helps strengthen the human and institutional capacity of the National Bank of Ethiopia (central bank) so that it can discharge effectively its key functions of regulating and supervising financial intermediaries, undertaking economic research, and formulating and implementing monetary policy.
- Component 2 strengthens financial sector infrastructure by providing financial and technical assistance for payment system modernization; improving the credit information centre; developing the capital markets infrastructure, and setting up an asset/collateral registry to facilitate secured loan transactions.
- Component 3 develops new financial products that are critical to improving access to finance and fostering financial sector broadening and deepening. It includes housing finance; leasing finance; small and medium enterprise financing; agricultural risk insurance/management; and other products, such as a venture capital fund and credit cards.
- Component 4 enhances professional skills in the financial sector. It focuses on developing in-country training capacity, including strengthening of the Ethiopian Institute of Banking and Insurance and building up the capacity of financial sector professional associations.

#### **2.2.2 Provision of capital**

Provision of capital means that funds are made available to financial institutions (both government-run development banks and private sector financial institutions) on a grant or loan basis in order for them to mobilise credit lines or other financial instruments targeted to end-beneficiaries such as SMEs. An important purpose of provision of capital is to ensure better access to capital markets for commercially-run companies by developing innovative and more effective financing instruments, including investment funds, risk capital and equity and quasi-equity investments, underwriting guarantees for private (national or foreign) investment, or supporting private sector guarantee funds (see Box 3), franchising, leasing, factoring or risk-sharing (i.e. in Asia, associating

financial institutions to clusters of enterprises – through cluster development programmes – in order to improve access to credit).<sup>121</sup> This takes place in those cases where the financial market does not have a sufficient business incentive to respond to the needs of local enterprises, and thus an element of risk-sharing is needed.

The Commission's approach is that funding for provision of capital should not be provided by the Commission directly to financial institutions or enterprises (see also §3.1). Grant funding should rather be channelled through International Financial Institutions (IFIs) which have more experience in this area like the EIB, EBRD or other specialised financial institutions, including EU Member States' development banks which provide direct finance.<sup>122</sup>

### **Box 3. Support to guarantee-providing institutions in the Southern ENP region**

In the Southern European Neighbourhood the EC has financed:

- The creation of a guarantee fund, initially managed by the EIB then transferred to two Moroccan financial institutions, to offer guarantees (up to 50%) to local commercial banks providing loans to SMEs;
- The establishment of a Seed Capital Guarantee Scheme to provide risk coverage to seed capital in Lebanon (equity and venture capital funds, private resources etc.) for funding the initial phases of innovative entrepreneurial projects.

In both cases, funding for technical assistance was also provided for ensuring an efficient set-up and organisation of the guarantee instrument.

<sup>121</sup> Franchising allows companies to expand without having to shoulder all of the associated investment requirements: by becoming franchisors they are able to sell their brand and techniques to franchisees and thus expand rapidly using the capital and resources of their franchisees. Leasing addresses financial needs of enterprises because they can get access to investment goods (production equipment, etc.) without having to finance them up-front. Rather, they pay periodic payments. Under factoring a business sells its accounts receivable (i.e. its unpaid invoices) to a third party at a discount in exchange for immediate money with which to finance its continued business.

<sup>122</sup> For more information, see [www.proparco.fr/jahia/Jahia/](http://www.proparco.fr/jahia/Jahia/) and [www.kfw-entwicklungsbank.de/EN\\_Home/index.jsp](http://www.kfw-entwicklungsbank.de/EN_Home/index.jsp).

#### Box 4. FEMIP and the ACP Investment Facility

FEMIP was launched in 2002, with the aim of enhancing the supply of financing for the private sector in the MEDA region. In this context, the Commission directly supplies the EIB with financial resources as follows:

- Risk capital and technical assistance (EU budget €128 million for the period 2007-2010): the aim is to foster the creation or strengthen equity and quasi-equity resources for SMEs in the Mediterranean partner countries.
- Technical Assistance Support Fund (EU budget €105 million for the period 2003-2008): the aim is to help the partner countries and private promoters to improve the preparation, management and supervision of their investment projects.

The ACP Investment Facility is a €3.35 billion risk-bearing instrument financed from the EDF since 2003. It aims at fostering private sector investment in the ACP countries, in particular through global loans to local financial institutions. In addition, the EIB can lend up to a further EUR 1.7 billion to the ACP countries from its own resources.

Examples of EC grants to investment facilities which have been entrusted to the EIB include the Facility for Euro-Mediterranean Investment and Partnership (FEMIP), the ACP Investment Facility (see Box 4) and more recently also other investment facilities (Neighbourhood, Central Asia, Latin America).

An innovative mechanism to support investments in renewable energy and energy efficiency is the Global Energy Efficiency and Renewable Energy Fund (GEEREF), a public-private partnership drawn from the Patient Capital Initiative. Structured as a “fund-of-funds” and running for 15 years, the GEEREF’s strategy is to invest

#### Box 5. Successful combination of technical assistance and direct provision of capital – the SMEDF II, Vietnam (2003–2009)

The Small and Medium Enterprises Development Fund (SMEDF II), Institutional Support for Lending Institutions in Vietnam. The objective of the project was twofold:

- To create and operate a revolving financing facility – the SMEDF – in order to offer medium to long-term financing to selected commercial banks for on-lending to SMEs;
- To strengthen the institutional capacity of the Vietnamese Development Bank and a selected group of intermediary banks in dealing with the financing needs of SMEs.

The lending component was combined with specific training for the selected commercial banks in order to enhance their understanding of SMEs’ financial needs and their capacity to develop / promote tailored services.

The positive impact of SMEDF II can be attributed to the combination of provision of capital and capacity building. Unlike in the programme’s first phase, where capacity building of banks had been planned but was never implemented, training activities constituted a key activity in the second phase and comprised the following:

- On-the-job training of staff at the Vietnamese Development Bank (VDB)
- Training of participating banks’ top management to introduce strategic thinking and management in SME lending
- Training of participating banks’ staff and later of SME managers to introduce new appraisal techniques and management skills for bankers and SME managers
- Outsourcing to a training organisation (Bank Training Company, Bank Academy) which had a high direct impact on the development of BTC and new local trainers
- Provision of a website with free access to training materials and financial modelling for business planning.

These activities, in combination with the establishment of a small but targeted medium and long term fund had a relevant impact on the selected banks’ portfolio, increased the diversity of SME lending products and strengthened their reputation as SME bankers.

in private equity funds whose investments target small- and medium-sized projects in the areas of energy efficiency and renewable energy.

The experience of other donors shows that the simple provision of capital may not be sufficient to bring about change, but it has to be combined with capacity building in order to strengthen regulatory as well as financial institutions. Recent ADB's and IFC's evaluations<sup>123</sup> have shown that the simple provision of capital (credit lines) in Asia did not allow for the achievement of the expected results in terms of private sector development. As a result, the ADB has shifted towards policy-based lending, coupled with technical assistance to support the implementation of the reforms in financial service institutions and financial sector policies.

Conversely, capacity building can benefit from the combination with direct financing because the provision of direct capital can give more leverage to the capacity development activities.

The Small and Medium Enterprises Development Fund in Vietnam (see Box 5) is an example of a programme which became more successful in its second phase, when capacity building was provided alongside the provision of capital, as opposed to a difficult first phase which focused on provision of capital.

## Microfinance

One area within *access to finance* which has received substantial attention during the past decade is microfinance. Support to sustainable microfinance means supporting the development of domestic financial systems that work for the poor and in particular segments of population that are not served by traditional banks. To do so, it is necessary to strengthen local providers of financial services to poor populations (microfinance institutions), underpinning networks of providers and the financial industry infrastructure (meso-level), and set up appropriate regulatory frameworks (macro-level) in order to improve their outreach, efficiency and sustainability. Lack of institutional and technical capacities especially at the level of banks and microfinance institutions (MFIs) is one of the main bottlenecks for developing domestic financial systems that serve the poor. Grants are an appropriate instrument for capacity building in microfinance.<sup>124</sup>

As a public donor, the EU complements available commercial sources for microfinance by focusing its support on institutional capacity building and working with partners that have an established track record in microfinance and the necessary monitoring capacity in place to ensure the quality of their actions. The Guidelines for EC Support to Microfinance (2008) fully reflect this approach and include criteria for selection of eligible grant beneficiaries and types of interventions, measuring performance in microfinance, and guidance on end-of-project strategies for revolving funds. This is also the approach adopted by the EU/ACP Microfinance Framework Programme (see Box 6).

### Box 6. The EU/ACP Microfinance Framework Programme – a success case<sup>125</sup>

The Programme provided grant support in three areas of intervention in ACP countries:

- Eleven capacity building initiatives selected following a Call for Proposals addressing issues such as diversification of financial services, application of technology in microfinance, expansion of services to underserved markets and enhancement of transparency on financial and social performance.
- Co-funding of microfinance institutions' ratings in order to improve information available on their risks and performance and to promote transparency and stimulate improvements industry-wide, and of microfinance information systems upgrades for ACP financial institutions.
- Initiatives undertaken by the Consultative Group to Assist the Poor focusing on promoting institutional and product diversity, building transparency in financial and social performance reporting, enhancing regulatory and policy frameworks in ACP countries, and scholarships for ACP policymakers (central bank, ministry of finance, etc.) to attend an intensive microfinance training programme.

123 ADB 2008: Support for Financial Intermediation in Developing Member Countries. Evaluation Study, SES: REG 2008-71, December 2008. IFC 2006: Access to Finance for Small and Medium Enterprises (SMEs), IFC Monitor, No. 3, June 2006, and IFC 2008: Access to Finance. Highlights Report 2008.

124 See the Good Practice Guidelines for Funders of Microfinance endorsed by the members of the Consultative Group to Assist the Poor (CGAP) which includes the EC at [www.cgap.org/p/site/c/template.rc/1.9.2746](http://www.cgap.org/p/site/c/template.rc/1.9.2746).

125 See [http://ec.europa.eu/europeaid/where/acp/regional-cooperation/microfinance/about/about\\_en.htm](http://ec.europa.eu/europeaid/where/acp/regional-cooperation/microfinance/about/about_en.htm); Tsilikounas, Caroline 2008: Mid-term Evaluation of EU/ACP Microfinance Framework Programme. Final Report, 25 July 2008.

**Table 3. Broad areas of intervention and key activities**

Intervention level	Broad areas of intervention	Key activities
<b>Macro level</b>	Financial sector policies and regulatory frameworks	<ul style="list-style-type: none"> <li>• Reform of financial sector policies</li> <li>• Support to improve banking regulations and supervisory systems</li> </ul>
	Strengthening regulators and supervisory authorities	<ul style="list-style-type: none"> <li>• Provision of training and advice to central bank on supervision and banking regulations</li> <li>• Provision of training and advice to financial sector regulators and supervisory authorities</li> <li>• Strengthening of national/regional training institutions for the financial sector</li> </ul>
<b>Meso level (financial institutions and BDS providers)</b>	Strengthening financial institutions (financial service providers)	<ul style="list-style-type: none"> <li>• Assistance to associations of banks and non-banking financial institutions to develop their capacity to create awareness amongst their members on issues and opportunities related to enhanced access to finance for SMEs</li> <li>• Establishment of SME finance units within commercial banks and training of their staff on SME lending (e.g. on risk management, collateral / alternative requirements, cash flow based lending)</li> <li>• Strengthening expertise of service providers (incl. MFIs) e.g. in auditing, financial and risk management, accounting systems, management of information, etc.</li> <li>• Support to rating agencies for microfinance (incl. R&amp;D and performance assessments)</li> <li>• Strengthening of business support organisations in order to enhance their capacity to provide information and advice to SMEs in the area of finance</li> </ul>
	Development of financial infrastructure	<ul style="list-style-type: none"> <li>• Support to the creation / strengthening of financial information infrastructure (credit bureaux, credit reference services<sup>126</sup>, collateral registers, rating agencies)</li> </ul>
	Development and delivery of financial services	<ul style="list-style-type: none"> <li>• Product development (including trade finance and export guarantees<sup>127</sup>, microfinance products).</li> <li>• Provision of capital to investment funds for onward funding</li> <li>• Provision of capital to banks and MFIs: equity, loans, guarantee funds</li> <li>• Provision of grant funding for risk-sharing and capacity building in relation to start-ups and green-field investments (for MFIs)</li> </ul>
<b>Micro level</b>	Facilitation of access to finance for SMEs <sup>128</sup>	<ul style="list-style-type: none"> <li>• Support to enterprises in finding financial information, preparing bankable business plans and/or loan applications (i.e. through SME support centres/schemes)</li> <li>• Pre-investment feasibility studies and due diligence<sup>129</sup> assessments for local enterprises</li> <li>• Information dissemination to SMEs</li> </ul>

<sup>126</sup> These institutions provide checks of the creditworthiness of potential borrowers and contribute to the improvement of repayment discipline. Their databases are accessible only to approved subscribers, having reason to check on a particular person or company, usually because of a need in their normal business (bankers, financiers, traders, securities firms, insurance companies, credit and charge card companies and legal firms).

<sup>127</sup> Export guarantees are insurance policies aimed at protecting exporters against non-payment by importers. They can be provided by export promotion agencies and include the insurance cover on an ad valorem fee that takes creditworthiness of the importer and country risk into consideration.

<sup>128</sup> Programmes focusing on access to finance and funded by the Commission do not provide financial services directly to enterprises, but they tend to involve or associate organisations which are capable of providing financial services, because these represent essential services for SMEs development.

<sup>129</sup> Due diligence refers to the degree of care and caution required before making a decision, in this case a financial and technical investigation to determine whether an investment is sound.

## 3. How can it be done?

### 3.1 Methods and levels of intervention

One of the key decisions to be taken when designing *access to finance* interventions concerns the choice of the appropriate aid modality – i.e. is the project approach suitable, is direct provision of capital appropriate, or is budget support the adequate modality?

Experience with budget support for *access to finance* is limited. The relevance of stakeholders from the private sector in the financial and capital markets do not contribute to make this area a frequent candidate for budget support. Another element not playing in favour of budget support is the lack of simple conditions and indicators in this area. Moreover, partner countries often need substantial technical assistance to redesign and strengthen financial services sectors in order to facilitate access to finance for the private sector. Government could not be held directly accountable for performance measured through indicators that would rely at least to an extent on market dynamics. Thus the project approach is likely to continue to be the implementing modality in the area of *access to finance*.

The direct provision of capital for the financial sector is in general entrusted to International Financial Institutions (IFIs). This is also the Commission's approach, in particular by providing capital through "facilities" managed by the European Investment Bank.

### 3.2 Expected results and results measurement

The definition of suitable indicators for results measurement in *access to finance* is more difficult for programmes at the macro level than for meso or micro-level projects. For example, it is more difficult to measure the quality of a new regulation establishing new rules on loan collaterals than an increase in beneficiary bank loans to SMEs. Overall, the design of macro level projects is particularly complex, with standard blueprints hardly usable. Table 4 provides selected indicators for *access to finance* interventions.

### 3.3 Cross-cutting issues

Cross-cutting issues on which access to finance interventions may have an impact include gender and environment.

#### 3.3.1 Gender

Access to finance is commonly considered as a gender-based barrier. Examples of barriers faced by women entrepreneurs include:

- Legal and socio-cultural obstacles such as lack of personal identification documents held by women; lack of collateral as property is often registered under the husband's name; or need to obtain husband's permission/counter signature.
- Higher default risk perceived by banks due to limited information about performance of women entrepreneurs, lack of confidence by (often male) loan officers in women entrepreneurs, etc.

Although this has generally not been the practice in past interventions (see Box 7), *access to finance* initiatives can address at least some of these barriers by incorporating components that address gender issues (i.e. training activities, awareness-raising events, and advocacy). These issues need to be mainstreamed into any *access to finance* initiative, and require an analysis of gender issues as from the design stage. Monitoring indicators should be disaggregated by gender, as indicated in section 3.1 above.

Part of the very rationale for the provision of microfinance is its objective of poverty reduction. Since women often constitute the most vulnerable segment of population (and enjoy the reputation for rigorous payment discipline), some microfinance programmes specifically target women and they often have a positive impact on their situation and environment.

#### Box 7. Financial sector projects and gender issues<sup>130</sup>

It may be politically sensitive to support programmes directly aimed at inducing policy, institutional or cultural changes to address structural impediments to women's access to financial services, such as projects that improve women's inheritance rights and their access to typical collateral resources such as land and other property. However, there are some good practices in this area. Because identity documents can be problematic for women seeking microfinance and other services, a GTZ project in Egypt helped educate women on recent changes in national policy that have reduced requirements for documentation and helped women to get identity documents and legal assistance.

**Table 4. Selection of results and indicators for measurement**

<b>Results</b>	<b>Indicators</b>
<b>Financial sector policies and regulatory frameworks reformed and improved</b>	<ul style="list-style-type: none"> <li>• New financial laws and regulations published</li> <li>• Banking regulations and supervisory systems in place</li> <li>• Improvement of the country's ranking in World Bank's Doing Business "Getting Credit": <ul style="list-style-type: none"> <li>– Legal Rights Index (degree to which collateral and bankruptcy laws facilitate lending)</li> <li>– Credit Information Index (rules affecting the scope, access, and quality of credit information)</li> </ul> </li> </ul>
<b>Regulators and supervisory authorities strengthened</b>	<ul style="list-style-type: none"> <li>• Number and types of training programmes and advisory services provided to: <ul style="list-style-type: none"> <li>– Central Bank on supervision and banking regulations</li> <li>– Financial sector regulators and supervisory authorities</li> <li>– National/regional training institutions for the financial sector.</li> </ul> </li> <li>• Organisational charts of the organisation showing increase in staff and functions</li> </ul>
<b>Financial institutions (financial service providers) strengthened</b>	<ul style="list-style-type: none"> <li>• Number and types of associations of banks and non-banking financial institutions assisted through training and advisory services in order to develop their capacity to raise awareness amongst their members on issues and opportunities related to enhanced access to finance for SMEs</li> <li>• Number and geographic coverage of events and campaigns to promote awareness on access to finance for SMEs organised by associations of financial institutions</li> <li>• Number and geographic coverage of SME finance units established within commercial banks and number of staff trained on SME lending (e.g. on risk management, collateral requirements, cash flow based lending)</li> <li>• Number and types of local service providers (incl. MFIs) providing services e.g. in auditing, financial and risk management, accounting systems, management of information, etc.</li> <li>• Publication of ratings by rating agencies for microfinance (incl. R&amp;D and performance assessments)</li> <li>• Number and amounts of loans provided to financial institutions/of equity participations in investment funds</li> <li>• Increases in the number and variety of services to SMEs in the area of finance by business support organisations</li> </ul>
<b>Financial infrastructure set up / developed</b>	<ul style="list-style-type: none"> <li>• Increase in the number of operational credit bureaux, credit reference services, collateral registers, rating agencies</li> </ul>
<b>Financial services tailored to enterprises (and in particular to SMEs) developed, and delivered</b>	<ul style="list-style-type: none"> <li>• Breadth of portfolios of financial services for SMEs (broken down by gender, sector, type of enterprises)</li> <li>• Quality of loan portfolios / collection performances (portfolios at risk, loans at risk, recovery rate)</li> <li>• Average amount of outstanding loan per client / enterprise</li> </ul>
<b>Access to finance for SMEs facilitated</b>	<ul style="list-style-type: none"> <li>• Increase in the number of loan applications by SMEs</li> <li>• Percentage of successful loan applications by SMEs (broken down by gender, sector, type of enterprises)</li> <li>• Number of SMEs participating in public information events on financial services</li> </ul>



### 3.3.2 Environment

Initiatives on capacity building in the field of **access to finance** usually do not specifically address environmental issues. Initiatives providing direct capital are entirely different in this regard. They can address environmental issues in two ways. First, finance facilities can be established which are dedicated exclusively to environmental issues, e.g. by providing finance only for energy saving investments. Second, funds can mainstream environmental issues by requiring environmental impact assessments or environmental due diligence prior to disbursing funds (or providing guarantees). Such assessments are necessary because an investment may have a negative impact on the environment, as a firm can use loans provided under a donor supported credit scheme for an investment in production processes which may turn up to be harmful to the environment.

### 3.4 Risks

This thematic review provides sufficient reference to the need to ensure the link between technical assistance and provision of capital in the design of programmes aimed at improving access to finance for SMEs. It is clear that the appropriate reforms of the legal and regulatory framework are essential to underpin the efforts of meso-level institutions to develop financial services tailored to emerging enterprises in general and SMEs in particular. Concessional finance may be needed at various levels of the financial system, but in providing capital it is crucial to avoid the risk of creating a situation in which countries depend on subsidies from public donors. The purpose of subsidised funding should be to support pilot initiatives and new approaches, fill gaps that are not addressed by conventional capital market, reduce real or perceived risks and transaction costs of local financial institutions and engage them to support SMEs.

## 4. Where to find out more?

The following sources can be useful in the process of designing access to finance interventions.

### *Tools for identifying the problem - investment climate or business environment assessments*

- The World Bank Doing Business Indicator provides measures of business regulations and their enforcement across 181 economies and selected cities at the sub-national and regional level. Sub-indicator for access to finance: [www.doingbusiness.org/ExploreTopics/GettingCredit](http://www.doingbusiness.org/ExploreTopics/GettingCredit)
- World Bank Enterprise Surveys cover 114 countries and assess business environment as experienced by firms, performance measures, firm characteristics, and perceptions regarding obstacles to growth. They are complementary to the Doing Business Indicator, being based on surveys of individual firms. Sub-indicator for access to finance: [www.enterprisesurveys.org/ExploreTopics/?topicid=7](http://www.enterprisesurveys.org/ExploreTopics/?topicid=7)

### *Diagnostic tools, guidelines and good practices for diagnosis and strategy definition*

- EuropeAid 2008: Guidelines for EC Support to Microfinance  
[www.cc.cec/dgintranet/europeaid/activities/the-matic/e2/2\\_microfinance/operational\\_guidance\\_and\\_tools](http://www.cc.cec/dgintranet/europeaid/activities/the-matic/e2/2_microfinance/operational_guidance_and_tools)
- IFC 2008: Access to Finance. Highlights Report 2008.
- The website of the Financial Sector Assessment Program of the IMF and the World Bank includes country reports on observance of standards and codes in the financial systems of member countries: [www.imf.org/external/np/fsap/fsap.asp](http://www.imf.org/external/np/fsap/fsap.asp)
- USAID/IRIS: Legal and regulatory reform for access to finance. A policy and programming tool, available at: [www.iris.umd.edu/download.aspx?ID=e2188a92-b61a-4c86-ba00-f12d8d951a2a](http://www.iris.umd.edu/download.aspx?ID=e2188a92-b61a-4c86-ba00-f12d8d951a2a)
- Malhotra, Mohini/Chen, Yanni/ Criscuolo, Alberto 2007: Expanding Access to Finance: Good Practices and Policies for Micro, Small, and Medium Enterprises, Washington DC: World Bank.

### *Web links*

#### Banking and Finance - general

- IFC Access to Finance site:  
[www.ifc.org/ifcext/sme.nsf/Content/Access\\_to\\_Finance](http://www.ifc.org/ifcext/sme.nsf/Content/Access_to_Finance)
- OECD DAC Evaluation Resource Centre – banking & financial sector:  
[www.oecd.org/findDocument/0,3354,en\\_35038640\\_35039563\\_1\\_35102003\\_1\\_1\\_1,00.html](http://www.oecd.org/findDocument/0,3354,en_35038640_35039563_1_35102003_1_1_1,00.html)
- World Bank Research Website on Access to Finance – The Unfinished Agenda (conference report, presentations, working papers):  
<http://go.worldbank.org/JT5BIZL290>

#### Microfinance

- The Consultative Group to Assist the Poor (CGAP) is an independent policy and research centre housed by the World Bank. CGAP's website provides best practices, recommendations, case studies and research related to microfinance: [www.cgap.org/p/site/c/home](http://www.cgap.org/p/site/c/home)

#### Trade finance

- The International Trade Centre's Trade Finance Programme provides guides, working papers and a database of trade finance institutions: [www.intracen.org/tfs](http://www.intracen.org/tfs)

#### Gender issues

- Toolkit on mainstreaming gender equality in EC development cooperation  
<http://ec.europa.eu/europeaid/sp/gender-toolkit>
- IFC's Gender Tools and Resources related to Access to Finance  
[www.fias.net/ifcext/sustainability.nsf/Content/Gender\\_Tools\\_AccessToFinance](http://www.fias.net/ifcext/sustainability.nsf/Content/Gender_Tools_AccessToFinance)

#### Environment and climate change issues

- Guidelines on the integration of Environment and Climate Change in Development Cooperation, 2009  
[http://ec.europa.eu/europeaid/infopoint/publications/europeaid/172a\\_en.htm](http://ec.europa.eu/europeaid/infopoint/publications/europeaid/172a_en.htm)

## **Thematic Review 8**

### **Competitiveness**

# 1. What does the theme cover?

## 1.1 Definitions and terminology

### 1.1.1 Exploring the concepts

In addition to external barriers to trade, many developing countries (DCs), in particular the least developed, tend to face internal, supply-side constraints that severely inhibit economic growth due to the limited competitiveness of their economies.

Competitiveness is a function of the levels of

- **productivity** (that allows for more competitive pricing and/or wider margins),
- **diversification** (which offers more choice to the consumers and more opportunities for market access to suppliers) and
- **quality** (that may help in differentiating a product or service and secure more up-market segments or specifically regulated markets).

Given the importance of enhancing competitiveness of developing countries by supporting the development of their private sector, this Thematic Review focuses on a few selected issues which are key to the strengthening of productive capacities and to the promotion of innovation, while taking the ‘enterprise’ as the analytical entry point.

This document therefore reviews the role of value chains, clusters, industrial upgrading and sectoral approaches in fostering economic growth and harnessing market forces to achieve development goals. It also addresses the concept of innovation as an essential factor for finding new solutions to production/delivery processes, widening the choice of products and services and improving their design, quality and cost-effectiveness.

The concept of ‘Strengthening Productive Capacities’ (SPC) refers to the ability to deliver goods efficiently, in terms of time, cost, and quality. UNCTAD defines productive capacities as “*the productive resources, entrepreneurial capabilities and production linkages*”<sup>131</sup>, which together determine the capacity to produce goods and services”.

In order to analyse and address competitiveness gaps, a ‘system map’ may help in visualising its key elements and their environment. As shown in the system map in Figure 1, each firm utilises a specific combination of core production and innovation capacities that may be influenced by endogenous, intermediary, and exogenous factors (i.e. factors that can be addressed at micro, meso and macro levels).

At enterprise level, the core elements in such a map include the following:

- **Inputs and supplies** are all raw materials or semi-finished goods necessary for the production process.

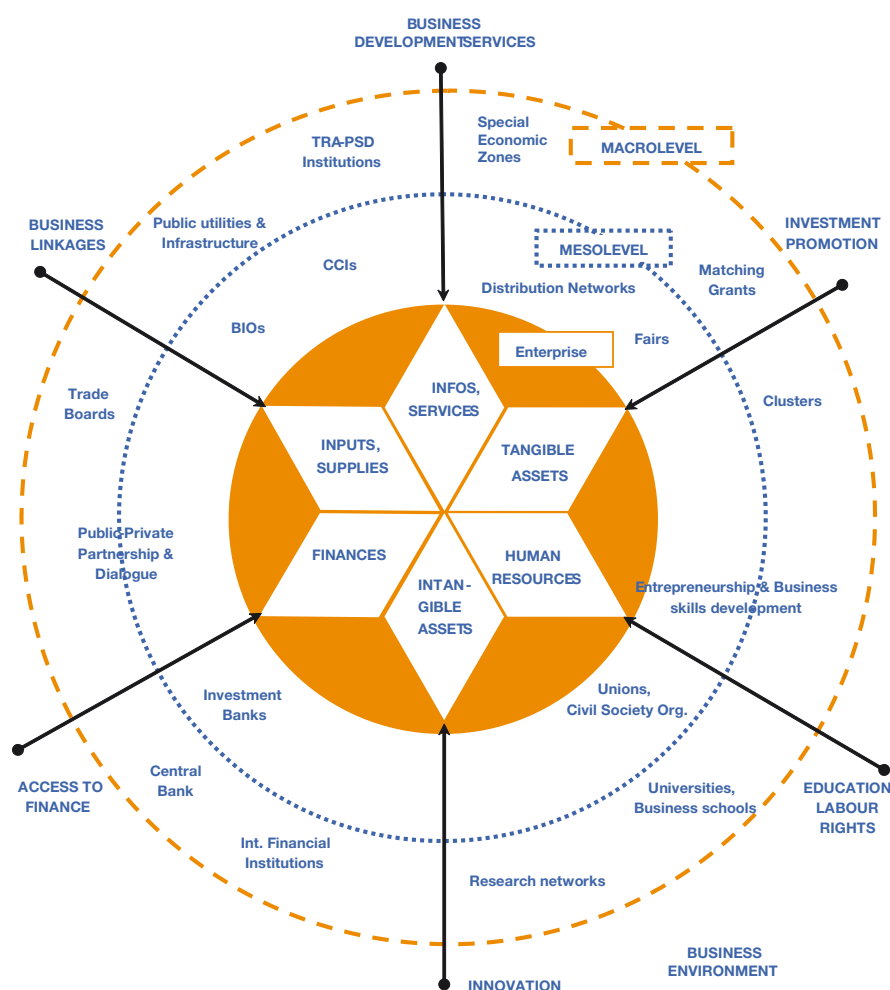
- **Information and service** capacities aim at building the capacity of the enterprises in different fields: technical, commercial, financial, legal, institutional, etc.
- **Tangible assets** include ‘current’ assets such as inventory/stock, ‘liquid’ assets (cash and bank accounts), and ‘fixed’ assets (land, buildings, equipment, furniture).
- **Human resources** are the vectors for the different skills and functions: managerial, administrative/operational, financial, technical and design-related/innovative.
- **Intangible assets** refer to intellectual capital and property rights (e.g. copyrights, trademarks, franchises, brand and trade names, patents and software) as well as to more fluid and informal factors such as entrepreneurial and innovative attitude, customer network, business image and reputation, social capital, etc.
- **Finance** is the ability to face short-term and long-term expenses of the enterprise.

These competitiveness core factors at the firm level are surrounded and affected by many other elements as illustrated in the map:

- At **macro level**, competitiveness relates to improving the relationships of production systems with domestic markets and/or the global economy. The so called ‘business enabling environment’ (i.e. policies, strategies, legal and regulatory framework and relevant implementation capacities by national and local administrations), sector-specific or inter-sectoral schemes, the extent and quality of industry- and market-related infrastructure etc., all have the potential to support or hinder the competitiveness of an enterprise, an industry or a country.
- At **meso level**, competitiveness of firms is influenced by linkages with and capabilities within their partners such as financial institutions, marketing agents/distribution networks, suppliers and service providers, business intermediary organizations, training institutions, R&D institutes, etc.
- At the **micro level**, competitiveness of the individual firm can be enhanced by increasing the efficiency in the combined use of factors, both at strategic level (e.g. product/service development, business planning – including new marketing strategies, process re-engineering, managerial upgrade) and operational level (rationalisation of production processes, standards compliance, adoption of appropriate technology and equipment, sourcing of relevant financing, etc).

<sup>131</sup> This TR addresses some aspects of vertical (backward, forward) and horizontal linkages to be promoted at the level of value chains and/or clusters. On the issue of facilitating linkages, inter-firm ones and ones involving business intermediary organisations (BIOs), see also the Thematic Review on Business Development Services (BDS).

Figure 1. System map of competitiveness factors



Competitiveness is therefore not a static concept, but evolves due to the following change drivers:

- **Capital accumulation** – increasing capital stock through investment
- **Technology and design-based innovation** – introducing new/improved goods and services or methods of production/delivery through transfer and adaptation of technology and design capabilities.
- **Process innovation** – the implementation of a new or significantly improved production or delivery method (which may introduce additional efficiencies and/or better quality assurance)
- **Structural change** – change in the inter- and intra-sectoral composition of production, and in pattern of linkages amongst sectors and enterprises and along value chains
- **Evolving demand** in the destination markets<sup>132</sup>
- **Evolving supply** in the inputs or intermediary markets (supplies, energy, technology; BDS, financial services)<sup>133</sup>
- **Changes in the business environment**, different 'rules of the game'.

The Thematic Reviews on Business Enabling Environment, Business Development Services, Access to Finance and Investment Promotion cover a range of exogenous and intermediary elements that directly or indirectly affect competitiveness. As already mentioned, in this Review, the focus is on approaches to enhance competitiveness from the points of view of productive capacities and innovation (through value chain and cluster development, industrial upgrading, etc.) by tackling endogenous factors more directly.

### 1.1.2 Main definitions

Productivity is a ratio used to measure how efficient an entity is in converting inputs (factors of production, combined with resources such as technology and information) into outputs (goods or services). Ratios such as 'output per worker' and 'output per hour' are measures of labour productivity, i.e. an efficiency ratio. Total factor productivity (TFP) takes into account the variations in capital and shifts in technology. This indicator is more

<sup>132</sup> Including emergence of new opportunities, such as those offered by the green economy, or the climate change mitigation and adaptation needs.

<sup>133</sup> See previous footnote.

useful for comparing productivity levels across countries or regions. Such measurements are significant, because higher productivity levels translate in lower production costs, thus increasing competitiveness. Productivity can be influenced by various changes in key productive capacities, and in particular innovation may bring in new processes and technologies that facilitate efficiency and rises in TFP.

Innovation is a continuous, dynamic process of successful conception, production, assimilation and commercial exploitation of new products, services and processes, which takes place within a defined economic, legal and regulatory framework and is driven by competition. Innovation can be either 'radical' or 'incremental'.

Innovation can, moreover, take two distinct paths. Companies develop a solution (or ask scientists to do so) for a specific business problem. This is a demand-driven, "PULL" method. In other cases, scientists develop a new technology that can be valuable in production or service delivery in both technical and economic terms, and then search for commercial applications. This is a supply-driven, "PUSH" method. Depending on whether innovation is supply-pushed (based on the new technological possibilities) or demand-led (based on the social needs and market requirements) a different approach will have to be taken in stimulating or supporting innovation.

The main activities related to innovation are R&D (research and development activities), other acquisition of knowledge (patents, licences, technical services, etc.), acquisition of machinery and equipment (both incorporating new technology or already established but needed in producing a new product), and various other actions taken in relation to production/delivery, including equipment upgrading, staff training, new marketing strategies, etc.

Innovation comes in different types: product/service, process, marketing and organisational innovation, as outlined below.

- **Product/service innovation:** the introduction of a good or service that is new or significantly improved with respect to its characteristics or intended uses. This includes significant improvements in its design<sup>134</sup>, and the relevant technical specifications, materials, components, and incorporated software.
- **Process innovation:** the implementation of a new or significantly improved production or delivery method. This includes significant changes in techniques, equipment and/or software. Lean production

processes can bring about substantial savings in terms of input required, while at the same time have a positive impact on the environment and the natural resources base.

- **Marketing innovation:** the implementation of a new marketing method involving significant changes in product presentation or packaging, product placement, promotion and/or pricing.
- **Organisational innovation:** the implementation of new organisational methods and systems in the firm's business practices, workplace, production line and/or external relations.<sup>135</sup>

The aspects of innovation on which this Thematic Review focuses are **product/service and process innovation**.<sup>136</sup>

A comparative advantage<sup>137</sup> (of a country, industry or firm) is the ability to produce a product more efficiently than other operators, resulting from access to certain resources. On the other hand, a competitive advantage is created by combining more efficiently than others different resources, primarily knowledge and technology. Comparative advantages are said to be 'static', as they may be surpassed by using competitive ones, which are typically 'dynamic'<sup>138</sup>. Cumulative advantages derive from the ability to capture suppliers' advantages, combining these into a final product specifically responding to market needs.<sup>139</sup>

Regarding the exchange of goods or services, several linkages connect different businesses such as primary producers, processing industries, and service providers (e.g. traders, forwarders, insurers)<sup>140</sup>, forming a nexus of links referred to either as a 'value chain' or as a cluster.

A value chain<sup>141</sup> constitutes a coordinated economic system of inter-related actors and operations, organized around a particular commercial product or service, adding value progressively from its conception to placement on the final market. Nowadays 'global' value chains are production networks spanning continents and involving thousands of players organized in segmented systems. Elaborating the final product involves the cascading contributions of enterprises in different sectors, each of these organized around a typical activity.<sup>142</sup>

By contrast, clusters are characterized by a geographical concentration of competing, complementary and inter-dependent firms and other economic actors of a same sector or sub-sector of the economy, where assembling in one space may have advantages in terms of access

<sup>134</sup> Including functionality, ergonomics, eco-design and aesthetics - as appropriate.

<sup>135</sup> Oslo Manual (2005), OECD/Eurostat

<sup>136</sup> Forms of marketing and organizational innovation that may be promoted at the firm level can be the object of Business Development Services (e.g. through support to business planning, training, mentoring, etc.). See Thematic Review on BDS for more details.

<sup>137</sup> A full definition can be found on the site of the Peterson Institute: [www.piie.com/publications/chapters\\_preview/47/3iie2644.pdf](http://www.piie.com/publications/chapters_preview/47/3iie2644.pdf)

<sup>138</sup> As for their determinants, refer to "The Competitive Advantage of Nations", Porter M., (1998), Free Press, New York.

<sup>139</sup> For example, Nigeria is rich in hydrocarbons and has a comparative advantage in crude oil production accounting for some 80% of its GDP, but must purchase fuel abroad since the oil refineries are incapable of meeting the internal demand. Saudi Arabia, by diversification through a long-term planned programme, has built a competitive advantage first by controlling oil refineries, then by investing into operations with a high degree of processing, and now by engaging in the construction of integrated petro-chemical complexes to produce chemicals and plastic products.

<sup>140</sup> Adapted from GTZ, "Value Links Manual. The Methodology of Value Chain Promotion" (2009), [www.value-links.de/manual/distributor.html](http://www.value-links.de/manual/distributor.html)

<sup>141</sup> The term market chain, less used, refers to the succession of actors actually owning the product up to end users.

<sup>142</sup> For example, the value chain for production of TV sets will combine sectoral contributions from plastics (injection), electronics (components, assembly), glass, light industry (metal parts, screw, springs...), etc.



to infrastructure, energy, supplies, subcontracting, services, distribution, etc.

Integration is one of the processes by which enterprises can increase their competitiveness. **Vertical integration** occurs when companies take control of suppliers (seldom clients), in order to benefit from their advantages (e.g. a car firm that is expanding into manufacturing of motor blocs and tire molding). **Horizontal integration** occurs when a firm is merged with another in the same industry and at the same node of the value chain / stage of production as the merger firm.

**Differentiation** involves work on branding, marketing, packaging, labelling and general presentation of the product, or modification of product details, materials and features to enhance quality and/or expand choice. It consists as well in expanding product offerings such as after-sales services and guarantees, so that the product is perceived as 'different' and more desirable from other products of the same type in the same market. Branding strategies and marketing techniques therefore contribute towards differentiation. Eco-labeling, fair-trade labels, environmental certification can also offer opportunities for differentiating products and accessing new markets, while also being able to reap a higher benefit.

**Diversification** is another market growth strategy, aiming at increased sales volumes from new products and new markets. Diversification can occur either at the business unit or at the corporate level. At the business unit level, it is most likely to expand into a new segment of an industry in which the business is already. At the corporate level, it is about entering a promising business outside of the scope of the existing business unit: it is achieved through vertical integration both upstream and downstream, or through horizontal / geographical diversification. In other words, diversification is about 'creating' new products/services, for new markets. Diversification is typically the riskiest of the four strategies but may lead to the highest returns, especially in the long run.

'**Human resources**' or '**human capital**' refers to an enterprise's skills and knowledge embodied in human beings, which may be acquired through education, training, and access to information. In DCs, the poor health of employees is cause of high absenteeism and turnover levels, hence lower productivity. The inadequate skills level leading to inconsistent quality of products, and the poor market and enterprise relations ending in instability of supply chains, are also recurrent problems in DCs. Human resource management (HRM) refers to managing the people of an organization, so as to gain an optimum output from a given number of staff. Part of this includes human resource development (HRD), defined as a combination of on-the-job and other forms of training and education. The extent to which firms have access to adequate human resources, manage them well, avoid their de-skilling and in fact support their continuous

development, may have a substantial impact on competitiveness levels, for reasons linked to both productivity and innovation.

An entrepreneur initiates, organizes, manages and assumes the risks and reaps the benefits of a (new) business. The most obvious form of **entrepreneurship** is that of starting new businesses, but it can also apply to promoting and fostering productive change within an existing organization. Schumpeter's definition of entrepreneurship is strongly linked to innovation: entrepreneurship in this sense would be about creating, promoting, or tapping into new products, markets, production processes and forms of organization.

## 1.2 Rationale for intervention in developing countries

The link between economic growth and poverty reduction is partly determined by the competitiveness of firms, which in turn is influenced by productivity and diversification. The latter can be enhanced through different ways of strengthening productive capacities or innovating, such as cluster and value chain development, industrial upgrading, sector-based approaches, introduction of new designs, technologies or processes. Developing economies however are often dualistic, with low productivity sectors usually employing the majority of population, and more productive sectors benefitting from investment (FDI and, to an extent, domestic investment), and from technology transfers from developed countries or from more advanced countries within their region. Low productivity levels in DCs are often determined by inadequate infrastructure (transport, energy and communication), underperforming or energy-wasting equipment, inappropriate work conditions, and low skill levels.

Innovation is considered as one of the means for building a country's competitiveness and constitutes a key ingredient for a thriving private sector. For the private sector to be successful, a functioning "innovation system" is needed, which will efficiently and effectively exploit resources in those sectors where they can be best and most profitably utilized. The right policies and enabling environment can help countries fulfill their potential and enable a better quality of life for their citizens. Innovation has proven instrumental for enabling developing and middle-income economies to leapfrog to higher stages of development and fostering economic and social transformation, while at the same time embarking on a more sustainable economic growth path through the adoption of cleaner technologies or eco-innovation. However, some parts of the world are more innovation-friendly than others, based on a number of gaps at the micro, meso and macro levels. Interventions are thus needed in order to spark and strengthen innovation processes – in particular those that have the potential to bring substantial benefits to the more disadvantaged sections of the population (through pro-poor economic

growth). Figure 2 shows the inter-relation between different factors influencing competitiveness, and the ultimate goal of poverty reduction.

The enhancement of competitiveness by strengthening productive capacity and innovating in a developing country's economy can contribute towards socio-economic development and poverty reduction through four main channels:

- The **employment channel** - more and better jobs for unemployed and underemployed people because of expanding economic activities with higher productivity
- The **price channel** – lower and more stable prices of goods and services
- The **governance channel** - more government revenues available for funding public services
- The **productivity/diversification channel** – through reducing dependence on imports, expanding exports and increasing choice and quality available to consumers.

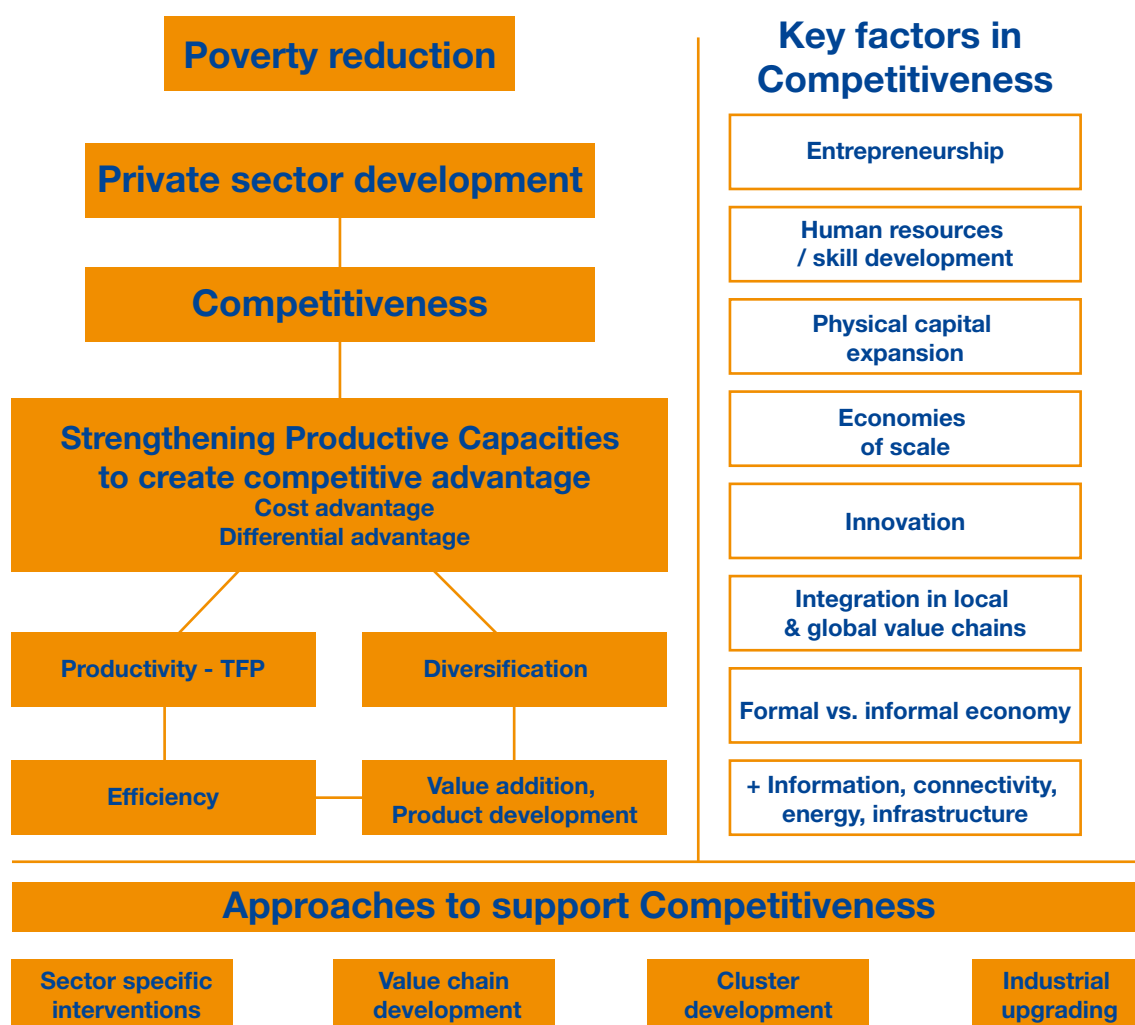
Reciprocally, reducing poverty and enhancing sustainable economic growth also affects positively productive capacities and competitiveness through three channels:

- The **human development channel** - through overall increased spending on education, health, nutrition and skill development
- The **consumption channel** - increasing demand from consumers stimulates the full use and growth of productive capacities
- The **entrepreneurship channel** - through reduced insecurity, less short-termism and more risk-taking.

### 1.3 Legal and regulatory framework

While there is no particular legal and regulatory framework to which one might refer when it comes to competitiveness issues and strengthening productive capacities, certain components of the overall legal and regulatory framework can be seen as being particularly conducive to the promotion of innovation and competitiveness:

Figure 2. Competitiveness and poverty reduction (concept map)



- A reformed legal and regulatory framework relating to the overall business enabling environment
- The legislation, jurisprudence and institutional framework concerning Intellectual Property Rights (see the Thematic Review on IPR)
- Technical regulations imposing standards which incorporate the present state of technological progress (see the Thematic Review on Quality infrastructure)
- Specific sets of rules favourable to promote competitiveness and innovation: fiscal and other incentives (e.g. tax credits, grants for research and development activities).

## 1.4 Key actors and issues

### 1.4.1 Key actors

**Enterprises** are of course the primary actors in the process of enhancing competitiveness. Especially in those economic sectors where the minimum efficient scale of production (MES) is relatively low (e.g. some specific sub-sectors such as agro-processing, garments, leather, crafts, furniture, etc.), the lower barriers to entry make this type of enterprises the repositories of inclusive economic development, creating jobs and self-employment, as well as opportunities for skills development and innovations in local products and appropriate technologies.

**Business Intermediary Organisations (BIOs):** their actual roles range from the one consisting in advocacy and lobbying to the one providing an information hub as well as business development services. BIOs include in particular chambers of commerce and trade and business associations.

**Enterprise and local development agencies** are usually created to accompany the implementation of economic policies at times focused on SMEs. Though they may be sometimes impeded by bureaucratic approaches and insufficient capabilities for outreach and capacity building, their role as executing bodies may be crucial especially as clearing houses or national platforms for initiatives on SME development in the country.

The various institutional components of the **quality infrastructure** play an equally important role: organisations such as national standard setting bodies, metrology bodies, laboratories, accreditation bodies and other. Their capacity and role need to be taken into account in interventions supporting competitiveness (see the Thematic Review on Quality infrastructure).

**Technology and research institutes** (including universities) may play a role in stimulating and supporting innovation, tracking new production and marketing trends, and piloting their transfer and application in country. In order to be relevant and effective, they need to be sufficiently driven by the industry and markets

needs, and also to be well connected with the multiple stakeholders in the innovation and technology dissemination processes. Where their funding comes from the private sector, this is usually a sign that research is quite industry-relevant.

The **financial sector** (the Central Bank, other regulatory and supervisory bodies, the financial infrastructure – credit bureaus, training institutes, etc – as well as the individual financial institutions – banks, leasing companies, investment companies, credit unions and cooperatives, export credit agencies, MFIs, etc.) play a key role in the financing of enterprises and in particular of investments (in tangible and intangible assets and other resources) necessary for productivity increases and innovation.<sup>143</sup>

### 1.4.2 Key issues

Developing competitive advantages is crucial. Different types of strategies at firm or sector level can be adopted to that end. In DCs, the most important are the following:

#### *Cost-based competitiveness strategies*

- Increasing productivity and efficiency
- Developing access to large amounts of low-cost inputs
- Developing external service providers to allow for cost-effective outsourcing
- Facilitating access to suppliers, so as to produce inputs at a lower cost, or to reduce dependency
- Investing in production assets/capacity to exploit economies of scale (also by horizontal integration)
- Review and rationalise manufacturing or service delivery methods
- Improving distribution channels.

#### *Diversification and differentiation-based competitiveness strategies*

- Gaining an advanced knowledge of market trends and consumer expectations (for consumer goods)
- Investing in creative design and product development
- Developing horizontal integration (in a way to integrate with design-oriented actors in the same field)
- Strengthening branding, marketing and sales capabilities
- Gaining certification for quality management standards (e.g. ISO 9000, 14000) and private/voluntary standards, e.g. Ökotex (organic textiles), UTZ, Rain Forest and other forest stewardship schemes, and GlobalGap (food-related products).

In DCs, progress towards diversification has been mixed. Some countries in the upper-middle income group (e.g.

143 See also the Thematic Review on Access to Finance.

Thailand, Mexico, Malaysia) have successfully diversified their production for domestic trade and export. Several others are still facing constraints, such as the lack of adequate knowledge in product, service, or process development, the inadequate industrial development and economic diversification policies and regulatory framework (also in relation to standardization, innovation, R&D, investment) and generally a lack of market incentives to invest into new (and potentially competitive) areas of business. Market development strategies are constrained in DCs by the size or nature of, and access conditions to national or regional markets. Some countries (such as Indonesia, Egypt and Vietnam) enjoy both a growing domestic demand and the proximity of developed economies' markets and therefore have better incentives and opportunities to invest in diversification strategies.

### Constraints for innovation

The innovation environment in developing countries is often complex and problematic, characterised by poor business and governance conditions, low education levels, sub-optimal use of the labour market and a lack of infrastructure. These factors inhibit both entrepreneurship, productivity and innovation, thus hindering overall competitiveness. In addition, the business sector is often composed of a large number of micro-enterprises operating in the informal economy. The pool of foreign based firms may be more or less important but the latter tend to be disconnected from the rest of the economy. In this context supporting innovation at a grass-root level is important. Indigenous knowledge and the local context are key factors in identifying opportunities for innovation. Often innovation is born out of the blending of indigenous knowledge with technological and organisational inputs from the developed world. Also, resource constraints may make it necessary to proceed by incremental product and process improvements.

To make an innovation system work effectively, several aspects have to be taken care of. There must be (i) science, both hard and soft aspects (ii) product development, with technological and other aspects suited to consumer groups and (iii) entrepreneurship, as it offers the arena for innovation to take place and be tested.

### Typical barriers to entry

A barrier to entry is "a cost of producing which must be borne by a firm seeking to enter an industry, but which is not borne by firms already in the industry"<sup>144</sup>. These barriers may include high start-up, fixed and transaction costs, or sunken costs reflecting the need for additional investment due to trade-related regulations (SPS-TBT, rules of origin), IPR barriers (patents, trademarks), etc.

The following conditions affect the extent of entry barriers that may be faced by firms in a specific market, and need to be taken into account for realistic and effective interventions:

- **Market entry and other economic conditions:** high ratio of fixed to variable costs (e.g. for need of specific equipment or technology); cost advantages created by economies of scale and resulting in asymmetric costs of entry; difficulties with product development; costs of advertising for gaining a share of the market and developing consumer loyalty;
- **market interdependence** (especially in oligopoly): competitors' reactions that may take various forms of marketing warfare and retaliation;
- **information barriers:** limited knowledge of market dynamics, customer preferences, inadequate business organizations.

Because of their context and competitiveness constraints, SMEs from DCs suffer more from barriers to entry in the global market. In particular, they may be less able than SMEs in developed countries to do the following:

- to establish economies of scale, due to lack of, and poor linkages with, the necessary suppliers and providers in-country;
- to secure cost advantages because of lower productivity, lack of proprietary low-cost product design and processes, or lack of preferential access to necessary inputs;
- to develop different products, due in particular to inadequate R&D capacities and weak market knowledge.

### Need for business and entrepreneurial skills

Enterprises in DCs often lack basic entrepreneurial and business-related skills, which may heavily affect their productive capacities and ability or propensity to innovate. Gaps may be found at the various points of the planning, production, and distribution cycle, hence specific BDS may be needed.<sup>145</sup>

Entrepreneurs will face different constraints and have different needs depending on their social group (youth, women, ethnic minorities, marginalised groups) or location (urban, rural). In rural areas, the needs of a would-be entrepreneur may be similar to those in urban areas, but are usually compounded by isolation, difficult access to markets, and to a lesser extent by the lack of self-confidence and/or recognition by the community<sup>146</sup>. Youth entrepreneurship is specifically constrained by limited resources and life/work experience.

144 Stigler, Georges, cited in the American Economic Review, Vol. 94 N° 2, pp 461-465, accessed on Nov. 2009 at [www.jstor.org/pss/3592928?cookieSet=1](http://www.jstor.org/pss/3592928?cookieSet=1)

145 Issues concerning business and entrepreneurial skills are covered by the Business Development Services (BDS) Thematic Review.

146 Ex: some initiatives in India and Kenya have been successful in deploying ICT in support of rural entrepreneurs. E-Choupal, E-Shakti and Drumnet programmes, led by ITC Ltd, India Lever LLC, and Pride Africa respectively, combine the provision of business services, the set up of internet- or cell phone-based information systems, and linkages between rural entrepreneurs and their markets.

### *Relevance of the informal economy and resulting constraints*

As the informal sector constitutes a major part of the local economy in many DCs and provides a good extent of jobs and income to a large portion of the population that otherwise could not be absorbed by the public sector of formal businesses, it is essential to consider its role in the analysis of a country economy or economic sector whose competitiveness needs to be enhanced. In certain economic sectors the informal economy also provides a number of products and services, thus it is an essential (although often not sufficiently productive) actor in the local value chains. It can therefore not be ignored.

The informal sector covers a wide range of economic activities that can be classified by three sub-sets underpinned by different strategies:

- **Survivalist activities**, such as casual or unpaid jobs, subsistence agriculture, or holding multiple jobs ('straddling').
- **Illegal earning strategies** that include unofficial business activities (tax evasion, avoidance of regulations, labour and others) and underground activities (corruption, fraud, black market).
- **Profitable businesses** (usually *MSEs*) for which high registration and transaction costs act as a deterrent from formalisation. The informal economy largely evades state regulation, and this represents a gap in the national fiscal revenue. Although there are several definitions of the informal sector, and statistics on this part of the economy are often lacking or not fully reliable, it has been estimated that such firms tend to account for approximately one third of production and one half to three-quarters of the non-agricultural labour force in DCs.

The informal economy provides an extent of flexibility (e.g. in terms of low barriers to entry and exit from markets) that makes it particularly suited to the coping strategies of low-income or marginalized/disadvantaged social groups. Because of its buffering capacity, the informal sector plays a key role in social and political stability, both in countries suffering from crises and conflict, and in transition economies when structural changes, modernization or downturns result in shrinkage of employment in the formal sector<sup>147</sup>.

It is quite complex and labour-intensive to gather data on the productivity, innovation and growth barriers of informal enterprises, as well as their spillover effects and linkages with the formal economy<sup>148</sup>. A key issue is how to identify those informal economic activities that have a true potential for increasing their productivity, differentiation or diversification and hence competitive advantages.

<sup>147</sup> On this aspect, GTZ states that reducing poverty entails reinforcing the people who work in the informal economy. Raising their productivity generates tangible effects on income. (cf. GTZ web site pages on informal economy)

<sup>148</sup> This tends to be measured and analyzed for very specific target groups at the project level. Aggregate data that may gauge the problem at a sector level are difficult to obtain.



## 2. What can be done?

### 2.1 Problem identification and diagnostic tools

#### 2.1.1 Problem identification

When preparing interventions on enhancing competitiveness, a first crucial step is to assess stakeholders' capacities and needs in a systematic and comprehensive manner. The assessment may be able to draw on pre-existing data and documents, such as the Diagnostic Trade Integration Studies for LDCs (implemented through the multi-donor facility Enhanced Integrated Framework), the World Bank country studies, or other programme-related assessments. These broad analyses of the economy and its trade and competitiveness potential aim to identify constraints and opportunities for the country's participation to international trade, key economic sectors/sub-sectors or even specific value chains or clusters within/across those sectors. Enterprise should be taken as an analytical entry point in a problem-based approach<sup>149</sup>.

Examples of key questions relating to competitiveness factors can be organized on three levels (refer also to Fig 1):

**a. Macro-level** (business environment and investment climate):

- What are the country's policies in the relevant areas, in particular those relating to the business environment, industrial development, competitiveness/innovation, business education, vocational training and quality standards/infrastructure?
- Is competitiveness included in national development plans or strategies (including the Poverty Reduction Strategy Paper, where applicable)?
- How is the legislative and regulatory framework related to business, industrial production and innovation (incl. IPR and fiscal and other incentives)? What are the main gaps?
- How does the country compare in the region for the Ease of Doing Business Indicators?
- Are there important limitations to productivity with respect to infrastructure at the national level (e.g. transport, energy, communication)?

**b. Meso-level** (intermediary markets, and the operational context of firms):

- Have any recent studies and research on productive capacities and/or innovation been carried out? Are they focused on SMEs or other segments of the economy?

- Have industry and other business associations adequate representation and advocacy skills? Are they involved in competitiveness issues? Are they equipped to deliver relevant services to their membership/sector?
  - Are there existing clusters, innovations hubs, industrial parks, export consortia, common facility centres, special economic zones or other structures/initiatives set up to promote productivity and innovation? What has been their experience so far?
  - What kind of service providers (especially for BDS and financial services) are available for the firms/clusters that have a key role in the productive and innovative capacity of the target area?
  - What is the link between research centres / technology institutes, or other bodies related to R&D and design, and the key economic actors of economic (sub) sectors and value chains with a good potential for competitiveness?
- c. Micro-level** (the enterprises -- referring to a representative sample in the targeted area/sector or sub-sector, specific node of the value chain, or selected cluster, etc.):
- Does the firm have a strategy and/or overall business plan? Is it geared towards building its competitive advantage?
  - What is the level of in-house business and technical skills? Is the firm able to outsource the necessary design skills?
  - Are there problems with the availability/quality of supplies, equipment, technology, infrastructure, utilities?
  - Have firms adequate access to financial solutions, especially investment-related finance for SMEs?
  - Have firms sufficient access to market information, trends in consumer preferences, and related innovation potential?
  - What is impeding the enterprise to establish supply chain linkages or to climb up the value chain?
  - What is the overall perception of challenges by the business owner/manager in that specific sector/industry?

#### 2.1.2 Diagnostic tools available

Various diagnostic tools can be used in order to assess competitiveness from the point of view of productive capacities and innovation issues, in order to ensure the relevance and strategic focus of the intervention.

<sup>149</sup> This means looking at productivity and innovation issues from the standpoint of the typical enterprise in the selected sector/area, and analyzing its constraints and needs at firm, intermediary and business environment level.



The following tools may be relevant at different points in time, i.e. during identification and formulation (should for example enterprise or sectoral surveys not be available) or during the inception or implementation phases of a project.

### *At firm level*

ITC's "Competitive Edge"<sup>150</sup> is a software-based checklist that can be made available to national partner institutions. The partner operates the tool, enabling enterprises to assess their international competitiveness. Customizable by sector, it covers marketing, sales and exports, organization and management, financial control, production records, and helps in prioritising areas of action.

PHAROS<sup>151</sup>, developed by UNIDO, is a software package for measuring, monitoring and benchmarking strategic business performance of enterprises. It can be complemented by the use of other modules such as the Business Environment Strategic Toolkit (BEST), a decision support tool.

"Imp3rove" is an SME competitiveness assessment tool developed with the support of EC's Innova<sup>152</sup> for European SMEs. "Imp3rove" tests the firm's innovation management capabilities, and benchmarks its performance against other competitors. The benchmarking is followed by different kinds of feedback and technical assistance. However, as "Imp3rove" is designed for European SMEs, it may need adaptation to a developing country environment.

The two other tools are similar by scope (any SME context) and conception and are proprietary software.

### *At sector level*

The Porter Diamond tool can be used for the analysis of key drivers of competitiveness: factor and demand conditions, related and supporting industries, firm strategy, market structure and rivalry, government influence / institutional factors. It is a comprehensive conceptual framework, however it allows for qualitative assessment only.

The Participatory Appraisal of Competitive Advantage (PACA)<sup>153</sup> combines the above Porter Diamond analytical concept with rapid / participatory appraisal in order to identify quickly implementable activities that can stimulate local economic development.

### *Value chain-related*

The World Bank Group's Foreign Investment Advisory Service (FIAS) has developed a guide<sup>154</sup> on "Moving towards Competitiveness: A Value Chain Approach". The tool identifies constraints to industry growth and competitiveness through Value Chain Analysis (VCA). It includes useful methodological pointers on process mapping of industry chains, establishing benchmarks for performance indicators, as well as on the analysis of political and institutional factors affecting business performance. An important preparatory step for the VCA includes sector choice, which can be determined by criteria such as contribution to GDP, export earnings, attractiveness for private investment, job creation and local value added.

GTZ has published a comprehensive and action-oriented handbook for value chain promotion, the "Value Links Manual" (2007), structured in 12 modules. The first three modules constitute assessment tools for evaluating potential limits or strengths of value chain promotion, the selection of a value chain and its analysis<sup>155</sup>.

USAID has also published various tools for assessing value chains. In the checklist for implementing value chain and enterprise development<sup>156</sup>, the analysis and screening start from country, sector and the value chain contexts, then follows with linkages, business models, economies of scale, and value addition.

Amongst the above tools, the FIAS and GTZ handbooks are the most comprehensive. The PACA method, which requires external facilitators, has a broader focus on local development.

### *At national level*

UNIDO proposes the Industrial Development Report and Scoreboard<sup>157</sup>, meant to assess and monitor the development of industry. The scoreboard is based on a number of indicators that measure a country's industrial productive capacity, growth and other key characteristics and trends at country level. The list of indicators is divided into performance indicators and technology-based variables. The performance indicators cover economic, social and environmental dimensions of industrial performance. The technology-based indicators assess variables affecting industrial capabilities such as modern infrastructure, skills, research and development activities, inward foreign direct investment, acquisition of technology, and imports of capital goods.

150 [www.intracen.org/ec/edge/bepartner.htm](http://www.intracen.org/ec/edge/bepartner.htm)

151 [www.unido.org/index.php?id=863](http://www.unido.org/index.php?id=863)

152 Europe INNOVA is an EC-funded initiative within the Competitiveness and Innovation Framework Programme 2007-2013 Entrepreneurship and Innovation Programme (CIP-EIP).

153 [www.paca-online.de](http://www.paca-online.de), [www.paca-online.de/docs/The\\_Donor\\_Guide\\_to\\_PACA.pdf](http://www.paca-online.de/docs/The_Donor_Guide_to_PACA.pdf). Developed by Mesopartner (a knowledge firm that specialises in territorial development, competitiveness and innovation).

154 [www.ifc.org/ifcext/fias.nsf/AttachmentsByTitle/MovingTowardCompetitiveness/\\$FILE/Value+Chain+Manual.pdf](http://www.ifc.org/ifcext/fias.nsf/AttachmentsByTitle/MovingTowardCompetitiveness/$FILE/Value+Chain+Manual.pdf)

155 [www.value-links.de/manual/distributor.html](http://www.value-links.de/manual/distributor.html)

156 <https://www.businessgrowthinitiative.org/BGIProducts/Documents/Checklist%20complete%20final%20formatted.pdf>

157 <https://www.unido.org/index.php?id=661>

The Harvard<sup>158</sup> model of ‘product space’ builds on the fact that not all products are alike in terms of impact of their production on long term economic development. Specializing in some goods will bring higher growth compared to specializing in others. For any given product, tools allow for measuring the income potential, the number of other products connected to it (‘path’), and the technological gaps to be covered for producing it (‘density’). The combination of these measures for the country’s range of exports forms the ‘product space’ that can be depicted in maps showing how closely this basket matches what other countries produce. It illustrates the ‘distance’ to be covered, in terms of capability and assets needs, and therefore the structural change to be undergone by a country for successful diversification of products and market destinations. It thus allows for analyzing the country’s possibilities in the light of its technological and social capabilities. This model has been applied for example by the Asian Development Bank in Malaysia, Philippines and more recently by the World Bank in the Lao PDR<sup>159</sup>.

When specifically analysing the case for fostering innovation in a given country, it is necessary to assess the country’s ‘*readiness to innovation*’ and develop insights into the strengths, weaknesses and opportunities of the country’s innovation-related policies and practice. The assessment areas usually relate to:

- Existing innovation policies and institutions, relevant legal and regulatory framework
- Existing R&D institutions/resources and educational/training systems
- Sectoral capacities to initiate or absorb innovation (at firm / cluster level, or along value chains)
- Overall business environment, investment climate and infrastructure.

The Business Growth Initiative (BGI) has developed the enterprise development diagnostic tool MEASURE<sup>160</sup> which assists in understanding changes in enterprise performance, behaviour and decision-making, and how those changes are impacted by the business environment. MEASURE provides a snapshot of the overall state of enterprise development in a country. It consists of an assessment of enabling environment indicators, and an enterprise survey. MEASURE checklists and methods are freely available.<sup>161</sup>

‘The Global Innovation Rankings and Report 2008-2009’, a joint publication by INSEAD and the Confederation of Indian Industry, is an example of a framework for assessing countries’ innovation readiness (its 2008-2009 edition covers over 130 countries). The report brings together indicators to measure innovation performance,

taking into account the country’s ability to draw the best advantage from leading-edge technologies, expanded human capacities, better organisational and operational abilities and improved institutional performance. The framework is based on five ‘input pillars’ (‘Institutions and Policies’, ‘Human Capacity’, ‘General and ICT Infrastructure’, ‘Market Sophistication’ and ‘Business Sophistication’), defining aspects of the conducive environment required to stimulate innovation within an economy. Furthermore, the framework includes 3 ‘output pillars’ (‘Knowledge Creation’, ‘Competitiveness’ and ‘Wealth Creation’), which provide evidence of the results of innovation within the economy.

## 2.2 Broad areas of intervention and key activities

The objectives of competitiveness initiatives mainly relate to improving productivity and stimulating innovation (which in its turn can increase both efficiency and diversification) at country, sectoral, value chain or firm/cluster levels. Taking the enterprise as an analytical entry point, interventions addressing competitiveness will target the needs of the firm, which can be unrolled also to meso and macro levels, as relevant.

The projects and programmes aiming at enhancing competitiveness will as a rule take the form of SME support programmes with several components as detailed below.

### *Promotion and support of innovation*

An important step for promoting and supporting innovation is to bridge industry needs and scientific capabilities, by developing relevant contacts and by promoting and sharing the development of new products and processes on various levels.

In DCs, firms and especially SMEs are not amenable to rapidly adopt innovations, hence awareness raising, information sharing and demonstration pilots can prepare the ground for more innovative local economies. Support programs can also be designed for the identification and dissemination of adequate mechanisms to facilitate the exploitation, private financing and transfer of technologies and research results, while guaranteeing protection of the knowledge acquired. In case of limited resources, programs may facilitate the creation of resources centres, the set-up of joint ventures, or the pooling of SMEs (e.g. into clusters, economic zones, industrial parks). Technological incubators can support new SMEs emerging from the business application of innovations.

Interventions related to innovation have to take into account baseline levels of overall development as well as technical and business-related skills. Differences in institutional capacities need also to be taken into

158 Hausmann R. and Klinger B., “The structure of product space and the evolution of comparative advantage”, CID working paper No 146, 2007; and Hausmann R., Hwang J., and Rodrik D., “What you export matters”, CID paper No123, 2005, Kennedy School of Government, Harvard University.

159 Record, R. and Nghardsayone “Export dynamics and diversification in the Lao PDR: An analysis of the product space”, 2009, the World bank, [http://siteresources.worldbank.org/INTLAOPRD/Resources/293582-1236825229768/5910147\\_1266221816570/3\\_LaoTradeBriefingNote1.pdf](http://siteresources.worldbank.org/INTLAOPRD/Resources/293582-1236825229768/5910147_1266221816570/3_LaoTradeBriefingNote1.pdf)

160 <https://www.businessgrowthinitiative.org/BGIProducts/Documents/MEASURE%20Ethiopia%20final.pdf>

161 BGI was established by USAID’s Office of Economic Growth of the Bureau for Economic Growth, Agriculture and Trade (EGAT/EG).

consideration. Moreover, depending on whether a ‘push’ or ‘pull’ approach is adopted, the intervention framework will be different: a supply-driven push approach tends to be more capital intensive and will require the establishment of R&D institutions, as opposed to a demand-driven approach where product innovation emanates from local customers’ needs and preferences, and can be achieved through incremental changes in product/service design and in the production process.

### *Support to technology development and investment*

Access to technology is crucial for innovation and for strengthening productive capacities in allowing incremental gains in productivity (output). Inputs on methods and organization of business without change in technology mostly result in low marginal gains. Technology development is also often a prerequisite for different forms of innovation that result in product diversification and quality improvement, which are needed to secure effective competitiveness effects.

Development interventions for enhancing technology levels can include the following activities:

- Support to *research activities* by specialised institutions and/or by firms’ in-house R&D structures;
- *Technology transfer* through match-making, purchasing of patents and licenses, South-South sharing of technology and expertise through dedicated programmes/facilities (e.g. at regional level);
- *Better linkages*, through business partnerships or sub-contracting;
- *Technology diffusion* from other sectors.

Investment is perhaps the fastest way to access technology<sup>162</sup>. FDI allows global firms to disseminate technologies, to increase technical capabilities and skills,

and to impart the relevant organizational and managerial practices to their business partners and other firms in host countries, thus enhancing their competitiveness. Domestic investment in response to competition with imported goods (technology content of imports) also enables local enterprises to gradually upgrade their equipment and processes.

It is noteworthy that diaspora and migration, via exposure and the accumulation of knowledge, may allow a widening of country capabilities, provided the returning persons have a favourable environment to share and apply such knowledge.

### *Promotion of entrepreneurship*

The debate is still open on the respective influence of nature and culture in entrepreneurial behaviour. Yet, evidence exists that entrepreneurial abilities can be nurtured through embedding entrepreneurship-relevant curricula in the education system, and through schemes to encourage, train and assist start-ups at the local level. A review of entrepreneurship programmes in Europe and Latin America<sup>163</sup> indicates that best practices in supporting entrepreneurship include:

- Support for country-level policy-making and measures that encourage entrepreneurship such as: incentives (e.g. grants and soft loans, venture capital backing, national awards), the provision of information and other resources, specific taxation measures (tax freezes and credit), enabling business regulations, support to start-ups (hosting and coaching).
- Focus on *identifying local/regional assets* and converting these into entrepreneurial activities. An untapped resource (such as a local valuable fruit) is used as a starter for new ventures, as for example in Morocco by the Amal cooperative (argan oil production) with the support of the International Development Research Centre and the Canadian

#### **Box 1. Ghana Regional Appropriate Technology Industrial Service – GRATIS III (2000-2006), €4.35 million**

The program’s overall objective was to support the development of the emerging industrial sector in Ghana, by promoting the dissemination of appropriate technologies among micro and small enterprises. Specific objectives were to strengthen the ability of GRATIS and regional centres to develop and deliver specialised training programmes and technology transfer services. Sound participatory project design, combined with relevant technical assistance inputs, led to the programme having over-achieved the expected results. The number of technological solutions adopted and of apprentices trained was above target, and GRATIS introduced support to entrepreneurs in addition to their project work plan<sup>164</sup>. The project has laid the foundation for an independent, local institution.

<sup>162</sup> For details on investment promotion, refer to the relevant Thematic Review.

<sup>163</sup> Cf. Kantis et al., ILO/Cinterfor, [www.ilo.org/public/english/region/ampro/cinterfor/temas/employer/pymes/doc/des\\_emp.htm](http://www.ilo.org/public/english/region/ampro/cinterfor/temas/employer/pymes/doc/des_emp.htm). Entrepreneurship policies differ depending on countries’ level of development, but differ more in their targeting and scope rather than by their delivery methods. Where LDCs will strive to create more primary processing MSMEs by targeting individual entrepreneurship, DCs would aim at improving competitiveness by targeting innovation/entrepreneurship within or around existing firms.

<sup>164</sup> GRATIS Foundation evolved out of the Ghana Regional Appropriate Technology Industrial Service (GRATIS) Project, which was established by the Government of Ghana in 1987 and mandated to promote small-scale industrialisation in Ghana. To accomplish this mandate, GRATIS established Intermediate Technology Transfer Units (ITTUs) now designated Regional Technology Transfer Centres (RTTCs) in nine regions of Ghana to transfer appropriate technologies to small-scale industrialists through training, manufacturing and the supply of machine tools, plants and equipment. Instead of phasing out GRATIS after the establishment of the RTTC network, the GOG and other stakeholders agreed that it should be incorporated as a company limited by guarantee called GRATIS Foundation. This is to enable the Foundation to play a key role in Ghana’s plans to become a middle-income country by the year 2020.

## Box 2. The Village Business Incubator, Syria

The Village Business Incubator (VBI)<sup>165</sup> was established through an EC co-funded, NGO-implemented project to promote women entrepreneurship in Syria. It supports entrepreneurship in the local value-added economy by offering a package of services including business counselling (orientation, training and business planning), product development (with firm-level work by international and local designers), finance facilitation (access to micro-finance suited to crafts and agro-processing enterprises), marketing and promotion. Successful products have been developed and marketed, and number and viability of women-led enterprises has increased in line with expected results. Despite initial challenges with training and retaining adequate human resources and with reaching a critical mass of clients, the VBI has now attained financial and institutional sustainability.

### Micro-Enterprise Development Programme, Nepal

Another relevant approach is the UNDP Micro-enterprise Development Programme in Nepal, that starts by building awareness among communities, and then goes on to screen and select potential entrepreneurs. The programme uses different micro-enterprise creation and development packages, developed in collaboration with local institutions. The typical training has four modules consisting of (i) development of entrepreneurial competency, (ii) business identification and selection, (iii) market and marketing concepts, and (iv) preparation of business plans.

International Development Agency. A pristine rural landscape and lifestyle may also become the foundation of economic growth, as exemplified by GTZ projects in Lao PDR to develop eco-tourism.

- **Generating community support** for entrepreneurship (awareness raising, support networks, common facility centres).
- **Securing/developing support services** for new entrepreneurs through technical assistance and business management training, business planning/counselling, access to finance, regulatory guidance, exposure to local, regional and international markets, etc.

### Productive capacities in the informal sector

Interventions aimed at enhancing the productive capacities of a country or economic sector, would support informal economic operators in the following cases:

- When there is a **particular poverty reduction focus**: Informal economic activities often do not require specialised skills<sup>166</sup>, and often involve in DCs social groups that have limited access to vocational training and education (elderly, women and youth). Engaging such groups may require interventions combining productivity enhancement (e.g. training in technical and business skills, access to appropriate technology, support to marketing) and aspects of social development (awareness raising and support on hygiene and sanitation, health and safety, family planning/reproductive health, child labour, etc).
- When there is **employment generation potential**: The informal sector can provide relevant services or inputs to formal sector enterprises, hence improving its

performance may be instrumental to strengthen specific segments of a value chain. Creating awareness, facilitating organization and linkages/sub-contracting between the two areas may result in synergies: gains in flexibility and cost reduction for the firms, and increase in business volume and employment for informal sector operators. This in turn may facilitate the formalisation of these operators.

- When vocational training can help to **link the informal to the formal economy**: as mentioned above, even if they remain informal, MSMEs can play an important role as suppliers in value chains, but adapted management and technological competence are the prerequisites for this. However, employees and the self-employed avoid contact with governmental facilities when they are in need of advice or training, because they fear inspection and sanctions. Also, formal training courses are seldom tailored to their needs: they are too long, too costly and spatially and thematically “too far away”<sup>167</sup>. It is therefore crucial to design and deliver appropriate forms of training and capacity building, that can both enhance productivity and encourage incremental transformation towards more formalised business practices.

Because of the challenges mentioned above, civil society organizations, NGOs, or local aid networks may play a crucial facilitation/implementation role, given their field knowledge, and engagement with authorities for policy/reform purposes. Bottom-up approaches are deemed necessary, where results and findings from fieldwork would (ideally) nurture dialogue and the shaping of institutional/regulatory arrangements needed to sustain impact. However, lessons learnt indicate the following conditions for formalization: i) a minimum number and concentration of operators, ii) sufficient potential for

165 [www.vbi-lattakia.org](http://www.vbi-lattakia.org). Project implemented by AIDOS and Syria Trust for Development.

166 Or entail skills that can be learnt on-the-job, e.g. through imitation or informal apprenticeships.

167 [www.gtzt.de/de/dokumente/en-skills-development-for-employment-informal-sector.pdf](http://www.gtzt.de/de/dokumente/en-skills-development-for-employment-informal-sector.pdf)



### Box 3. Waste management in Maputo (AGRESU, phase I, 2003-2007)

Within the project “Waste management in Maputo”, the municipality and GTZ are jointly improving waste management. The project’s approach is based on participation and market economy principles, whereby waste is viewed as an independent sector. The project initiated and supported cooperation between the public sector, the private sector, and the catadeiros (informal waste sorters). The latter have been trained and organized into cooperatives, enabling them to carry out joint activities more efficiently and to a higher standard of safety, hygiene and service. Public sector was required to provide space and sorting equipment throughout the city, and the latter accepted to contract the cooperatives for handling the waste collection / treatment. The industry committed to take back waste for recycling. Outcomes of the project are: i) a reduction in environmental pollution, ii) an increase in the use of recyclables due to higher volume and easier availability of these raw materials, and iii) organization of the poor from the informal sector into cooperatives, which resulted in more and better jobs, and higher income.

competitiveness gains to ensure positive cost-benefit ratios (both for Government and operators), and iii) adequate awareness level among partners.

Activities for the gradual insertion of informal operators into the mainstream economy may include support for:

- Building of communities/ activity groups,
- Networking of sections of the informal economy with good potential,
- Education and vocational training,
- Linking to processing companies or markets, placement services,
- Awareness raising on potential benefits of formalisation,
- Performance/ productivity enhancement (e.g. access to small equipment),
- Basic security and safety improvements,
- Setting up suitable business rules or ad hoc work contracts,
- Access to other financial and non-financial services for informal micro-enterprises.

The two following areas of intervention are very relevant for enhancing competitiveness but are often the subject of specific programmes.

### *Standards and competitiveness*

As shown in more detail in the Thematic Review on Quality infrastructure, standards compliance is a prerequisite for accessing international markets. Standards contribute to competitiveness in several ways. First, standards and labels add value to product: for instance, organic or fair trade indications may increase the consumer’s willingness to pay higher prices (environmental and social premiums). Secondly, because standards suggest attaining better product characteristics, they often demand process review and improvement, hence higher productivity.

However, the majority of MSMEs in DCs often do not have sufficient resources for complying with SPS/TBT requirements. A standards-for-competitiveness intervention strategy is therefore likely to have impact only if other conditions are verified, such as access to capital (equipment, funds, knowledge) and market entry conditions.

A standards-based intervention may target the country’s quality infrastructure, in relation to weaknesses identified herein. Typical activities are capacity development for standards and certification bodies, awareness raising and outreach of SMEs, support to sectoral associations supporting the capacity to conform to standards, building skills within firms, and facilitating linkages with service providers. Interventions in this area may target value-chains, in supporting specific partners to comply with standards/requirements, e.g. supporting a group of suppliers to reduce environmental impact by complying with electric waste, or to embrace forest stewardship schemes. Last, higher level interventions can also support standardization as a tool for achieving objectives of modernization or of quality/export policies, requiring in these cases strong linkages with trade promotion and investment agencies. More details can be found in the Thematic Review on Quality Infrastructure.

### *Support to Human Resource Development*

Support to HRD could be systematically channelled through SME support programmes., so strong is the need for a clear link between competitiveness projects and technical-vocational education and training (TVET) efforts. However, the latter are often designed in the first place from the angle of the labour market dynamics. They will therefore generally not directly become industry-driven. On the other hand, some Competitiveness interventions may focus on potentially competitive sectors of the economy without ensuring sufficient resources/attention for the development of the necessary skills and competences.

Wider interventions may act at macro level through education policy reform and by strengthening the relevant

#### **Box 4. Technical and vocational training programme, Bangladesh**

The Bangladesh TVET programme was co-funded by the EC and ILO. Taking stock of previous efforts, where isolated, targeted interventions had a rather low impact, the program design adopted a time-bound and holistic approach with the purpose of establishing a market-oriented and flexible TVET system, able to meet the needs of employers, the population and the Government. All aspects in the system were covered, from legislation to management and organization of TVET institutions, curriculum and course development, quality assurance, teachers' capacity building, awareness raising and cooperation with the private sector. Some components of the intervention specifically targeted poor urban women and youth.

public institutions that have a role in developing industry-relevant skills and qualifications. Developing a country's human capital to match industry needs requires adequate policies and specific enterprise-related curricula both in the mainstream and in TVET. Interventions in support of HRD at meso level would target specific education institutions (e.g. technical and vocational colleges), competence centres and industry-based resource centres, networks of training providers focusing on information and knowledge management, and setting up learners' networks through the organised civil society (e.g. for the informal economy). TVET initiatives can involve different actors: Ministry of Education, chambers of commerce, technical and vocational schools, business associations and NGOs. It is therefore crucial for any TVET support project, to foster a collaborative relationship between TVET institutions and industry, to ensure that industrial

needs are included in training contents. In particular, emphasis should be set on the development of practical skills suitable to the adoption of new technologies.

Besides the above interventions, HRD can be supported directly at business associations and enterprise levels. Human resource management techniques can be promoted and implemented in enterprises in connection with initiatives in the fields of productivity, decent work, or quality management, with adequate adaptations with regard to culture and local conditions. Tax incentives can be introduced for developing lifelong learning programmes and formal training within firms (part of continuous professional development, CPD), as is practiced in developed countries. The effective adequacy of such measures to the developing countries' context needs, however, to be assessed on a case-by-case basis.



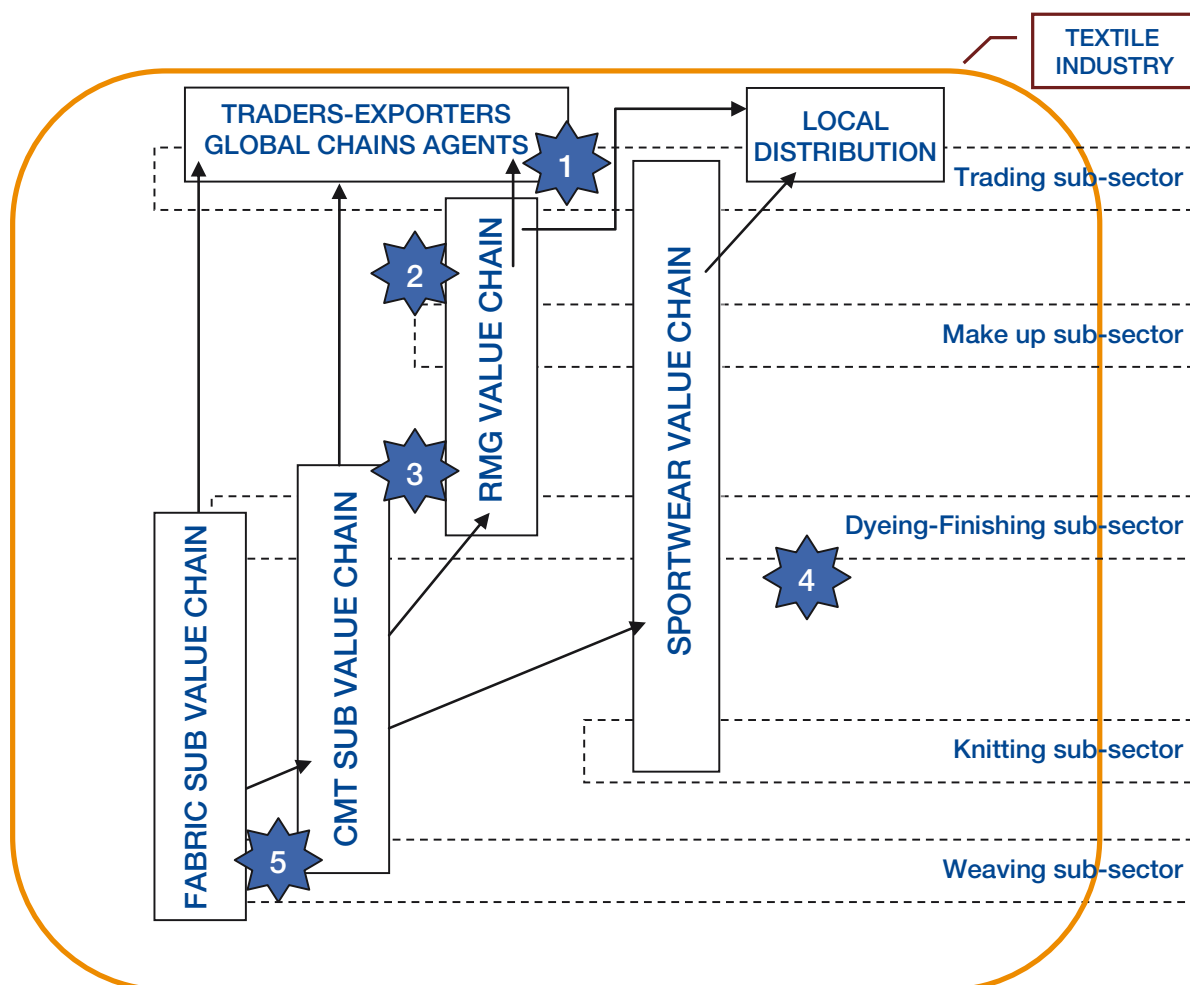
### 3. How can it be done?

#### 3.1 Methods and levels of intervention

Referring to the concept map in Figure 2, the key methods for enhancing competitiveness are sectoral approaches, value chain development, cluster development and industrial up-grading. Far from being exclusive, these approaches can be used in combination, jointly or sequentially in time and space as illustrated in Figure 3. A competitiveness approach for the textile sector may support the industry chamber (\*1) to increase export value through better market linkages and higher productivity (quality, design, response time); and then can proceed to supporting the particular value chain of ready-made garments (RMG). This may start with supporting firms

through the Business Intermediary Organisations (BIOs) in their sector or area (\*2), for better linkage/planning capacities, business skills, access to investment, and social and quality standards compliance. When the first results are gained, follow-up interventions may aim at organizing smaller firms/operators in a cluster (\*3) or at strengthening existing clusters. Interventions at enterprise level may also target more advanced firms in specific sub-sectors for demonstration effect and/or positive externality (investment in environment-friendly process,\*4). At a later stage, once benefits have materialized, interventions for industrial upgrading in the lower segments of the supply chain (\*5) can be proposed.

Figure 3. Competitiveness interventions map exemplified for a textile sector



Note: CMT = Cut, Make & Trim; RMG = Ready-Made Garments

### 3.1.1 Sectoral approaches

Sectoral initiatives are industry (sector)-specific efforts to examine and address an industry's needs. They bring together multiple firms, intermediaries and other stakeholders in the industry to identify and address common issues. The rationale for choosing a sector-based approach is thus a string of key common constraints affecting the competitiveness of a sector, or a particular interest for a sector, also from a development perspective e.g. in terms of poverty reduction, employment generation, gender focus potential, environment protection.

Depending on the minimum efficient scale of a specific sector/sub-sector of the economy, there may be large-scale lead firms, or there may be a predominance of SMEs, either clustered geographically or grouped along value chains. Sectoral policies may be different depending on the average firm size of the industry in question, and in the case of SME predominance, improvement in the presence and type of SME policy in the country/region will have an impact.

Sector-based approaches can be particularly relevant in the context of regional integration, when specific sectors are targeted, as for example in connection with the EPAs. Interventions would aim at harmonizing sector policies across countries, supporting regional systems for market access, and improving export capacities through regional schemes (certification, technology transfers, HRD).

Successful sectoral interventions are influenced by:

- The presence of strong sector association(s) or of lead firms/clusters
- Buy-in and ownership of the project objectives across the range of industry stakeholders
- Suitable implementation arrangements
- Interventions at meso level tend to be critical, recurrent and more cost-effective, given the key role of

business intermediaries and representative organisations (chambers, BDS providers etc.) in delivering services to enterprises and advocating/lobbying for relevant reform. Nevertheless, initiatives addressed at the micro-level (firm level) are at times needed in order to support lead firms with pivotal roles in the selected sub-sectors, and/or to exploit positive externalities and opportunities for learning-by-doing and demonstration effect.

### 3.1.2 Value chain analysis and development

Value chain approaches are based on identified specific chains for products or services that have the potential to enhance the competitiveness of a sector or sub-sector of the economy. They are therefore more focused and have a narrower scope (but for this reason they can go more in-depth and have rather concrete outcomes) than broader sectoral approaches. The latter might however be more suitable to address issues across sectors, define wider strategies and collaboration, strengthen capacities of common institutions and generate sector-wide spill-overs. The focus on value chains can also be seen as a phase following the focus on a sector. If - based on the analysis of the context - a value chain approach is chosen, the points outlined below should be taken into account.

First of all it is necessary to assess current performance, which entails a **value chain analysis (VCA)**<sup>168</sup>, with three main steps:

- Mapping of industry chains in qualitative, geographical, and quantitative terms by disaggregating metrics such as cost, time, productivity, and value addition along the various segments of each chain. The qualitative mapping presents all activities, actors, relationships along the segments of the chain and interaction between the various stakeholders, including producers, intermediaries and buyers.

#### Box 5. The Spinning and Weaving Sector Support program (MED/2004/6223, 2004-2009), €80 million

In Egypt, the cotton sector was on the verge of collapsing due to mismanagement of State-owned enterprises (SOEs), a lack of investment, and restrictive administrative practices constraining trade in cotton. On the basis of an external sector study, the Government initiated an ambitious sector recovery strategy that the EC supported through the Spinning and Weaving Sector Support program (MED/2004/6223, 2004-2009) with M€ 80 funding in sector budget support. The project was organized along a matrix of actions/conditions, with objectives set as: i) to improve regulatory framework, (ii) to improve the efficiency of the industry by restructuring and privatising enterprises; and (iii) provide a safety net for the redundant labour force. The existence of a sound strategic backbone, and the Government commitment to embrace a wider reform agenda have been crucial for the programme's success. Nevertheless, the component on regulatory framework was rated as only partly relevant and sub-effective, because a policy for the agricultural sector was not in place, and the line Ministry not included among the beneficiaries. This experience points to the importance of linking sectoral interventions to a broader analysis of the country's economic context, in order to take into due account the interdependence of different industries.

- Establishing performance indicators. Primarily they will reveal the under-performance areas and main prevailing bottlenecks. In addition, when compared against benchmarks and best practices in other countries/regions, they will help in assessing the relative importance of the different performance drivers, and in ranking the constraints that directly affect the competitiveness of an industry.
- Analysis of performance gaps. This leads to explicitly understanding the policy/institutional and market-related / firm-level factors underlying performance issues. The analysis helps in developing a targeted change agenda that would enhance growth and competitiveness of the supported industries, and may potentially attract investment. The latter initiatives will then form part of a **'value chain development'** programme.

*Value chain mapping* constitutes one of the key activities of VCA. This usually entails not just defining the stages and nodes of the value chain, but also its quantitative aspects (amounts and values), the actors involved, the market related to the specific value chain, governance issues in the chain, its environment - including the support institutions, specific key issues such as internal and external financing, etc. The aim is to get a full picture of the composition, functioning and challenges in the chain, in order to identify where it is appropriate to intervene to strengthen some capacities, address some bottlenecks, or unlock some potential. Interestingly, when relevant data are available, it is possible to carry out a pro-poor

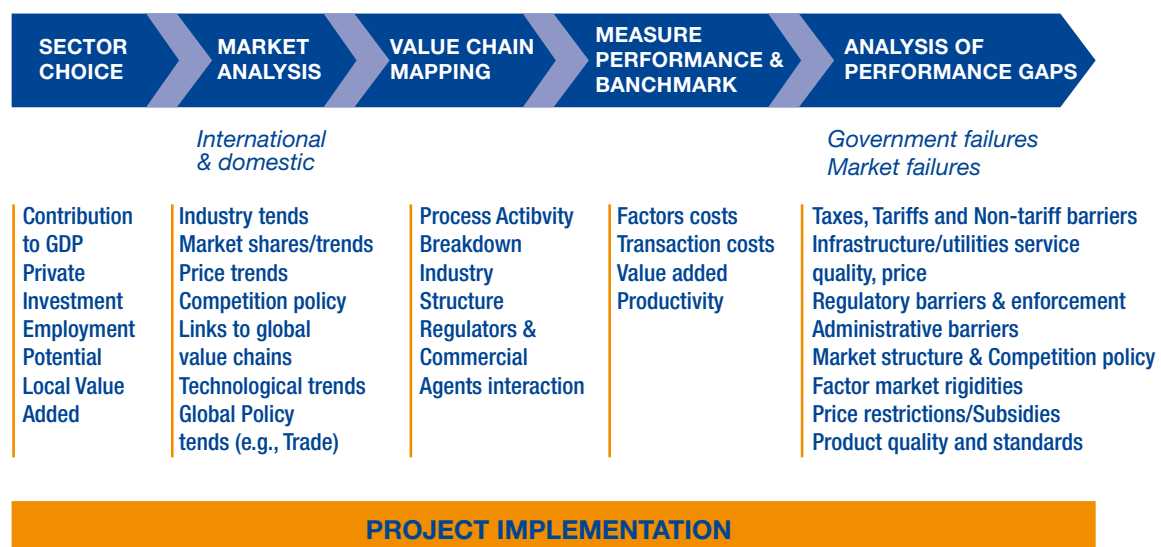
VCA, which allows to detect how the value progressively added is redistributed between economic actors, and thus at which stages of the value chain it is more strategic to intervene in order to maximize the poverty-reduction impact of a value chain development intervention.

When identifying the business linkages within a value chain, it is important to identify the different market segments and operators, the diverse functions each operator performs, and the type of relations and coordination among the chain actors. It is furthermore important to assess the intensity and sustainability of cooperation among the different SMEs, but also among business associations and Business Development Services (BDS) providers. Other factors to be assessed are the existence of leading firms, the sector organization, the competition for resources and potential asymmetry of information.

VCA can be used in developing and implementing action plans to address gaps in specific nodes of a value chain whose competitiveness needs to be enhanced. VCA can thus be used as an entry point for a wide range of interventions, either based on the value chain itself (along its length or at specific nodes), or on specific functional areas (linkages), or on certain areas where actors concentrate (clusters), or on groups of activities common to similar/adjacent value chains (sector and sub-sector). In terms of scope, value-chain interventions can be designed at local, national and regional level.

Streamlining of value chains usually entails vertical integration, which may lead to building an interface between

Figure 4. Key stages in VCA



Source: adapted from Subramanian 2007, WBG

the national and global economies. Traditional approaches aim at helping lower value chain tiers develop or improve linkages, but an alternative approach is to collaborate with large multinationals to establish global to local linkages with countries that show good potential. In this regard, supply chain development programs can include matchmaking centres and upgrading of suppliers skills.

Value chain development interventions can include:

- Supporting more value added at each stage of the production process, including cost-sharing provision of facilities such as cold storage, trade hubs, village/district collection points, etc.;
- Increasing compliance with standards and technical regulations;
- Improving the environmental aspects of products and services along the whole value chain from raw material and energy acquisition to waste management (e.g. in eco-tourism, light industry);
- Organizing / strengthening groups of operators, and building their backward and forward linkages (with possible relevance to informal economy operators);
- Addressing policy, regulatory and institutional issues;
- Developing information channels based on adequate ICT.

### 3.1.3 Cluster development approaches

As mentioned above, clusters are geographic concentrations of interconnected companies, with linkages to related organizations such as trade associations, government agencies, and research and educational institutions<sup>169</sup>. Related economic activity tends to agglomerate spatially for a variety of reasons, such as the presence of unique national resources, proximity to markets and reduced transaction costs.<sup>170</sup> Examples of world-class clusters in a DC context are the IT cluster in Bangalore, India, or the surgical instruments cluster in Sialkot, Pakistan. Firms located in clusters are more likely to be innovative and achieve greater productivity than firms that are geographically isolated, with few local linkages.

Cluster development is one of many strategies for enhancing an economy's competitiveness. For launching cluster development initiatives there needs to be a critical mass of economic activity to constitute a working cluster. In DCs, cluster development projects tend to have agro-processing as a main target. Understanding cluster dynamics provides an insight into how particular industries develop, and allows identifying constraints, relative strengths, and potential for enhancing competitiveness. Therefore cluster analysis can be effective for determining the needs of an economy without a cluster organization being part of the solution. There may be constraints to competitiveness that are fundamental, such as macroeconomic instability or an ineffective regulatory environment. In some countries, there may be widespread inefficiency at the firm level. In these cases, removing obstacles to growth may be more effective than launching cluster organisations or supporting the so-called 'cluster development agents' (facilitators of linkages within and services to clusters).

Cluster development approaches are usually aimed at expanding the capacity of existing clusters. They primarily focus on improving the efficiency of clusters at the firm level, through support to organizations (reaching MES and exploiting relevant economies of scales, joint bulk purchasing, shared production to fulfil larger orders, pooled human resources), and through management (business development, info sharing, cluster marketing).

Another intervention stream will aim at enhancing efficiency of local cluster development agents and service providers. Support activities may include deepening and broadening their knowledge base for innovation, design, quality control and information related to markets and marketing, and establishing or improving their linkages to a wider set of technology inputs and actors -including in the informal economy, when relevant. Components could also include the creation of/support to technical colleges, thematic industry-linked research centres, export promotion units and consortia, and common services centres. Transfer of technologies and of knowledge can be supported through partnerships with more performing clusters or value-chain leaders. Enhancing

#### Box 6. The Mekong Bamboo project

Prosperity Initiative (PI), a creation of Oxfam/IFC, leads the Mekong Bamboo project. To enhance access to markets, mainly related to wood substitute/flooring products, PI's strategy is to increase the productivity and value-added in the industry, thus creating additional income that can stimulate industry growth, provide incentives to improve the industry structure and thereby create opportunities for higher incomes to poor farmers and workers. While facilitating value-chain linkages (e.g. large buyers such as IKEA), PI is targeting two sub-sectors: developing industrial processing through the creation of a competitive industry (supply base, productivity and upgrading), and enhancing handicrafts. The impact here is through job creation and productivity (more jobs and better paid). In addition, horizontal components (markets analysis, M&E, producers' organization) facilitate implementation.

<sup>169</sup> See section 1.1.2 for full definition of clusters.

<sup>170</sup> "The Cluster Approach to Economic Development, Technical Brief N°7, September 2008, USAID.

### Box 7. Asia ProEco/Sustainable Industrial Networks: SME leather cluster project, China (2005–2008)

In India, 350 small-scale industries (SSI) clusters and about 2000 artisan-based clusters contribute to about 60% of manufactured exports. However, the majority of these clusters share significant constraints like equipment or infrastructure obsolescence, relatively low product quality, information deficiencies, poor market linkages and inadequate management. Development studies have been commissioned, such as the 'Indian Leather Sector Network Report'. This EU funded UNIDO-implemented project has contributed towards increasing competitiveness of the leather cluster in Chennai, funded by Italy. The main approaches were access to finance and technology; attracting investment; improving managerial efficiency; and fostering business partnerships. Using a "cluster twinning" approach<sup>171</sup>, long-term relationships between manufacturers of India and Italy were set up, and training for factories and for institutes was delivered. Lessons learnt show that a medium to long-term period was needed to succeed, and that a cluster-led institution (the South India Cluster Development Organisation) played a crucial role in the ownership of such initiatives. Technology transfer, capacity/skills development, and organizational change towards cleaner production and lean manufacturing are the activities that are designed to contribute to higher productivity and better environmental performance also in other cluster-related programmes.

business associations, export initiatives, and in certain cases, where appropriate, strategic alliances among public and private actors may as well be supported, especially in sub-sectors with high growth potential.

It should be noted that the cluster approach rarely shows impact in the short term and should be considered as a long term effort. Additionally, experience has shown that the best outcomes emerge from support to 'natural' clusters, rather than from attempting at 'inducing' clusters where they are not at least already present in simplified form.

#### 3.1.4 Industrial upgrading

Industrial upgrading initiatives support enterprises in improving production and export capacities as well as sustaining the development of a domestic segment that manufactures and trades competitive value-added products for local and export markets. Both equipment and intangible assets are upgradeable, in order to achieve higher productivity and diversification.

When they exist, *technical support institutions and BDS providers*<sup>172</sup> are the preferred intervention target to benefit from technical assistance and other inputs for capacity building. Provincial and national action plans can be developed for specific areas of activity (e.g. adopting clean technologies for leather processing plants), or for developing specific intangible assets (e.g. developing marketing tools, schemes to stimulate innovation). Indicative activities are: i) improving capacities of the above institutions to assist enterprises in the areas of technology, investment, marketing; ii) facilitating use of technology to develop innovation; iii) promoting centres of excellence to strengthen the interaction between research and industry.

Support to upgrading could also target *enterprises*, where upgrading may benefit immaterial or material assets, with interventions given as a menu of options at various levels as exemplified below.

Immaterial upgrading activities would support:

- Strategic/diagnostic studies leading to the identification of needs, including for management, staff and equipment
- Identification of investment and support to the adoption of appropriate equipment / technology
- Development of reorganisation plans, including training schemes
- Training and advice on production, upgrading of work plans.
- Development of marketing strategies and corporate communication
- Assistance for product and process development
- Quality, conforming to standards, traceability issues (e.g. CE mark, REACH directive)
- Support to partnerships for technology and/or trade purposes (including business linkages, support to clusters, other means of promoting transfer of know-how and technologies)
- Technical assistance to governments aimed at setting up industrial modernisation programmes (including national agencies or boards for industrial upgrading)
- Institutional capacity building at meso and macro level (service providers, professional and government bodies)

171 Cf. [www.unido.org/index.php?id=7881&tx\\_ttnews%5Btt\\_news%5D=380&chash=8af230c658](http://www.unido.org/index.php?id=7881&tx_ttnews%5Btt_news%5D=380&chash=8af230c658). Another twinning example is the Fashion and Textile Cluster supported by the EC in Turkey, EuropeAid/117581/D/SV/TR, 2005-2006, [www.textilecluster.com/en/es.html](http://www.textilecluster.com/en/es.html)

172 For specific information on Business Development Services, refer to the relevant Thematic Review



### Box 8. Industrial upgrading in Senegal

From 2004 to 2008, AFD implemented a pilot project aimed at developing and testing a methodology to support SMEs in Senegal through the provision of industrial upgrading services. The project succeeded in its objectives to create a national body in charge of industrial upgrading (Bureau National de la Mise à Niveau), to train its staff and kick-start the provision of services to a pilot group of 60 enterprises:

- Diagnostic studies and development plans for SMEs, funded by the project up to 80%;
- Support to the implementation of the development plans, funded by the project to up to 70% of soft investments and 20% of the equipments.

After the pilot phase and as a part of its “Strategy for Accelerated Growth”, in 2008 the government of Senegal decided to take full responsibility for the functioning of the Bureau and to extend the range of services (to include diagnostic studies on environmental performance) and the outreach (target group: 200 enterprises in 4 years). Under the 10th EDF, the EU agreed to support such efforts through a contribution (€5 million) to the second phase of the programme, which is steered by AFD.

Material upgrading activities would support:

- Sourcing modern or intermediate equipment, access to equipment fairs
- Modernization through facilitation of linkages between suppliers and firms
- Designing or revamping facilities, especially in respect with productivity, economies of scale, and decent work
- Re-engineering production chains, with focus on energy-, water-efficiency and reduced environmental impact

### 3.2 Aid delivery modalities

Support to competitiveness, by focusing on the enhancement of productivity and innovation, is at a crossroad with several economic development themes. There is therefore a need to gain a clear understanding of the problem to be solved, and a well-defined position of partner Government bodies. Stand-alone competitiveness projects (e.g. for cluster development, value chains development or industrial upgrading) may yield substantial impact, but require a well-defined scope of intervention, a good potential for improvement, and a committed implementing partner. The project approach is generally seen as a suitable modality to strengthen productivity and competitiveness in a targeted manner. When such initiatives are part of a wider TPSD umbrella programme, there is a possibility to improve gradually larger parts of the economy, with implementation of discrete projects.

Targeting non-state actors (NSAs) has proven useful in certain cases as an entry point or piloting for larger PSD projects, in particular with reference to local innovation. In Bangladesh, the Small Project Facility (SPF) developed 27 NGO-led partnerships, allowing the selection of 3 themes for a subsequent PSD project; in Guatemala an initial support to local NGOs has evolved into the formation of a local business association.

### 3.3 Sequencing of activities

Competitiveness activities can be sequenced in a way to build progressive gains, including sometimes combining simultaneously elements of value chains, cluster development, industrial upgrading, promotion of innovation and sectoral approaches. A programme may start with sector projects addressing constraints such as standards compliance and upgrading in important and growing sectors of the country, with a focus on a selected number of clusters; this should be part of a programme which aims at and includes strengthening of BIOs and BDS providers. In addition, a trade-oriented development program component may then seek to enhance exports through targeted value chain projects promoting better market linkages and higher productivity (product quality, design, response time).

The most appropriate sequencing will have to be determined on a case-by-case basis depending on the competitiveness objectives, the targeted sectors, the focus on one or multiple value chains with good potential, the presence of clusters, the need for specific types of upgrading.

### 3.4 Expected results and results measurement

In relation, to the enhancement of competitiveness, results and indicators are defined at various result levels. Table 1 includes a number of examples but does in no way pretend to be exhaustive. It should be noted that these indicators are best used at firm level (with reference to a sample from the target group addressed by the intervention, for which baseline surveys and regular monitoring can provide more reliable data).

Wider effects at sector and overall country levels may be very difficult to demonstrate in terms of attribution, given the high degree of interdependence and external effects in market dynamics. Values aggregated at impact level should be seen as the result of a ‘contribution’ of the programme towards economic development and poverty reduction, but cannot be fully attributed to it.



**Table 1. Section of results and indicators for measurement**

Results	Indicators	Sources of verification
<b>Output level</b>		
New MSMEs are included in value chains or in clusters	<ul style="list-style-type: none"> <li>Number of new MSMEs integrated</li> <li>Increment in turnover of value-chain</li> </ul>	Enterprise-level surveys
Enhanced supply of technical inputs and equipment	<ul style="list-style-type: none"> <li>Value of Investment in equipment and technical inputs over programme span</li> <li>Ratio: leverage effect of the programme</li> </ul>	Enterprise accounts
New producer associations are created	<ul style="list-style-type: none"> <li>Number and membership of producer associations</li> </ul>	Intermediary surveys
Enhanced provision of technical services (engineering, maintenance, equipment leasing, packaging, lab testing, etc)	<ul style="list-style-type: none"> <li>Range of services offered</li> <li>Number of service providers</li> </ul>	Intermediary surveys
Enhanced channel/infrastructure for Innovation/	<ul style="list-style-type: none"> <li>Creation of resources centre, incubator</li> <li>Number of enterprises established (or expressing an interest in establishing) in incubators, technology parks</li> <li>Number of collaborations between enterprises and research centres /academics</li> </ul>	Intermediary surveys
Industry managers are better skilled in business management and strategic planning	<ul style="list-style-type: none"> <li>Range and number of training opportunities created</li> <li>Number of managers trained</li> </ul>	Intermediary surveys
<b>Outcome level</b>		
Higher productivity	<ul style="list-style-type: none"> <li>Output per worker, output per machine hour</li> <li>Return on equity (dividend/ average equity)</li> <li>Net income/ average value (return on assets)</li> <li>Lead and processing time values (decreases)</li> <li>Workers benefitting from TVET</li> </ul>	Average data from firm statements
Higher technology /innovation level	<ul style="list-style-type: none"> <li>Enhanced investment in tangible (ICT and machineries) and intangible assets (trademarks, brands, patents)</li> <li>Number of patents/ license used</li> <li>Percentage of qualified staff</li> </ul>	Firm accounting statements
Higher efficiency	<ul style="list-style-type: none"> <li>Capital cost per unit output</li> <li>Labour intensity</li> </ul>	Average data from firm statements
Increased value added and quality	<ul style="list-style-type: none"> <li>Average value/unit of output</li> <li>Unit value of product</li> <li>Number of new products launched</li> <li>Exports value, global and per unit of output</li> <li>Number of certificates for relevant standards</li> <li>Number of certified firms</li> </ul>	Average data from firm statements
Enhanced competitiveness	<ul style="list-style-type: none"> <li>Export value (global and by unit), and change</li> <li>Number of qualified staff hired</li> <li>Total product cost ex-works and f.o.b.</li> <li>Export value and rank in sector</li> <li>Number of new domestic customers</li> <li>Number of new export customers</li> </ul>	Average data from firm statements
Increased networking, cooperation	<ul style="list-style-type: none"> <li>Number of agreements/contracts (e.g. for subcontracting, joint procurement, joint marketing)</li> <li>Number of joint ventures/partnerships</li> <li>Number of common facility centers (CFCs)</li> <li>Type and number of operators integrated in value chain</li> </ul>	Average data from firm statements

### 3.5 Cross-cutting issues

#### Gender

The competitiveness of a country or economic sector cannot be developed without taking into account women as economic actors. In most DCs, women account for the majority of workers in the informal economy – this entails job insecurity, lack of access to training, social protection and other resources, making them unable to develop their productive potential and more vulnerable to poverty and marginalization. Women in DCs often hold low-skill, low-wage jobs and they are trapped in a low-productivity situation. Therefore, competitiveness interventions should include specific activities to overcome these constraints, to meet women's needs in order to enable them to take an active part in entrepreneurial restructuring of their communities, to start their own ventures, to expand existing businesses, or to function as social entrepreneurs. Access to Finance often also constitutes a serious barrier for entrepreneurial women (see also Thematic Review on Access to finance).

#### Environment

Environmental concerns can easily be mainstreamed in competitiveness strategies:

- At firm-level, by promoting eco-efficient production technologies and modernizing equipment; firms may find a range of incentives when adopting more environment-friendly process. This process can facilitate compliance with environmental standards and certification, thus adding value to the products
- At sector/value chain level, by supporting compliance to environmental standards and environmental impact assessment
- At cluster level, by mainstreaming research, development and innovation in the field of green technologies (intelligent energy, waste reduction processes)
- At national and regional level, by supporting efforts in awareness-raising, research, policy-making and education.

At national and enterprise level, there is still insufficient recognition of the economic and productivity potential of environment-friendly approaches. Because this requires in-depth process analysis and re-engineering, the adoption of cleaner and more water- and energy-efficient processes can also lead to significant productivity and efficiency gains. In this respect, support programmes can highlight the business case and thus the market incentives for entrepreneurs to take the 'green growth' path. Support to environmentally friendly production may fit into upgrading capacities or investment programmes.

Intervention to support the private sector in the adoption of new technologies/methods would include:

- Awareness raising and promotion of new attitudes, both at industry and civil society levels

- Advisory services and on-the-job training for environmental screening of production processes
- Strategic Environmental Assessment or Environmental impact assessment studies at sector level, capacities development for local providers to follow up at firm level
- Training on concept of profitable environmental management, training of 'environmental coaches' and of 'environmental trainers'
- Knowledge and experience sharing networks, resource pools and databases (national/ regional).

#### Human rights/decent work

There are two approaches to decent work, the rights-based approach and the productivity approach. The ILO defines 'decent work' as productive work which generates an adequate income, in which workers' rights are protected and where there is adequate social protection — providing opportunities for men and women to obtain productive work in conditions of freedom, equality, security and human dignity. This agenda aims at addressing security, wellbeing, wages and representation issues among others. However, ILO conventions are non-committing, and the organization has no enforcement powers. Trends in EU and other markets show a raising sensitivity among consumers for fair labour conditions and fair trade, but these concerns do not always match people's purchasing behaviour. In this context, the rights-based approach may be uneasy to translate into operational programmes, because DCs' partners often argue that it will erode their labour-based comparative advantage. At policy level, the dialogue between EU and trading partners may help in promoting reform for decent work. At program level, a possible approach would be to promote the shift from labour-cost based 'comparative advantage' towards a 'competitive advantage' based on commitment to labour/ social standards. Two elements are relevant here: i) compliance to labour/social standards must be certified by a reputable organisation, and ii) only products with access to niche markets can secure a premium for such certification/labelling.

Under the productivity approach, better performance is deemed to derive from enhanced fitness to physical and intellectual work, which results from the absence of disease, from proper nutrition, and from adequate skills level. The link between decent work and productivity is well recognized in developed economies, but has not been largely studied in developing economies; most of the SME managers in DCs would thus reluctantly consider decent work as a priority. Support to awareness raising and pilot projects is thus necessary, as is supporting the development of partnerships with value chain leaders, which may provide guidance to their suppliers in upgrading productivity and/or work standards. For maximizing impact, interventions should first be targeted at meso-level (BIOs and relevant authorities), and subsequently reach enterprises with facilitation packages (training, support to implement labour standards, basic health awareness, safety and work conditions).

## 4. Additional resources

### 4.1 Bibliography

#### General documents

*“Improving the competitiveness of SMEs through enhancing productive capacity—Proceedings of Four Expert Meetings”*, UNCTAD, 2006. The report gathers the analyses and recommendations of experts, backed by national case studies. The four thematic areas covered are SMEs linkages, financing technology, technology development for SMEs, and promoting SMEs export competitiveness  
[www.unctad.org/en/docs/iteteb20051\\_en.pdf](http://www.unctad.org/en/docs/iteteb20051_en.pdf)

*“Innovation Policy. A Guide for Developing Countries”*, The World Bank, 2010. [http://publications.worldbank.org/ecommerce/catalog/product?item\\_id=9581432](http://publications.worldbank.org/ecommerce/catalog/product?item_id=9581432)

*“Promoting Innovation in Developing Countries: A Conceptual Approach”*, Jean-Eric Aubert, World Bank Institute July 2004  
<http://info.worldbank.org/etools/docs/library/137729/0-3097AubertPaper%5B1%5D.pdf>

*Guidelines and model ToR for these studies can be found in the Guidelines for the Integration of the Environment and Climate Change in Development Cooperation* (2009)  
[http://ec.europa.eu/europeaid/infopoint/publications/europeaid/172a\\_en.htm](http://ec.europa.eu/europeaid/infopoint/publications/europeaid/172a_en.htm)

#### About diagnostic tools

Europe Innova and European Commission “Imp3rove”  
[https://www.improve-innovation.eu/opencms/opencms/en/01\\_IMP/](https://www.improve-innovation.eu/opencms/opencms/en/01_IMP/)

“The Competitive Advantage of Nations”, Porter M., 1998, Free Press, New York

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[www.paca-online.de](http://www.paca-online.de)

“The Global Innovation Rankings and Report 2008-2009”, a joint publication by INSEAD and the Confederation of Indian Industry<sup>173</sup>.  
[www.insead.edu/facultyresearch/centres/elab/documents/GIIFinal0809.pdf](http://www.insead.edu/facultyresearch/centres/elab/documents/GIIFinal0809.pdf)

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<https://www.businessgrowthinitiative.org/BGIProducts/TrainingWorkshop/Documents%20Library/BGI's%20MEASURE%20Presentation%20final.pdf>

“Moving towards Competitiveness: A Value Chain Approach”, IFC/FIAS, 2007.

[www.ifc.org/ifcext/fias.nsf/AttachmentsByTitle/MovingTowardCompetitiveness/\\$FILE/Value+Chain+Manual.pdf](http://www.ifc.org/ifcext/fias.nsf/AttachmentsByTitle/MovingTowardCompetitiveness/$FILE/Value+Chain+Manual.pdf)

“The Methodology of Value Chain Promotion”, GTZ, 2007.  
[www.value-links.de/manual/distributor.html](http://www.value-links.de/manual/distributor.html)

The last two references are more useful for implementation, while ‘MEASURE’ checklists may lack guidance. The PACA tool has a focus on local development.

#### About methods of intervention

##### • On Cluster Development

*“Clusters for Competitiveness: A Practical Guide and Policy Implication for developing Cluster Initiatives”* World Bank, 2009.

This book offers a practical approach for developing industrial clusters to achieve export competitiveness in developing countries. It outlines ten useful tools, describes overall life cycles of such initiatives and discusses current practices around the world.

[http://siteresources.worldbank.org/INTEXPCOMNET/Resources/cluster\\_initiative\\_pub\\_web\\_ver.pdf](http://siteresources.worldbank.org/INTEXPCOMNET/Resources/cluster_initiative_pub_web_ver.pdf)

*“Cluster Initiatives in Developing and Transition Economies”*, Centre for Strategy and Competitiveness, 2006. Cluster-based competitiveness projects have become an increasingly widespread tool for economic development. The report provides a basis for improving the quality of cluster initiatives, making them a better tool. Based on a systematic analysis of the best data available, it provides benchmarks of current practices based on the collective experience in key areas related to the operation and organizational structure of cluster initiatives.  
[www.cluster-research.org/dldocs/CIsDevelopingTransitionMay06.pdf](http://www.cluster-research.org/dldocs/CIsDevelopingTransitionMay06.pdf)

##### • On Value Chain Analysis and Development

*“ValueLinks Manual (The Methodology of Value Chain Promotion)”*, GTZ, 2007. It is ‘a compilation of action-oriented methods for promoting economic development with a value chain perspective’. The Manual includes 12 sections, out of which Section 5 is particularly useful when dealing with business linkages, as it focuses on strengthening business linkages and develops the concepts of brokering vertical collaboration (supplier–buyer contracting), fostering horizontal collaboration of value chain operators and business match-making.  
[www.value-links.de/manual/distributor.html](http://www.value-links.de/manual/distributor.html)

*“Donor approaches to supporting pro-poor value chains”*, Donors Committee for Enterprise Development

173 ‘The Global Innovation Rankings and Report 2008-2009, INSEAD and the Confederation of Indian Industry, 2009.

(DCED), 2007. This report examines the relevance of the value-chain concept for pro-poor growth, identifying opportunities and threats for developing countries. It elaborates on the interests of different stakeholders involved in value chain activities, and presents different methodologies for value chain analysis and procedures to design intervention strategies. The report then sketches an overview of the major policy options and discusses the issue of impact assessment.

[www.enterprise-development.org/page/linkages-value-chains](http://www.enterprise-development.org/page/linkages-value-chains)

*“Staying Competitive in the Global Economy: Moving Up the Value Chain (Synthesis Report)”*, OECD, 2008. This report deals with the globalization of value chains, including the rise of outsourcing/ off shoring. It first examines how OECD countries are affected by the globalization of production, on both the macroeconomic and sector-specific levels. The costs and benefits of globalization are then discussed, with an emphasis on employment and productivity. Finally, this report analyses how globalization affects the competitiveness of OECD countries. The report discusses the moving up the value chain that takes place in OECD countries but also in China, as R&D is increasingly going to emerging countries.

<http://lysander.sourceoecd.org/vl=4956328/cl=46/nw=1/rpsv/~6671/v2007n12/s1/p1l>

The *USAID Value Chain Framework* is an approach which seeks to understand how and when MSEs can successfully compete in growing value chains, targeting sectors where the poor are concentrated—agriculture, natural products, and labor-intensive industries. The approach then works to improve the competitiveness of industries (or value chains) in which significant numbers of small firms participate while addressing the constraints that hinder MSEs’ potential contributions to and benefit from value chain growth.

[www.microlinks.org/ev\\_en.php?ID=9652\\_201&ID2=DO\\_TOPIC#criteria](http://www.microlinks.org/ev_en.php?ID=9652_201&ID2=DO_TOPIC#criteria)

## 4.2 Useful websites

- *Action for Enterprise* ([www.actionforenterprise.org](http://www.actionforenterprise.org)) is a private consultancy agency which works in the sector of PSD and enterprise development. AFE has developed her own value chain methodology in order to promote MSME competitiveness. In the website, there are useful documents as a value chain grid and a value chain assessment and value chain selection and analysis.
- *The Business Growth Initiative* ([www.business-growthinitiative.org](http://www.business-growthinitiative.org)) is a USAID initiative aiming at promoting and disseminating best practices in enterprise development. The website provides a wide range of useful reading and resources ranging from general themes to more specific issues such as the enterprise development diagnostic (MEASURE), or practical example to develop entrepreneurship or cluster approach to economic development.
- *The Center for International Private Enterprise* (CIPE, [www.cipe.org](http://www.cipe.org)) is a non-profit affiliate of the US Chamber of Commerce, it supports the establishment and development of market-oriented democracies and it sustains the increase in private sector participation in the democratic process. CIPE publications focus more on advocacy, reform, governance and inclusion of private sector in the reform strategy and business development plan.
- *The Commonwealth Secretariat* ([www.thecommonwealth.org/subhomepage/143691/](http://www.thecommonwealth.org/subhomepage/143691/)) has a section for SME development that provides extensive information on different issues from governance, human rights, public sector, and youth. There is also a section on Economic development which is more focuses on Trade and Regional integration. Some short articles are linked to PSD, but not specifically to SPC issues.
- *FAO’s site on Agricultural Marketing*. ([www.fao.org/ag/ags/subjects/en/agmarket/agmarket.html](http://www.fao.org/ag/ags/subjects/en/agmarket/agmarket.html)) Agricultural Marketing constitutes a strategy to promote Value Chain links between agribusinesses, large retailers and farmers in order to achieve greater product diversification and differentiation in the agribusiness sector
- *MSME development at Inter-American Development Bank* ([www.iadb.org/sds/mic/index\\_mic\\_e.htm](http://www.iadb.org/sds/mic/index_mic_e.htm)). This website provides documents and guidance on upgrading, entrepreneurship and local development. Additional documents and evaluation can be found concerning the other TRs (e.g. (enabling environment, BDS, and access to finance).
- *The Royal Tropical Institute* (KIT, <http://smart-site.kit.nl/smartsite.shtml?ch=FAB&id=12505>) has an information portal concerning *Value Chain for Development* which provides documents such as research papers, lessons learnt, evaluation, handbooks, newsletters, news and events on this subject.
- The Small Enterprise Development website of the *Swiss Agency for Cooperation* (SDC, [www.intercoop.ch/sed/main](http://www.intercoop.ch/sed/main)). Among the documents and resources published there is an interesting handbook on Gender-oriented entrepreneurship promotion. Other toolkits have to be requested by e-mail.
- The *Small Enterprise Education and Promotion network* ([www.seepnetwork.org/bdsguide.html](http://www.seepnetwork.org/bdsguide.html)) have a guide to Business Development Services that connects microenterprise to develop practical guidance and to build capacity. The website provides a collection of different documents from several development agencies and research centers concerning value chain development.

- The *Synergies Project* (ITC-ILO, [www.itcilo.org/synergies](http://www.itcilo.org/synergies)) constitutes a platform on current applied research and practical implementation of linking financial services to business services that contribute to pro poor enterprise development. The website includes an interesting section concerning the linkages between financial services and value chain development initiatives.
- *MICRO Links* ([www.microlinks.org](http://www.microlinks.org)) is a USAID knowledge management portal which provides documents, report and tools on several issues. Among them enterprise development and value chain resources.

The value chain development wiki is a useful application which provides diagnostic tools, definition and practical examples.

- The *World Research Institute's Next Billion website* (<http://povertyprofit.wri.org>, [www.nextbillion.net](http://www.nextbillion.net)) provides some new and interesting highlights on subjects as Empowerment like food value chain and poor empowerment. However it focuses more on other issues as greener technologies, microfinance and inclusive business. The website would be more relevant for other TRs.





## **Thematic Review 9**

### **Business Development Services**

# 1. What does the theme cover?

## 1.1 Definitions and terminology

Business Development Services (BDS) include a wide range of non-financial services provided by public and private, local and/or international, both non-profit and commercial suppliers (the 'BDS providers') to micro, small and medium enterprises (MSMEs). The latter utilise BDS with the aim of enhancing their business performance, which may include starting up, consolidating or expanding a business, and is relevant to both domestic market and export-oriented enterprises.

The specific types of services on offer in a functioning BDS market are determined by the demand from the relevant enterprises as well as the supply-side capacity on the part of the BDS providers. This is therefore a dynamic market process, and the role of development agencies and donors active in MSME development may considerably affect that market - especially in its early stages of evolution.

A distinction can be made between 'operational' and 'strategic' business development services. Operational services are those needed for day-to-day operations, such as information and communication, operational management, keeping of accounts and tax records, compliance with labour laws and sector-specific regulations. Strategic services are used by the enterprise to address medium and long-term issues in order to enhance the competitiveness of the enterprise and its ability to access to domestic and international markets. For example, strategic services can help the enterprise to identify and target markets, design new products and services, improve its branding and market positioning, upgrade facilities and seek financing.

Table 1 provides some examples of different categories of BDS addressing various points of the planning, production and distribution cycle.

**Table 1. Categories and examples of Business Development Services**

BDS categories	BDS examples
<b>Market information</b>	Access to market data, including for international trade; targeted market research; customer segmentation; customer feedback surveys.
<b>Product development and access to technology</b>	Product design and adaptation; technology information; technology transfer and commercialization; equipment upgrade; relevant technical skill development. (Applicable also to service development as relevant).
<b>Procurement</b>	Information on input supply features, pricing and sources; facilitation of input supplier – entrepreneur linkages; facilitation of bulk buying (joint procurement) groups.
<b>Training, technical assistance and advisory (strategic and operational aspects of business)</b>	Business incubation for start-ups; feasibility studies and business plans; business counseling; twinning and mentoring of existing MSMEs; small business management training (including business and production process management); technical training related to production or service delivery; legal and taxation advice; accountancy, book-keeping and inventory management.
<b>Distribution, transport and communication-related</b>	Storage and warehousing; transport and delivery; ICT services.
<b>Market access</b>	Trade fairs, product exhibitions and buyer-seller meetings (business-to-business matchmaking); advertising; packaging and labeling design; facilitation of subcontracting and outsourcing.
<b>Facilitation of access to finance</b>	Linking businesses to banks, micro-finance institutions and other non-banking financial institutions serving SMEs (leasing and factoring companies, export credit agencies, etc.); providing information on credit schemes and conditions; assist in business planning for loan applications.
<b>Policy advocacy and industry representation</b>	Industry platform, representation of industry interests in public-private dialogue for policy dialogue (e.g. for regulatory reforms affecting business).

Source: Adapted from ILO (2003) "BDS Reader: Developing Commercial Markets for Business Development Services, BDS Primer" by Miehlandt, A. & MacVay, M. for ILO SEED.

Despite the wide range of BDS potentially available to MSMEs, it is worth pointing out that the above-mentioned operational and strategic services are of course only one aspect of enterprise support. They usually need to be complemented by an enabling business environment<sup>174</sup>, and by a functioning market-related as well as quality-related infrastructure<sup>175</sup> (with particular reference to international trade). Furthermore, BDS are usually targeted on individual enterprises (all part of a target group), but in some cases they may be designed to tackle common problems in clusters or address bottlenecks along value chains<sup>176</sup>.

## 1.2 Rationale for intervention in developing countries

MSMEs in developing countries and transition economies face internal (endogenous) and external (exogenous) constraints. Internal factors that constitute significant obstacles towards enhancing competitiveness and efficiency include weak business and management skills, limited product development and productive capacities, scarce knowledge about markets (local, regional or international) and relevant standards and quality requirements, as well as an inadequate branding and marketing strategy. These may be compounded by external constraints such as a non-conducive legal and regulatory framework, the lack of opportunities for vocational and technical training, information asymmetry in the markets, BDS' limited outreach, their lack of diversification and high costs, as well as limited incentives and resources to stimulate and foster innovation, to name a few.

Many gaps emerging from these internal, intermediate and external factors can be addressed through effective BDS delivery, aimed to improve productivity, competitiveness and export capacity of MSMEs, i.e. the overall objective of BDS-related interventions.

## 1.3 Legal and regulatory context

The national legal framework can influence the development and use of BDS through:

- Rules regulating the establishment and registration of BDS providers (e.g. permits to operate, licensing requirements), including on deregulation and liberalization of the service sector<sup>177</sup>;
- Rules and regulations governing the certification and accreditation of BDS providers<sup>178</sup>.

International agreements that regulate trade in services may be relevant for the area of Business Development Services.<sup>179</sup>

## 1.4 Key actors and issues

### 1.4.1 Key actors

The *key actors* involved in BDS include MSMEs, BDS providers, BDS facilitators and governments.

The roles and functions of each actor are explained in Table 2<sup>180</sup>.

### 1.4.2 Key issues

When dealing with BDS, *key issues* to be identified and addressed in order to set a coherent and comprehensive strategy include, but are not limited to, the following:

- **Clear definition of target group(s).** For any BDS market intervention to be successful it is important to clearly define the target group(s) (e.g. micro-enterprises, SMEs, women-owned businesses, export-oriented businesses, etc.), sectors/sub-sectors of the economy (even specific segments of a value chain) and geographical coverage (national, sub-regional, regional).
- **Balance between demand-side and supply-side interventions and instruments.** It is important to address the supply side in order to ensure sustainability, but this will usually be accompanied by demand side interventions. To obtain an appropriate balance and selection of the services to address, a BDS market assessment is required, identifying constraints and opportunities. Examples of demand-side interventions are: raising MSMEs' awareness about the potential benefits of BDS, or incentives (such as voucher schemes) in order to promote BDS try-out. Supply-side interventions include the development of new or improved BDS based on customer needs or capacity building and institutional strengthening (through technical assistance and training) for BDS providers. Depending on the outcome of the BDS market assessment, some interventions could choose to work on both sides – for example by strengthening business-to-business linkages and introducing quality assurance to build client confidence.
- **'Traditional' and 'market development' approaches.** Two main types of approach are found: 'traditional' (direct delivery of BDS to MSMEs through a development intervention) and 'market development' (capacity building and institutional strengthening of BDS providers, and facilitation of relevant markets). The main assumption of the market development approach is that there is a minimum level of presence of local BDS providers as well as the awareness of and propensity to use BDS by local

174 See Thematic Review on 'Business Enabling Environment', with particular reference to the advocacy role of business intermediary organisations.

175 See Thematic Review on 'Quality Infrastructure'.

176 See Thematic Review on 'Competitiveness' (in particular for cluster development and value chains).

177 e.g. privatization of state-owned service providers, lowering barriers of market entry for foreign BDS providers;

178 A study conducted by the GTZ on the legal environment for BDS in Vietnam provides some examples related to training services, accounting and auditing services as well as intellectual property advice. For more detailed information: [www.bdsknowledge.org/dyn/bds/docs/285/GTZ-LegalEnvBDS-VN-Report.pdf](http://www.bdsknowledge.org/dyn/bds/docs/285/GTZ-LegalEnvBDS-VN-Report.pdf)

179 See the Thematic review on Trade Policy.

180 See also Figure 1A in the publication 'BDS Guiding Principles 2001' illustrating the functions of the various market actors, at the following link: [www.enterprise-development.org/page/business-development-services](http://www.enterprise-development.org/page/business-development-services)

Table 2. Main actors in BDS

Main actors	Description of roles and functions
<b>Micro, Small and Medium Enterprises (MSMEs)</b>	Growth-oriented MSMEs seeking to fill capacity and information gaps in order to become more competitive are the potential and actual clients of BDS (i.e. the target audience for which BDS-related interventions are designed). MSMEs represent the demand side of the BDS market. To the extent that business development centers and business incubators are considered as BDS providers, potential entrepreneurs seeking to establish a small business are also relevant actors in this context.
<b>BDS providers (public and private)</b>	BDS providers may include private for-profit firms (e.g. consulting companies, lawyers, accountants, etc. targeting the more formalized MSMEs with the appropriate purchasing power), private non-profit firms and NGOs (e.g. targeting micro-enterprises at the grass-roots level to increase self-employment and income-generation, being usually co-funded or supported by a development agency or the government), national or sub-national government agencies (e.g. SME agencies, local development agencies), business intermediary organizations (e.g. Chambers of Commerce and Industry, sector associations), business incubators, business support centres, cluster development agents, common facility centres in industrial parks. It is important to mention that in countries with a recent past of centrally planned economy and a strong state role (transition economies), BDS providers and enterprise development agencies set up by the public sector still play a major role and that their organizational model might be very different from the one of a smaller BDS provider (e.g. small scale, private providers such as trade associations or local training consultancies).
<b>BDS facilitators</b>	A BDS facilitator can be an international or local institution with the primary objective to promote the development of local BDS markets. BDS facilitators can intervene on the supply and/or the demand side of BDS markets. This may include the support to BDS providers (e.g. by developing new services and products, promoting good practices, and building or strengthening their institutional capacity) and extend to BDS users (by raising small businesses' awareness about the potential benefits of BDS access or by providing incentives to access and experience BDS). Other functions of BDS facilitators include evaluation, quality assurance and advocacy for a better policy environment for the local BDS market. Currently, most BDS facilitators are public institutions (government agencies), NGOs or donor-funded BDS-related projects (the latter have no legal and organizational status).
<b>Governments</b>	The principal role of governments is to provide an enabling policy, legal and regulatory environment for the private sector and BDS providers, as well as public goods such as basic infrastructure, education and information services. They may also provide incentives for the promotion of the use of BDS.

enterprises. The traditional approach towards BDS is mainly applied where the local market of BDS providers is not yet developed (e.g. low capacity or absence of BDS providers).

In recent years, the trend in BDS support leans towards market development, while maintaining in parallel the traditional approach where necessary, e.g. for demonstration purposes and in order to facilitate the evolution of the market. Particularly in very underdeveloped markets, BDS facilitators may need to start by supporting a particular BDS provider or directly launching a new BDS service, in order to demonstrate its potential. As the service becomes established, the BDS facilitator can then withdraw from a market leader to a facilitating mode, using experience gained in the initial provision to support BDS providers in building capacity to offer the new service. However, the following aspects need to also be taken into account, with particular reference to sustainability issues:

- **Combining the roles of BDS facilitation and BDS provision.** Because of their different objectives and interests, clarity of roles of facilitation and provision is needed in order to minimise market distortions and avoid inefficient use of resources.
- **Subsidies and distortion of BDS markets.** Subsidies may be needed to ensure that services can be performed or that clients are able to pay for them. As a general rule, transactional subsidies (e.g. direct subsidies to reduce the cost or price of service) tend to be more distortional than pre- and post-transactional subsidies. Pre-transactional subsidies include, for example, those used for R&D and the development of BDS services, test marketing and product adaptation, capacity building and awareness-raising. Post-transactional subsidies could be used for monitoring and evaluation of the impact of BDS interventions on BDS market development or socio-economic development, also including the relevant results in a feedback aimed at further improving BDS design and delivery. Such subsidies as well as

transactional subsidies may be justified in the short-term as an investment in the development of BDS markets (e.g. through development of new or adapted BDS services). However, it should be noted that long-term donor subsidies to the demand or supply of BDS are likely to distort existing BDS markets and crowd out the commercial provision of BDS services (thus undermining objectives such as impact, outreach, cost-effectiveness and sustainability).

- **Exit strategy.** BDS interventions should have a clear exit strategy defined, at least in its key strategic lines, at the onset of the intervention. In order to make a BDS intervention sustainable, the exit strategy needs to be closely linked to the achievement of defined objectives of the BDS market development intervention. It is important to take account of the

various dimensions of BDS sustainability: financial (e.g. cost-recovery or cost-sharing arrangements of BDS services where relevant) as well as institutional and technical (e.g. developing BDS providers as local institutions or commercial providers, developing or tailoring BDS services on specific needs of a particular BDS client segment).

Furthermore, BDS interventions must be seen in connection with the macro level of intervention: legal-regulatory framework and administrative reforms affecting the business environment and specifically BDS operations. Programmes relating to BDS are more effective when they do not operate in isolation. Where reforms at macro level are needed, it must be ensured that they take place alongside, with support of the same, wider programme or with other support.

## 2. What can be done?

### 2.1 Problem identification and diagnostic tools

A proper understanding of the existing BDS landscape (e.g. strengths, weaknesses, reasons behind lack of demand or supply of BDS and the extent of market distortions) is a key prerequisite for designing BDS-related interventions. This requires undertaking a BDS market assessment. Box 1 outlines some questions that can be used in such an assessment<sup>181</sup>. It should be noted that the survey can utilize the questions as follows: on BDS demand by addressing them to a sample of MSMEs from the programme's target area, the questions on BDS

supply to a sample of providers, and those on BDS transactions to MSME development organizations/agencies that have an overall view of the BDS market.

#### *Diagnostic tools*

Various BDS diagnostic tools can assist in the identification of problems and design of customized solutions. Table 3 describes a few useful diagnostic tools which are utilized by various stakeholders. Most are BDS-specific, while some are more generally related to SME development but include aspects that are useful for the assessment of BDS provision.

#### **Box 1. Selected questions for BDS Market Assessment**

##### **BDS Demand:**

- What are the main enterprise needs that can be addressed by BDS, in the targeted market segment?
- What type of MSMEs are using which types of BDS services? Which types of BDS are not being used?
- What main benefits are MSMEs looking for from BDS providers?
- Why do/don't MSMEs use BDS? What are the perceived needs vs. the real needs?
- How aware are MSMEs about BDS services? Do they understand the benefits of these services?

##### **BDS Transactions:**

- What prices are MSMEs paying for BDS services?
- How big is the market for BDS? What percentage of MSMEs access BDS?
- What is the market structure and type of competition in the current BDS context (number, size, service portfolio and positioning of BDS providers)?
- How are BDS services currently delivered? Through which organizations/providers? How do MSMEs want them to be delivered?
- What is the current status of cost-recovery of BDS in the market (overall)?
- Are any forms of cost-sharing, promotional measures and/or incentives for BDS use available?
- What are the effects of direct or subsidized provision of services by donors/governments on the BDS market?

##### **BDS Supply:**

- What kind of BDS providers are operating in the target area? Are they private (non-profit and commercial) or public?
- What type and range of BDS services are currently available? Are both operational and strategic BDS on offer?
- How adapted are available BDS to the types of enterprises/sectors served?
- What is the status of cost-effectiveness of offered BDS? To what extent is current pricing realistic for local purchasing power? What is the record of cost-recovery so far?
- What are the strengths and weaknesses of current BDS suppliers?
- What kind of substitutes for BDS do MSMEs use?



**Table 3. BDS-related diagnostic tools**

<b>Diagnostic tool</b>	<b>Brief description</b>
<i>Multi-Service Usage Attitude Image (UAI) Market Study</i>	This tool takes a broad look at the market for BDS services. A UAI market study provides an understanding of an overall market and reveals useful information from a BDS customer's point of view on the service, such as satisfaction, features and benefits of a particular BDS service that are important to the customer, BDS awareness level, a comparison of suppliers and information about the customers themselves. The analysis of this information can help decide if and how to enter a market.
<i>Single-Service UAI Market Study</i>	This is used to take a more in-depth look at one or a couple of BDS service markets including consumer satisfaction with various BDS suppliers, important service features, reasons for purchase or non-purchase and benefits expected from BDS use or purchase.
<i>Qualitative Consumer Analysis</i>	Provides qualitative information on demand for one or several BDS as well as consumers' perceptions of BDS supply. Qualitative consumer analysis is often used to pinpoint the reasons behind specific constraints and opportunities identified through quantitative studies. Qualitative consumer analysis aims to provide specific ideas for marketing and improving existing BDS or for developing new ones.
<i>BDS Supplier Diagnostics</i>	Rely on in-depth interviews with individual BDS suppliers that focus on gaining an understanding of the supplier's business, services offered, market expansion strategies, capacity and knowledge of their market and business environment. Supplier diagnostics provide an in depth view of strengths and weaknesses on the supply side of a BDS market and aim to offer specific ideas for strengthening the supply of services.
<i>Supply - Demand Matching Workshops</i>	Bring together customers and providers of BDS to determine why more BDS transactions are not taking place and how BDS providers might better meet the demand of consumers. This tool is often used to bridge the research-action divide.
<i>'What if' scenarios involving BDS providers and customers</i>	This tool is an adaptation of product concept tests and uses a group setting to introduce potential new BDS products or possible BDS market development interventions to gain feedback from BDS providers and customers. The tool is used both to determine which BDS service or intervention to pursue and how to modify the BDS service to make it more acceptable or effective.
<i>Rapid Economic Appraisal (REA)</i>	REA has been developed within the area of local and regional economic development (LRED) as a tool to assess the major comparative and competitive advantages of the local economy. The diagnostic tool analyses five different components (MSMEs – and their BDS needs, enabling environment, support institutions – including BDS providers, infrastructure, human and natural resources).
<i>Sub-Sector Business Services (SBS)</i>	SBS follows a dynamic approach that identifies the priority sector/sub-sector (e.g. segments of a value chain or a cluster of enterprises) with the highest potential in terms of market, income and employment, while also analysing the constraints of each selected sector. This approach follows a four stage process: (1) Selection of the priority sector, (2) Analysis of the sub-sector (market segments, market channels, linkages, value-chain, clusters, etc.), (3) Analysis of the BDS/training service market (e.g. awareness and understanding of BDS, market size and penetration of BDS, satisfaction of consumers) and (4) Definition of appropriate services (including BDS) and relevant interventions.

Source: Adapted from DAI (Development Alternatives), 'Existing BDS Market Assessment Tools', Working Paper (2003)

More specifically for business linkages activities, 'Building sustainable linkages between small-size enterprises, their larger scale business partners and support institutions' is an example of a diagnostic tool developed by the UNIDO Cluster and Business Linkages Unit.

The information in Box 2 provides two examples of how consumer surveys combined with focus group discussions were used in order gain more detailed insights into BDS markets and for developing customized and demand-driven BDS interventions.

## Box 2. BDS Market Assessment: Swisscontact (Bangladesh) and GTZ (Nepal)

In 2000, Swisscontact conducted an assessment of BDS markets in three urban areas in Bangladesh. The assessment provided the basis for designing a BDS market development program. It started with a consumer survey of 410 small enterprises with 1-50 workers in order to appraise their awareness, knowledge, use and perception of ten types of BDS. The survey was followed by focus group discussions with both users and non-users of BDS in order to gain more information on the BDS market and its potential for growth.

GTZ conducted an assessment of BDS markets in urban areas of Nepal under the Private Sector Promotion Programme. The assessment provided information for designing a BDS market development program. The formal assessment included a consumer survey of 504 enterprises in Nepal in order to appraise their knowledge, use and perception of thirteen types of BDS (demand side). The survey was followed by several focus group discussions on the nine services that stakeholders were most interested in based on the results of the survey. Finally, a supplier diagnostics was conducted by visiting and interviewing a range of BDS suppliers (supply side). Based on the above analysis, specific BDS services and interventions were developed.

*Adapted from 'SEED Working Paper No. 28 – Assessing Markets for BDS: What have we learned so far?'*

## 2.2 Broad areas of intervention and key activities

BDS interventions should address both the supply side (BDS providers) and the demand side (MSMEs) of BDS markets by identifying the needs of MSMEs and by

strengthening the BDS providers' ability to respond to these needs. Table 4 provides a number of key activities on the demand<sup>182</sup> and supply side, related to the two main areas of intervention ('direct BDS delivery' and 'capacity building of BDS providers' at the micro and meso levels.

Table 4. Main areas of interventions and key activities

Levels, approaches and areas of intervention	Key activities	
	Demand-side	Supply-side
<b>Meso level</b> <i>'Market development approach':</i> <b>Building capacity of BDS providers</b>	<ul style="list-style-type: none"> <li>Information dissemination on existing BDS offer (information provision)</li> <li>Introduction of incentives for MSMEs to use BDS services (e.g. vouchers)<sup>183</sup></li> </ul>	<ul style="list-style-type: none"> <li>Identification of new market segments for BDS providers</li> <li>Awareness raising and information dissemination amongst BDS stakeholders (providers, support institutions, facilitators, etc.)</li> <li>Networking and platform building for BDS providers (especially local business intermediaries)</li> <li>Technical assistance and training for capacity building and institutional strengthening of BDS providers</li> </ul>
<b>Micro level</b> <i>'Traditional approach':</i> <b>Expanding BDS delivery to MSMEs</b>	<ul style="list-style-type: none"> <li>Diagnostic studies (carried out through the BDS programme or existing local BDS providers) to identify needs of MSMEs</li> <li>Awareness raising among MSMEs on the potential benefits of BDS</li> <li>Business linkages including linking buyers and suppliers through match-making events or business-to-business partnership meetings and inter-enterprise twinning/mentoring<sup>184</sup></li> </ul>	<ul style="list-style-type: none"> <li>Development of new BDS products (product development) based on customers' needs</li> <li>Improvement of existing BDS products (product adaptation) for targeted customers</li> </ul>

<sup>182</sup> The activities on the demand side in the shaded box are relevant to both micro and meso levels of intervention.

<sup>183</sup> Subsidizing (co-funding with the beneficiaries/customers of) service delivery may be necessary when local purchasing power related to BDS is particularly low and the BDS market needs to be kick-started or supported in its evolution towards sustainability. However, while instruments like voucher schemes may be effective if appropriately designed and implemented, matching grants (i.e. direct provision of grants to enterprises aimed at paying for BDS) are not recommended, due to the fungibility of cash grants and the possibility of the funds not being used for the expected purpose. In order to avoid as much as possible market distortions and to enhance sustainability prospects, subsidies are better placed in a less intrusive position, such as before the point of delivery (i.e. at the level of the BDS provider).

<sup>184</sup> See, however, the special observations made on business linkages activities at end of section 3.1.

### **Box 3. EC Institutional Capacity Building and Information Dissemination - Support to Micro and Small Enterprises in Kenya.**

This EC-funded programme supported the development of MSEs in Kenya through (a) institutional and capacity building of Business Associations, BDS providers, Micro Finance Institutions and other non-state actors involved in promoting and developing MSEs (e.g. improvement of existing BDS, development of new BDS); and (b) the dissemination of business information through Business Information Centres (e.g. business management, market research and market access, access to BDS); and (c) specific sectoral support targeted primarily at agro-processing, packaging and value addition, mainly in the horticulture and fisheries sectors.

### **Box 4. EC Institutional Capacity Building of BDS Providers - Private Sector Development Programme (PSDP) in Zambia.**

Under the institutional capacity building support component of the EC-funded PSDP, ten intermediary organizations/BDS providers in Zambia benefited from technical assistance for the improvement of their existing BDS and the design of new BDS in areas such as business management training, marketing, product development, business planning and entrepreneurship development. BDS providers submitted training and capacity building projects to obtain financing and technical assistance from the PSDP on a cost-sharing basis.

### **Box 5. EC Private Sector Support Programme (PSSP) in Swaziland.**

The development of the small-scale enterprise sector and the fostering of linkages with the large-scale manufacturing sector in order to improve production and technological capacities was one strategic priority area for the EC-funded PSSP in Swaziland. In order to actively promote linkages between small businesses and larger manufacturing companies the programme established an advisory service on at the Chamber of Commerce that used its knowledge of the private sector to develop a business network and manage the process of matching the capacities/capabilities of small businesses with the demand and requirements of larger companies, also stimulating the delivery of business-to-business BDS within the value chain.

### 3. How can it be done?

#### 3.1 Methods and levels of intervention

As already mentioned in Section 1.4.2 under ‘Key issues’, two main methods of supporting BDS through development interventions can be distinguished: the ‘Traditional’ approach and the ‘Market development’ approach.

The appropriate choice of intervention depends on the analysis and outcome of the BDS market assessment. In recent years, the trend in BDS support leans towards market development. Public intervention is shifting away from direct provision of subsidized BDS, while focusing on a facilitation function in the demand and supply of BDS services. One of the key assumptions of the BDS market development intervention is however a minimum level of presence and capacity of local BDS providers, as well as the awareness of and propensity to use BDS by local enterprises. Within this approach the support intervention focuses at the meso level, by concentrating resources on the capacity building and institutional strengthening of local BDS providers. The inclusion of some activities at the micro level may be relevant for BIOs’ on-the-job learning and for demonstration effect (examples of positive BDS impact on MSME performance). An example of this approach is the programme CA Invest (see Box 6).

The traditional BDS direct delivery intervention (focusing at the micro level) is suitable to contexts where the local market of BDS providers is not yet developed (e.g. low capacity or absence of BDS providers), as for example can be the case in post-conflict countries and fragile states. In such environments, infrastructure and enabling private sector policies and legislation are generally lacking or insufficient, and local intermediary organizations non-existent or very weak. In this case firm-level assistance in accessing BDS (direct delivery, cost-sharing, vouchers) can be seen as a transitional development intervention until the local market for BDS providers has been further developed (e.g. strengthened capacity of BDS providers) and the awareness of BDS among local enterprises has been increased. Demonstration effect (promotional aspect), on-the-job capacity building by local providers, as well as targeted support to address specific bottlenecks in value chains are among the most prominent advantages of this approach.

The main characteristics of both approaches are briefly described in Table 5 <sup>185</sup>.

#### Box 6. CA-Invest - Central Asian countries (2007-2011)

Central Asia Invest is a regional programme that aims to promote the sustainable economic development of Central Asian Countries (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan) by encouraging the development of local Small and Medium Enterprises (SMEs). The programme supports the establishment of relationships between European and Central Asian Business Intermediary Organisations (BIOs), with a view to the integration of the Central Asian markets in the world economy. CA Invest supports capacity building projects for BIOs in Central Asia, with the aim to develop a sustainable local BDS market. The activities aim to upgrade organisational strategies and systems, enhance the skills of staff members and reinforce networking. A combination of activities at the meso and micro levels makes the BIOs better equipped to service local businesses and to facilitate trade between Europe and Asia. Round tables and capacity building workshops, entrepreneurship training and matchmaking events, as well as the establishment of a EU-Central Asia Business Network are examples of activities aimed at enhancing capacity of and linkages between BIOs. More information can be found at [http://ec.europa.eu/europeaid/where/asia/regional-cooperation-central-asia/sme-development/ca\\_invest\\_en.htm](http://ec.europa.eu/europeaid/where/asia/regional-cooperation-central-asia/sme-development/ca_invest_en.htm)

<sup>185</sup> Adapted from ILO (2003) BDS Reader: Developing Commercial Markets for Business Development Services, BDS Primer by Miehlbrandt, A. & MacVay, M. for ILO SEED.

Table 5. Comparison of BDS intervention approaches

Aspects	'Traditional' (direct BDS delivery) intervention	BDS 'Market development' intervention
Scope	A non-profit or government organisation, often through a donor co-funded intervention provides BDS directly to MSMEs.	A primarily private sector market made up of competing BDS suppliers providing a range of services to MSMEs with at least partial cost-recovery.
Objective	To increase MSME access to BDS in a relatively fast and targeted manner.	To encourage others (BDS providers) to develop and provide services to MSMEs on a commercial basis.
Starting Point	Diagnosis of enterprise needs (needs analysis), surveys.	Assessment of BDS market (demand, supply side of BDS market, potential).
Entry-point of intervention	'First tier': direct provision to MSMEs of BDS through the project or through a local institution	'Second tier': facilitate and develop products for MSMEs, build the capacity of more than one BDS provider.
Sustainability and duration of involvement	Long term donor-funded programs for BDS delivery to MSMEs are not sustainable.	Temporary donor support, to be withdrawn as BDS market develops and becomes self-sustaining.
Subsidising access to BDS	Support free or low-price <sup>186</sup> services to MSMEs. Justified when MSMEs in particularly problematic environments are unable to cover full costs.	Financial support to BDS suppliers or cost-sharing of BDS at the point of delivery in the short run, if market development impact (including demonstration effect) outweighs distortion.

A particular observation may be made on business linkages activities. Though they have been subject, and still are, of EC-funded programmes organized on a regional basis, their effective impact may be questioned as they generally operate outside wider business support programmes, leaving the local enterprises too often without the support needed to take advantage of linkage opportunities. In this context, expectations of the companies from developed countries and from developing countries are not necessarily the same, undermining the relevance of such linkages.

### 3.2 Sequencing of activities

Depending on the analysis of a BDS market, the relevant key activities and levels of intervention can either be sequenced (e.g. capacity building of BDS providers as a first step, and provision of relevant information and incentives for BDS consumers as a second step), or carried out in parallel (intervention on the supply and demand side of a BDS market) at the same time.

### 3.3 Expected results and indicators

Results measurement of BDS support can be articulated into three categories of performance indicators, related to market development, institutional performance and client impact. Selected indicators used to measure key dimensions of BDS interventions are provided in Table 6.

<sup>186</sup> Although actual cost of delivery may be relatively high, especially in the early phases of BDS delivery and in marginal, underserved areas, very low prices may be charged whose primary aim is not cost-recovery per se but rather the attachment of value to the training (or other service) and signalling of genuine interest by the would-be or existing trainee entrepreneurs paying a nominal fee to participate.

**Table 6. Selection of results and indicators for measurement**

Results	Indicators
<b>The BDS market is developed and expanded</b>	<ul style="list-style-type: none"> <li>• Market size, demand: Number of MSMEs purchasing BDS</li> <li>• Market size, supply: Amount of annual sales of BDS</li> <li>• Market penetration: % of MSMEs accessing BDS services</li> <li>• Awareness: % of MSMEs aware of BDS services</li> <li>• Reach: % of those aware who have purchased BDS service at least once</li> <li>• Geographic outreach: Number of MSMEs by region purchasing BDS</li> <li>• Industry outreach: Number of BDS users by industrial sector</li> </ul>
<b>The BDS market has been deepened to reach underserved groups</b>	<ul style="list-style-type: none"> <li>• Absolute number/ percentage (%) of BDS customers by geographic area (e.g. urban and rural area)</li> <li>• Absolute number/ percentage (%) of BDS customers by target group (e.g. gender, youth)</li> <li>• Percentage (%) of target users purchasing BDS</li> <li>• Percentage (%) of potential MSMEs accessing BDS services</li> </ul>
<b>BDS are adapted to MSME needs and are available and relevant to customers</b>	<ul style="list-style-type: none"> <li>• Number of BDS providers (disaggregated by type of BDS provider e.g. business associations, business incubators)</li> <li>• Number of BDS service products offered</li> <li>• Number and proportion of repeat customers out of all BDS clients</li> <li>• Customer satisfaction with BDS use</li> </ul>
<b>BDS providers and facilitators use resources effectively and ensure effective delivery on a continuous basis</b>	<ul style="list-style-type: none"> <li>• Number of BDS suppliers at start of program compared to number of BDS suppliers at the end of program</li> <li>• Range and diversity of BDS offered (degree of service development)</li> <li>• Profitability of BDS suppliers and particular BDS service(s)</li> <li>• Ratio comparing total program cost to aggregate program benefits</li> <li>• Total program cost per BDS customer served</li> <li>• Total program cost per BDS supplier assisted</li> </ul>
<b>Business performance of MSMEs improved following regular use of appropriate BDS</b>	<ul style="list-style-type: none"> <li>• Change in percentage of customers applying BDS to their business as defined by the program (e.g. proportion of MSMEs who assessed new markets, developed new products, improved management practices, started keeping formal accounts, etc.)</li> <li>• Change in percentage (%) of BDS customers reporting a high satisfaction rating with BDS</li> <li>• Change in percentage (%) of repeat customers purchasing BDS (% of customers that purchase at least twice)</li> <li>• Change in estimated gross profit (in %) from before and after using the BDS service (attributed by the customers, or by enterprise analysts, to the change in BDS)</li> <li>• Change in sales / revenue / export quantities and value (in %) (attributed to BDS access)</li> </ul>

*Adapted from Joint Donor Committee for Small Enterprise Promotion, 'BDS Bluebook', 2001*



### Box 8. BDS and Cross-Cutting Issues (Gender) - Egyptian Social Development Fund (SFD)

As far as ensuring the participation of women in an EC funded SME project, the Egyptian Social Development Fund (SFD) with its large Small Enterprise Development Organization (SEDO) component is a positive example. SFD focuses on combating poverty and as such was involved in the design of a poverty map that offers a support mechanism to identify and target low-income groups and provide various programs of assistance and services aimed at low-income groups, in particular female headed households. SFD has adopted a policy that emphasizes women's role in the small enterprise sector. Its gender strategy has three main components: 1) Developing women's skills and capabilities 2) Feminizing the culture of entrepreneurship 3) Establishing a businesswomen network. A Women and Development Unit was created in 1998, later changing its name to Gender Unit. Gender-disaggregated statistics are used by SEDO, distinguishing between men and women among the borrowers.

### Box 9. BDS and Cross-Cutting Issues (Environment) - Ghana's Woodworking Programme

The overall objective of the EC-funded Ghana Woodworking Programme is the growth of the country's export revenue through support of the non-traditional exports in the woodworking sector, while ensuring the compatibility of these developments with the principles of sustainable forest management. Through training and awareness raising events, many companies realised the need to conserve the tropical forests and avoid wasteful depletion of such resources. The programme advised companies on forestry certification and specific certification programmes have been developed. A specific target has been set that 250,000 ha will be certified as 'sustainable managed' by the Forest Stewardship Council within a specific time frame.

## 3.4 Cross-cutting issues

Mainstreaming of cross-cutting issues into BDS interventions can be addressed by the choice of the intended target group (end beneficiaries), the choice of sectors/sub-sectors benefiting from the BDS intervention, as well as the types of BDS provided:

- Selection of target group(s) with high percentage of women employees, women entrepreneurs or women-owned businesses (*gender*);
- Choice of sectors/sub-sectors with a positive impact on the *environment* (e.g. organic products/agriculture, alternative/renewable energy);
- Type of BDS provided, e.g. provision of specific BDS to encourage the development of new environmental friendly products and adoption of 'green' technologies (*environment*) or technical assistance for the development of an industry code of conduct (good governance).

In order to emphasize cross-cutting issues, it is important to reflect them explicitly by including relevant and specific indicators in the program log-frame during the design phase.

## 3.5 Risks

Some of the risks that need to be considered when designing and implementing BDS interventions include the following:

- Development of programmes which are intervening directly at the transaction level (delivery/supply-side and consumption/supply-side of BDS) where potential market distortion is more invasive instead of focusing on the pre-transaction (e.g. ideas, BDS development, developing people and organizations, market information).
- Despite a well defined exit strategy<sup>187</sup>, market evolution does not support the new BDS provider established or strengthened by the intervention.

Overall, it should be noted that the results of a sustainable BDS support intervention will be linked to and influenced by market dynamics. These will entail a number of risks that are beyond the control of a BDS intervention, especially beyond its time-frame.

<sup>187</sup> The exit strategy should be defined at the beginning of a BDS intervention and be linked to the achievement of specific objectives, such as the creation of a sustainable BDS provider that has the institutional capacity to become sustainable (financially as well as institutionally) beyond the period of an intervention.

## 4. Where to find out more?

Much has been written about the topic of Business Development Services. The listing below provides useful sources for those readers who need more in-depth information.

### 4.1 Useful websites

**BDS Forum:** The BDS Forum is a database and discussion forum covering different aspects related to business development services. It includes information on different BDS strategies, case studies, useful links and tool kits, among others: [www.bds-forum.net](http://www.bds-forum.net)

**BDS Knowledge:** This website is structured around the following phases in the 'life cycle' of a typical market development programme or project: Market Assessment, Project Design, Implementation, Impact Assessment and Final Documentation. The website includes, among others, useful information on seminars and conferences: [www.bdsknowledge.org](http://www.bdsknowledge.org)

### 4.2 Selected readings

**ADE, 'Evaluation of European Community Support to Private Sector Development in Third Countries',** Final Report (incl. Annexes 1-10), December 2005. It provides useful findings and recommendation in the area of private sector development.

**Assessing Markets for Business Development Services: What have we learned so far?** by Miehlabrad, A., International Labor Organization (ILO), 2002. Based on 13 market assessments conducted by various donors, this paper looks at BDS markets and how developed they are. A useful source for BDS market assessments. [http://rbec.undp.org/index.cfm?menu=p\\_search/p\\_result/p\\_documents&DocumentID=4802](http://rbec.undp.org/index.cfm?menu=p_search/p_result/p_documents&DocumentID=4802)

**Assessing the Poverty Impact of Small Enterprise Initiatives,** by Nexus Associates, Inc., for DCED, September 2003. Provides a conceptual framework for measuring the poverty reduction impact of SME programmes, particularly those that focus on BDS. It represents specific methods that can be used in such assessments. [http://rbec.undp.org/index.cfm?menu=p\\_search/p\\_result/p\\_documents&DocumentID=4804](http://rbec.undp.org/index.cfm?menu=p_search/p_result/p_documents&DocumentID=4804)

**Best Practice in providing BDS to SMEs** by Asian Development Bank, GFA, Swisscontact. Policy Discussion Paper No. 2, 2002. The paper looks at the shift in approach to the support to business development services. [http://rbec.undp.org/index.cfm?menu=p\\_search/p\\_result/p\\_documents&DocumentID=4807](http://rbec.undp.org/index.cfm?menu=p_search/p_result/p_documents&DocumentID=4807)

**Blue Book – Business Development Services for Small Enterprises: Guiding Principles for Donor Intervention** by the Committee of Donor Agencies for Small Enterprise Development, 2001. The Blue Book outlines the new paradigm of BDS provision, which shifts the focus of the donor interventions from the direct provision and subsidies to a more strategic and sustainable BDS market development/facilitation i.e. facilitation of demand and supply of services, addressing the constraints which prevent BDS markets from functioning effectively. [http://rbec.undp.org/index.cfm?menu=p\\_search/p\\_result/p\\_documents&DocumentID=4775](http://rbec.undp.org/index.cfm?menu=p_search/p_result/p_documents&DocumentID=4775)

**Getting Realistic about Creating Financially Sustainable Business Development Institutions** by Stanton, D. and Boulter, R., DfID, 2002. The paper briefly reviews 3 particular BDS institutions supported by DfID in the context of the current emphasis on achieving financial and institutional sustainability. [http://rbec.undp.org/index.cfm?menu=p\\_search/p\\_result/p\\_documents&DocumentID=4818](http://rbec.undp.org/index.cfm?menu=p_search/p_result/p_documents&DocumentID=4818)

**Department for International Development (DFID), 'How to support Business Development Services',** How to Note No. 4, 10 December 2003. Provides information about DFID's approach towards BDS. [www.sed.manchester.ac.uk/research/iarc/edais/word-files/HowtoSupportBusinessDevelopmentServices.doc](http://www.sed.manchester.ac.uk/research/iarc/edais/word-files/HowtoSupportBusinessDevelopmentServices.doc)

**Gesellschaft für Technische Zusammenarbeit (GTZ), 'Making Business Development Services Markets Work for the Poor'** (elaborated for the OECD –ProNet Task Team on Private Sector Development and Pro-Poor Growth), Eschborn 2005. Provides information about BDS and their application as well as their relevance towards making markets work for the poor. <http://www2.gtz.de/dokumente/bib/06-1278.pdf>

**Guide to Market Assessment for BDS Programme Design** by Miehlabrad, A., ILO, 2001. This is a very useful and comprehensive guide for donor agencies and facilitating organizations before they start designing BDS programmes. The guide explains the reasons for market assessment, what information an assessment can provide and what are its limitations, what information an assessment should aim to collect and what tools are available for collecting information, how this information should be analyzed and used for programme design and last but not least, how to keep market assessment cost effective. [http://rbec.undp.org/index.cfm?menu=p\\_search/p\\_result/p\\_documents&DocumentID=4819](http://rbec.undp.org/index.cfm?menu=p_search/p_result/p_documents&DocumentID=4819)

**SEEP Guide to Business Development Services and Resources** by SEEP Network. The guide summarizes different BDS types, donor strategies, selection of services and service delivery mechanisms and performance measurement. It also refers to case studies and examples of best practices around the world. [http://rbec.undp.org/index.cfm?menu=p\\_search/p\\_result/p\\_documents&DocumentID=4820](http://rbec.undp.org/index.cfm?menu=p_search/p_result/p_documents&DocumentID=4820)

**Business Linkages: Lesson, Opportunities and Challenges** by IFC, International Business Leader Forum and Fellows of Harvard College (2007). The report provides useful examples of corporate action to promote Business Linkages; addresses the challenges in the practice of Business Linkages and provides a wide sampling of Business Linkages initiatives developed all around the world. [www.iblf.org/docs/BusinessLinkages.pdf](http://www.iblf.org/docs/BusinessLinkages.pdf)

**Swiss Agency for Development and Cooperation (SDC), 'Analysis of Swisscontact's Experience in the Promotion of Women Entrepreneurs in Micro-, Small and Medium sized Enterprises', SED Issue Paper No. 6, March 2001.** Provides information on BDS and cross-cutting issues with focus on women entrepreneurs, citing several project examples in developing countries which have been implemented by SDC. [www.value-chains.org/dyn/bds/docs/308/issue6.pdf](http://www.value-chains.org/dyn/bds/docs/308/issue6.pdf)

**United Nations Development Programme (UNDP), 'Business Development Services – How To Guide', UNDP Bratislava Regional Centre July 2004.** Provides information in form of a checklist covering main issues related to BDS interventions. <http://europeandcis.undp.org/poverty/show/FA14BD48-F203-1EE9-BFE68960B3314C1D>

### 4.3 Training opportunities

**ILO BDS Annual Seminar:** The *ILO BDS Annual Seminar* brings together BDS practitioners from around the world, who are engaged in designing and implementing projects to support small enterprise development and all share an interest in new ideas and approaches that may increase effectiveness: <http://learning.itcilo.it/bdsseminar/>

**ILO International Training Centre – Enterprise Development:** The *ILO International Training Center* offers BDS training courses in the following areas: Developing Commercial Markets for BDS, Managing BDS Providers for Increased Impact, Diploma Course in Market-Oriented BDS, SME Cluster Development: Principles and Practice (in cooperation with UNIDO): [www.itcilo.it/english/bureau/turin/training\\_calendar](http://www.itcilo.it/english/bureau/turin/training_calendar)

**Springfield Centre:** The *Springfield Centre* is an independent consulting, training and research organization specializing in private sector and small enterprise development in low-income countries. It offers a Business Development Services Training Programme, which is an intensive UK-based three-week course focusing on BDS programme design and management, with a practical emphasis. Aimed at senior staff in BDS funding, promotion and implementing organizations, the programme covers the essential principles, core skills and emerging experiences of BDS Best Practice: [www.springfieldcentre.com](http://www.springfieldcentre.com)



## **Thematic Review 10**

### **Doing Business with the Poor**

# 1. What does the theme cover?

## 1.1 Introduction

It has long been recognised that the private sector is key to economic growth and, through the right transmission channels, can contribute towards development and poverty alleviation by taking risks and attracting the investment, creating employment and generating revenues for the workers and by expanding the supply of goods and services. However, the many gaps, weaknesses and constraints existing in developing countries which hinder the development of the private sector tend to show that traditional ways of support to private sector development, while necessary, are not sufficient. Moreover, businesses do not necessarily target and/or benefit the poor. Yet low income communities harbour a potential for consumption, production, innovation and entrepreneurial activity that is largely untapped. This perspective coupled with principles of social responsibility and respect of social and environmental standards opened new ways to look at the potential role of private sector in development.

A growing body of literature and project experience suggests that market-based approaches to poverty reduction and innovative business models can increase the private sector's contribution to poverty reduction, development and achievement of the Millennium Development Goals. In particular, companies can more specifically serve the poor as clients and customers, but also engage with them as employees, producers/entrepreneurs and traders along the value chain, thus building capacities, generating employment and – if the environment is conducive – bringing small businesses from the informal into the formal economy. By developing innovative and affordable products and ensuring an inclusive value chain<sup>188</sup>, the private sector contributes to an improved overall quality of life, creating wealth with spill-over effects to the benefit of the wider population; and contributing to the provision of basic needs as water, sanitation, energy, housing, health care and communication services. In this connection, innovative approaches to engaging with the private sector in development can leverage private sector funding, skills and competences in a way which contributes to the countries' growth and competitiveness.

The number of development projects in this area however remains limited and contribution has, to date, most often consisted in grant funding schemes, co-funding of NGO initiatives, etc. However, the promising potential of these innovative projects calls for further interest.

The Commission, in its 2006 Communication "Making Europe a pole of excellence on corporate social responsibility" and more recently in its 2009 Communication on the role of Fair Trade and other non-governmental trade-related sustainability assurance schemes<sup>189</sup>, also underlines the interest and voluntary nature of such schemes. Both communications recognise the significance of such initiatives as dynamic mechanisms that develop along with societal and consumer awareness and demand, which also impact on requirements set within the framework of public procurement. For Fair Trade and similar sustainability schemes, the Commission has for that reason opted for an approach which aims not to privilege one scheme above another and let the private initiatives and the market (including through public procurement of decentralized public authorities) do their work.

In relation to innovative business models and other more recent approaches to engaging with private sector in development, the Commission services have announced a Communication for late 2011 and preparatory work has started.

This thematic review aims at this stage at presenting the various concepts and projects that have been/are being developed to inform in the first place, and to stimulate further thinking at the level of the Commission services. It does not pretend at this stage to go in-depth in terms of methods and tools for intervention and support through donor funded programmes.

## 1.2 Concepts and definitions

Figure 1 maps established and new ways of doing business in relation to the inclusion of the poor as economic actors.

The EU defines **Corporate Social Responsibility (CSR)** as "a concept whereby companies integrate responsible business practices and social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis."<sup>190</sup> CSR goes beyond philanthropy and compliance with social and environmental standards to address how companies manage their economic, social, and environmental impacts, as well as their relationships in all key spheres of influence: the workplace, the marketplace, the supply chain, the community, and the public policy realm. CSR deals with a number of different topics at different levels (industrial relations, labour standards, health and safety, stakeholder dialogue, human rights,

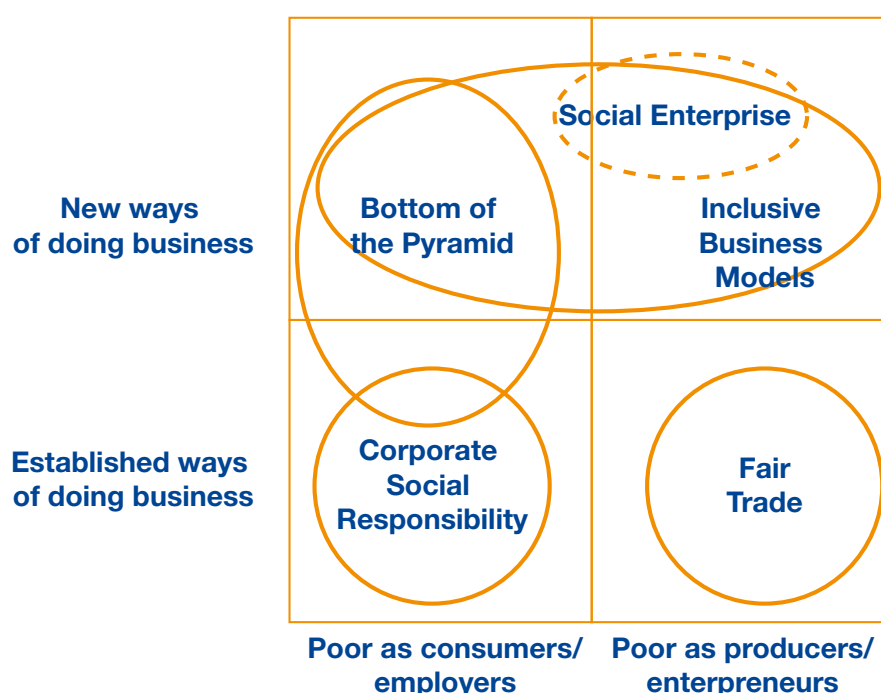
188 "Inclusive value chain" refers to the concept of "inclusive business model", which aims at integrating in the value chain the actors that used to be excluded, such as low-income or low-skilled communities, so that they take an active economic role as entrepreneurs, producers, consumers.

189 Communication of the Commission to the Council, the European Parliament and the European Economic Social Committee, Contributing to sustainable development: The role for Fair Trade and non-governmental trade assurance schemes. COM(2009) 215 final. [http://trade.ec.europa.eu/doclib/docs/2009/june/tradoc\\_143373.pdf](http://trade.ec.europa.eu/doclib/docs/2009/june/tradoc_143373.pdf)

190 "Making Europe a pole of excellence on corporate social responsibility - COM(2006) 136."



Figure 1. Innovative approaches of doing business with the poor



environmental concerns, etc.). That is why often, even among practitioners, similar terms are used<sup>191</sup> and various definitions are given.

**Fair Trade** is an alternative approach to conventional trade that aims to provide more balanced terms of trade for marginalized producers, workers and their communities.<sup>192</sup> The concept was shaped in Europe in the 1960s when concern grew about the flaws and unequal outcomes of mainstream business models and trade flows. The Fair Trade concept is based on a tripartite commitment by the producer, trader and consumer. The consumer is willing to pay a little more for the product (a 'social premium') in return for an assurance that this will translate into better conditions for the producer. The producer agrees to develop a community-based approach to production in the form of producer organisations and to comply with a number of social and ecological standards. The trader agrees to buy the product at a price guaranteed to cover the production costs (usually more convenient and more stable than global prices), to offer a premium over market prices and to sign long-term purchasing contracts. Inspired by Fair Trade initiatives a growing number of schemes of ethical trade have been and continue to be set up. They are voluntary initiatives sharing similar objectives: lift producers from developing countries out of poverty.<sup>193</sup>

**Bottom (or Base) of the Pyramid (BoP)**<sup>194</sup> models were developed based on the work by C.K. Prahalad in the 1990s. BoP strategies were initially developed to market good quality and affordable goods and services to the largely untapped 4 billion people living under the poverty line. This however required a shift in the enterprise strategy, and the setting up or strengthening of the relevant value chains of producers and suppliers, developing appropriate distribution channels, and identifying stimulating/creating demand at the local level. BoP initiatives paved the way for a wide array of market-based interventions aimed at poverty reduction. They rely on three success factors, the 3 A's: affordability (requiring innovation to adapt to the purchasing power of the target market); access (often distribution costs are higher than production costs); awareness (adapting marketing approaches to social groups under the poverty line).

More recently, Base of the Pyramid approaches evolved into a more comprehensive concept of '**inclusive business**' by putting more emphasis on the active involvement and capacity building of the local actors as entrepreneurs (both producers and distributors), in order to ensure a wider redistribution of benefits and clearer pro-poor focus, generating jobs and income at the local level.

191 It should be noted that in this area, the terminology is not clear cut. Terms such as corporate citizenship or responsible business may be used to describe similar activities, while the same terms may be used to cover different things. However these should not be confused with 'corporate governance', which is a set of processes, customs, policies, laws, and institutions affecting the way a corporation (or company) is directed, administered or controlled.

192 See [www.fairtradeadvocacy.org/images/charterfairtradeprinciples.pdf](http://www.fairtradeadvocacy.org/images/charterfairtradeprinciples.pdf). The Fair Trade General Principles contained in the Charter refer to: (a) Market Access for marginalised producers, (b) Sustainable and equitable trading relationships, (c) Capacity building and empowerment, (d) Consumer awareness raising and advocacy, (e) Fair Trade as a 'social contract'. Further principles refer to decent working conditions (as per ILO conventions), and environmental sustainability.

193 See also EuropeAid's information note on Fair Trade (September 2009). [www.cc.cec/dgintranet/europeaid/activities/thematic/e6/documents/rural\\_development/fair\\_trade\\_edited\\_final\\_version\\_en.pdf](http://www.cc.cec/dgintranet/europeaid/activities/thematic/e6/documents/rural_development/fair_trade_edited_final_version_en.pdf)

194 Later renamed 'base of the pyramid' in a more positive tone and wider outreach.

A subset of inclusive business models, **social enterprises**, aims at using the market and enterprise model as a tool for socio-economic development (while traditional BoP sees poverty reduction as a positive consequence of the market mechanism, not an objective *per se*). One of the distinctive features of social business is that profit is re-invested in the company in order to continue pursuing its social objectives (local development). Social enterprises often assist in filling the gaps in the public delivery of social services (e.g. health, education).

So-called '**new business models**' have therefore emerged as market-based approaches articulated around one or more of the following four dimensions<sup>195</sup> (with more or less emphasis on each, depending on the business project, context and actors involved):

**Innovation:** new appropriate products are developed, made affordable and accessible for customers under the poverty line. This often requires changing companies' processes and organization (e.g. access to mobile phones in Africa reaches more than 2/3 of the population, while landline access remains difficult. This expansion has been possible through different business strategies: phone sharing, village phone, street vendors offering mobile access on a per call basis...).

**Co-creation:** existing products are adapted to the specific situation of poor customers. It requires a thorough analysis of the targeted population to assess their needs and capacities and adapt the product to their daily life patterns. It also often requires the relevant technological innovation (e.g. mobile phone services include money transfers and other financial services, trade and market understanding (check the crop prices for instance), health-related services (long distance primary medical consultations).

**Value chain:** enterprises widen their scope and extend their work along the value chain, from production to distribution. It also calls for better institutional and public responses, such as in infrastructure and education (e.g. in Bangladesh the Danone Grameen Foods: Danone and the Grameen bank partner to locally produce a special and nutritious yoghurt, with milk sourced and processed locally, and yoghurt distributed locally). However, experiences based on local enterprises demonstrate that the involvement of multinational companies (MNCs) is not always essential to this approach.

**Social business:** the main objective of the business project in this case is social, and market and enterprise are only a way to attain it. It tends to involve segments of value chains involving local economic

actors and strengthening the local economic fabric (like in the inclusive business approaches), however profit for shareholders is not the main goal. While return on investment is also in this approach key for the sustainability of the business, profit is reinvested in the company to continue pursuing its social objectives.<sup>196</sup>

### 1.3 Rationale for intervention in developing countries

More responsible business practices as well as inclusive business models can be instrumental in reducing poverty and achieving the MDGs. Indeed, businesses can contribute in many ways to development, for example by providing goods and services, generating jobs and income and contributing to economic growth. But when products, services and jobs are targeted to poor communities they can trigger another set of benefits, like providing 'decent work' opportunities (e.g. increased compliance with labour standards may be promoted through CSR, fair or ethical trade initiatives), improved economic opportunities (e.g. social and environmental premium pricing through fair trade or other certification schemes, longer term buyer/supplier relationships, better integration of poorer communities in domestic and international value chains), innovative products, services or distribution channels that improve the poor's quality of life.

However, the business case for inclusive business models is not always apparent or well understood. Knowledge is often lacking about the potential opportunities and benefits related to investment, production, market access and branding, as outlined in Figure 2. Furthermore, risks associated with getting involved in new markets at the base of the pyramid, are often perceived as higher than for more mainstream approaches to business. For these reasons, support from development partners may be necessary to improve private sector's awareness of and potential for the above opportunities, and help in better assessing as well as reducing risks and upfront costs of investing in a new area and model. The rationale for engaging with business lies in the important potential for synergies between business and development.

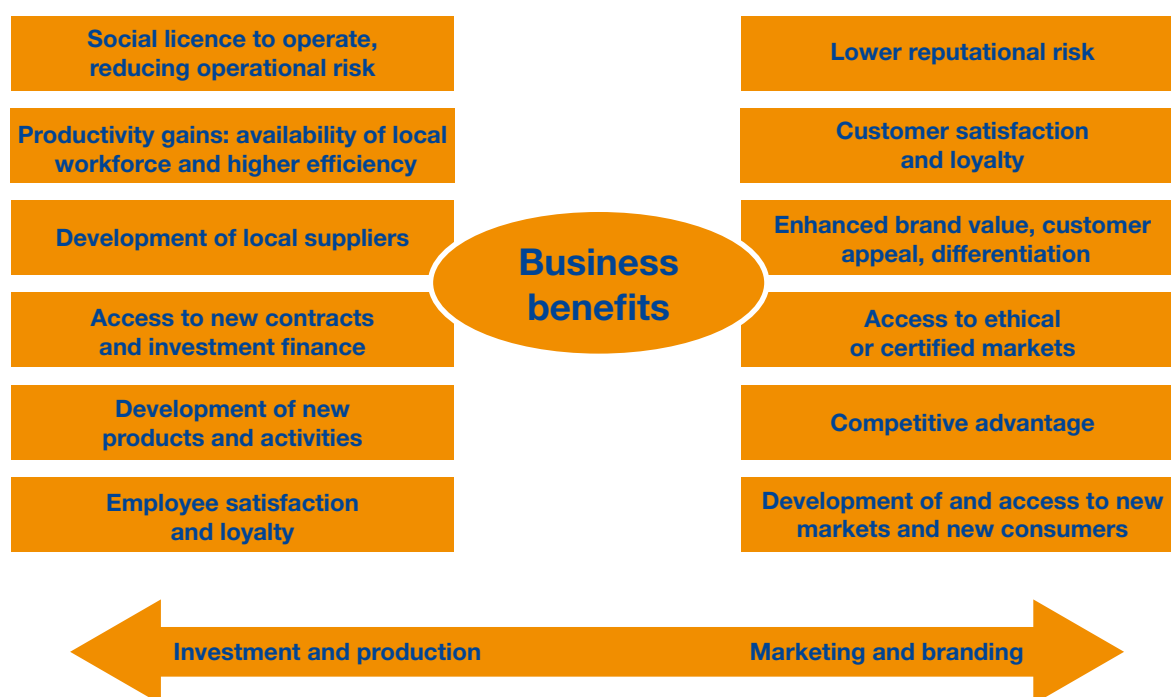
This is why, at the occasion of the September 2010 United Nations MDG Summit, a number of bilateral donors have adopted a joint statement strongly endorsing the powerful role which businesses can play in developing sustainable and market based solution to deliver economic and social progress and declaring their shared intention to support such private sector engagement for development and to make efforts to scale up such engagement<sup>197</sup>.

<sup>195</sup> For more details, see the site of the BoP Observatory: [www.bopobs.com](http://www.bopobs.com)

<sup>196</sup> These social enterprises are also called double bottom-line enterprises as they have to be viable (profit-making) in order to have the resources to meet their social objectives. Triple bottom-line enterprises are those that at the same time also aim to meet specific environmental objectives.

<sup>197</sup> See statement on [www.sida.se/Global/Nyheter/Bilateral%20Donor's%20statement.pdf](http://www.sida.se/Global/Nyheter/Bilateral%20Donor's%20statement.pdf)

Figure 2. Business benefits of private sector engagement in development



Source: "Returns on investment in responsible business practice: higher in a downturn?" ODI, London (2009)

## 1.4 Legal and regulatory context

No national legal or regulatory framework requires enterprises to adopt CSR practices, fair trade principles or inclusive business models. However, there is growing pressure at the international level for companies to demonstrate compliance with a number of international social and environmental standards for increased market access. A sample of instruments that may influence business conduct in the social and environmental area is presented below.

- Multinationals responding to consumer concerns and/or requirements in their target markets<sup>198</sup>, increasingly participate in international initiatives (e.g. UN Global Compact<sup>199</sup>) and require suppliers to follow certain social and environmental provisions most often through implementation of codes of conduct or conformity with international standards and certification schemes (organic, fair and ethical trade, environmental management,...)<sup>200</sup>.
- The OECD Guidelines for Multinational Enterprises set recommendations addressed by governments to multinational enterprises and provide voluntary principles and standards for responsible business

conduct in areas such as employment and industrial relations, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition and taxation.<sup>201</sup>

- The Equator Principles, promoted by the International Finance Corporation (IFC), and adopted by a growing number of financial institutions, are a voluntary set of standards for determining, assessing and managing social and environmental risk in project financing.<sup>202</sup>
- The 2006 ILO tripartite Declaration of Principles concerning multinational enterprises and social policy provides guidelines to businesses, governments, employers' and workers' organizations in such areas as employment, training, conditions of work and life, and industrial relations.
- The ISO 26000 on Social Responsibility contains standards for transparent corporate legal structures, human rights, good working conditions, compliance with the imperatives of environmental and climate protection, fair competition and anti-corruption, consideration of consumer interests, social commitments for society as a whole.

198 In some countries, certain categories of enterprises have the legal obligation to report on CSR issues down their supply chains.

199 The United Nations Global Compact is a strategic policy initiative for businesses that commit to aligning their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption. See [www.unglobalcompact.org](http://www.unglobalcompact.org)

200 These can be the multinationals' own code of conduct, international compliance schemes like the Fair Labour Association (labour standards), ISO 14001 (environmental management), EMAS (environmental management), FSC (Forestry Stewardship Council on sustainable forest management), Max Havelaar (fair trade), Rainforest Alliance (fair trade), organic labeling schemes, etc.

201 These Guidelines are part of the OECD Declaration on International Investment and Multinational Enterprises. Governments adhering to the Guidelines encourage the enterprises operating on their territories to observe the Guidelines wherever they operate, while taking into account the particular circumstances of each host country. For further information, see [www.oecd.org/daf/investment/guidelines](http://www.oecd.org/daf/investment/guidelines)

202 [www.equator-principles.com](http://www.equator-principles.com)

- At the international level, social and environmental provisions may also be included in international/regional trade agreements (e.g. CAFTA, AGOA), systems of preferences (e.g. EU GSP+) or other sets of rules (e.g. EU FLEGT regulation and related voluntary partnership agreements<sup>203</sup>).

It should be noted that fair and ethical trade, corporate social responsibility and inclusive business models are of a voluntary nature. Most of the above instruments are thus not binding but voluntary initiatives, codes of conduct and declarations of principles.

## 1.5 Key actors and issues

### 1.5.1 Key actors

At the firm level, multinational and national corporations, SMEs and social enterprises are naturally at the heart of private sector's engagement in development. They are the ones voluntarily engaging in fairer and more sustainable practices, and moving towards better inclusion of the poor in business models and value chains.

At the meso level, business intermediary organisations (BIOs) can play an important role in raising awareness of corporate social responsibility, fair trade and inclusive business models, providing relevant information, sharing/disseminating experiences and contributing towards building capacities. Other stakeholders, including NGOs, professional associations, universities and research institutions, business and public policy schools, may also play a role in enhancing private sector engagement, gathering and compiling information and case studies on best practices and lessons learnt, actively promoting and encouraging fairer and more sustainable business conduct, helping in brokering relevant partnerships, and partnering themselves with businesses in setting up business projects.

At the macro level, governments and public administrations can raise awareness of inclusive business initiatives, remove regulatory and other business environment constraints and define legal frameworks for potential opportunities for partnerships with the private sector for the pursuit of social goals and the delivery of public goods.

### 1.5.2 Key issues

The Commission has so far only a very limited experience with interventions in this area and has not a well defined policy for support in relation to corporate social responsibility and inclusive business projects. It appears important to highlight a number of issues which, on the basis of other donor's experiences and related studies, would seem to be key issues.

- a. An important question concerns the potential for facilitating such business projects involving the poor. In particular, five key constraints that hinder the development of inclusive business models have been identified by the UNDP Growing Inclusive Markets Initiative<sup>204</sup>:

- i. Limited **market information**: businesses often lack basic information regarding the poor's preferences, financial possibilities (what can they afford), and capabilities (products and capabilities they have to offer as employees, producers and business owners).
- ii. Ineffective **regulatory environment**: the markets of the poor lack regulatory frameworks that allow business to work. Rules and contracts are not enforced. People and enterprises lack access to the opportunities and protections afforded by a functioning legal system.<sup>205</sup>
- iii. Inadequate **physical infrastructure**: transportation, for example, is constrained by the lack of roads and supporting infrastructure. Water, electricity, sanitation and telecommunications networks are generally lacking in poor areas.
- iv. Inadequate **knowledge and skills**: poor consumers may not know the use and benefits of particular products, or may lack the skills to use them effectively. Poor suppliers, distributors and retailers may lack the knowledge and skills to deliver quality products and services consistently, on time and at a competitive price.
- v. Restricted **access to financial products and services**: lacking credit, poor producers and consumers cannot finance investments or large purchases. Lacking insurance, they cannot protect their meagre assets and income against shocks such as illness, drought or theft. And in the absence of transactional banking services, their financing is insecure and expensive.

One may add to this that the primary investment by the company leading the business project, will in practice need to take the form of 'patient capital'. Patient capital refers to the situation where the investor is willing to defer the return for an extended period of time (with the expectation of higher profits at a later stage).

It should also be noted that the constraints of the type mentioned under (ii) above should be tackled by interventions at the macro-level, not through support to business projects at micro-level or business support projects at meso level (strengthening

203 FLEGT stands for Forest Law Enforcement, Governance and Trade. The Council Regulation (EC) No 2173/2005 of 20 December 2005 on the establishment of a FLEGT licensing scheme for imports of timber into the European Community, aims to encourage the sustainable management of forests, ensuring legality of forest operations in partner countries. It is complemented by the regulation (EU) No 995/2010 of the European Parliament and of the Council that lays down obligations for the operators who place timber and timber products on the market.

204 UNDP (2008). "Creating Value for All: Strategies for Doing Business with the Poor." United Nations Development Programme. New York. July 2008. <http://www.undp.org/gimlaunch/docs/GIM%20Report%20Final%20August%202008.pdf>

205 This also links into the more general business enabling environment (see the Thematic review on Business Enabling Environment).

business organisations and business service providers). The constraints under (i), (iv), and (v) are issues which form entry points for bilateral donor support with a view to facilitating the set-up of business projects. Wider interventions and larger more important investment projects in the fields of infrastructure as mentioned under (iii) would go well beyond individual business projects and would be the subject of larger interventions aimed to improve the investment climate through the building of infrastructures (including through loan operations by development and investment banks).

- b. Business projects are in most cases individual business projects, involving one lead company working with local communities and micro and small enterprises and with not for profit organisations, including international NGOs. The projects tend often to be relatively small scale and rather context-specific. This and the overall business environment and investment climate in developing countries confront the private sector and donors with the challenge of scaling up inclusive business projects. It is generally challenging to adapt initial business model to new geographies and scales of operation when scaling up or replicating. However, in inclusive business, scale is important for business reasons (to compensate for low margins and reach commercial viability) and development reasons (to match the scale of the need on a sustained basis). In many cases the potential for scale comes from features such as:

- A “whole pyramid” orientation, in which higher-paying customers enable the company to cross-subsidize or to recoup the cost of up-front investments and expand service to low-paying customers at a low marginal cost.
  - Networks that provide cost-effective access to large numbers of suppliers, distributors, retailers, and/or consumers.
  - Collaboration and technology, which increase efficiency and expand outreach.
- c. In the fair and ethical trade area, key issues include the initial costs of joining Fair trade networks, as producers’ organisation, certification, inspection and monitoring procedures are costly. Furthermore, fair trade certification is subject to limitations as the number of products covered and the number of members remains small, as well as geographical coverage. Producers are also often able to sell only part of their production at a Fair Trade price to traders, which reduces the benefit/cost ratio for certification.
  - d. Fair and ethical trade is not a quick-fix. The restructuring of production and marketing chains are often time consuming processes, which require important degrees of initial investments and time commitment. It is thus key to consult and sustain dialogue with all stakeholders at different levels, notably traders or industrial processors, to ensure there is a long term sustained interest for such products. Wider market analysis and feasibility studies may need to be undertaken to ascertain the interest of traders or processors.



## 2. What can be done?

The EU supports Fair Trade and ethical trade interventions through co-funding within the framework of actions implemented by non state actors, both in developing countries and, for actions aiming at raising awareness among European consumers, in Europe.

In relation to corporate social responsibility and inclusive business projects, the Commission has not yet a well defined policy for support and very limited experience. Over the past years, however, a number of bilateral donors, in particular some of the EU member states, have provided support to innovative business projects as well as to other CSR based projects. This support has very much concentrated on individual business projects undertaken by larger companies together with other business and non business partners. Reference is made to various publications mentioned in section 4, which provide numerous examples of projects co-funded by bilateral donors. They also contain interesting examples of innovative business projects undertaken by local business without donor support.

The Commission has financed so far some projects supporting the respect of international conventions and promoting CSR within the private sector, and is now considering ways to support innovative business projects. Box 1 presents two recent programmes in this area, the first one of which still needs to be launched. They are part of an overall process which should assist the EU in exploring which types of actions it should focus on (including for awareness raising) and in exploring with other donors how to collaborate with a view on scaling up the number of projects through which business, both local and international, could engage more and better in development.

### 2.1 Problem identification and diagnostic tools

An important point to notice from the start is that donor approaches have so far been essentially demand driven. This would seem to be the logical consequence of the fact that actions in these areas are, as a rule, initiated and implemented by for profit business, often in partnership with local communities and local and international not for profit organisations; or, as is the case for fair trade, initiated and led by international NGOs in partnership with local communities and micro and small enterprises.

Some tools have been developed to help such decentralized actors in identifying the gaps to be addressed and opportunities to be seized.

#### 2.1.1 CSR Diagnostics

IFC FIAS' *CSR Diagnosis Module for Application in Value Chain Analysis*,<sup>206</sup> is a tool targeted at the industry sector level in emerging economies and regions, in relation to international export markets. It should enable to conduct a diagnosis, design solutions and quantify the implementation of CSR initiatives with the aim of enhancing international competitiveness and promoting inward investment.

In the context of broader value chain analysis, consideration of CSR factors is likely to fall within the following areas of investigation: (i) market entry for developing country firms into global value chains dominated by firms in developed countries, (ii) quality enhancement of production and (iii) consumer-orientation to create new "niche" markets.

#### Box 1. Pilot programmes on innovative business models and social and environmental entrepreneurship

- The 10<sup>th</sup> EDF €5 million All-ACP programme on Innovative business models (IBM) aims to strengthen a number of actors at meso level to become facilitators of IBM. At the same time it may support at micro-level a limited number of IBM pilot projects fostered by selected MLOs (including NGOs, CSOs, intermediary organisations, business networks, cooperatives, etc.), that would take the responsibility and ownership to develop and support these. Finally, it also targets policy makers by funding awareness raising and sensitisation actions.
- The "Green economy and social and environmental entrepreneurship in Africa" (€3.2 million, 7 countries), implemented in partnership by UNEP, COMESA and SEED, targets the policy related level (awareness raising and multi-stakeholders dialogue activities and promotion of national strategies) and supports social and environmental enterprises.

206 [http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2007/09/05/000020953\\_20070905160159/Rendered/PDF/407630CSR0Diagnosis0Module01PUBLIC1.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2007/09/05/000020953_20070905160159/Rendered/PDF/407630CSR0Diagnosis0Module01PUBLIC1.pdf)



### 2.1.2 BoP and inclusive business diagnostic tool

The UNDP developed a diagnostic tool the *Market Heat Maps Methodology* within the overall framework of its *Growing Inclusive Markets initiative*.<sup>207</sup>

The *Market Heat Maps* aim to identify which needs are met by the private sector and to illustrate how much the poor participate in markets (market inclusiveness). They aim to illustrate the market structure and the level of access to goods and services in selected sectors and countries, and to show how the goods and services are provided. The diagnostic is based on 3 steps: measuring the total number of possible poor consumers, measuring the total number of poor consumers with access to a good or service, and identifying and measuring the contributions of different actors on the supply side.<sup>208</sup>

## 2.2. Broad areas of intervention and key activities

As mentioned above, donor approaches have so far been essentially demand driven, supporting actions generally initiated and implemented by decentralized actors in accordance with their own strategies. Such support is generally motivated by the potential for poverty reduction combined with substantial local impact. Possible areas of intervention for donors could be drawn from the analysis of what hinders a larger or more effective role of the private sector in development.

Interventions targeted at addressing specific constraints to responsible business practices and increased inclusion

of the poor by the private sector therefore may include in particular the following:

- Information sharing and awareness raising activities on potential benefits of more responsible practices, of fair trade and similar sustainability schemes, and of inclusive business models. The target may be public actors and the aim to create enabling legal and institutional frameworks for such private sector initiatives and to improve market environment (e.g. the enhancement of the business environment, skills, services and infrastructure) or to promote other ways to harness or enable the private sector's contribution to development through core business operations. The target may also be the private sector so as to promote a better understanding on how market based approaches can have a positive impact on human development while ensuring for profit business development.
- Facilitating the development of responsible business practices and inclusive business, through business support institutions, business incubators and vocational training, building local networks, promoting market research, or through specific brokering activities, depending on the specific country context.
- Facilitating the launching of innovative business projects through sharing of risks by co-funding.

No strong typology of interventions in this area exists so far. It is therefore referred to the examples in section 3 to illustrate various ways of supporting actions in the fields of CSR, fair trade and inclusive business.

<sup>207</sup> The "Growing Inclusive Market Initiative" is a partnership between UNDP, bilateral donor agencies, think tanks etc, whose main objective is raising awareness about the impact of private sector engagement on development. For further details, refer to [www.growinginclusivemarkets.org](http://www.growinginclusivemarkets.org)

<sup>208</sup> In the GIM initiative, UNDP also developed a Strategy Matrix that aims to allow the identification of constraints in market conditions surrounding the poor and the possible solutions to the constraints faced by entrepreneurs (limited market information, ineffective regulatory environment, inadequate physical infrastructure, missing knowledge and skills, restricted access to financial products and services).

## 3. How can it be done?

### 3.1 Methods of intervention

As mentioned, the EU supports Fair Trade and ethical trade interventions through co-funding within the framework of actions implemented by non state actors, both in developing countries and, for actions aiming at raising awareness among European consumers, in Europe. It is characterized by a fully demand driven approach.

In some cases, programmes to support the agricultural and rural sectors funded under the Multi-annual Indicative Country Programming documents may include activities that contribute to facilitating Fair Trade or the Fair Trade readiness of farmers' organisations. The Special Framework of Assistance for traditional ACP suppliers of bananas and the Accompanying Measures for Sugar Protocol countries, for example, have contributed, among other things, in some countries to helping farmers to sell within the Fair Trade niche.

Ethical trading schemes can also be articulated with programmes aiming at developing business services, trade capacities, trade diversification and strengthening productive capacities, notably so as to increase the added value of the products.

In relation to actions to support CSR activities and inclusive business projects, the following aspects could be highlighted at this stage.

In the debate on CSR and on inclusive business projects, it is frequently referred to public-private partnerships (PPP). A PPP constitutes an approach to engage with the private sector in order to leverage its potential contribution towards development objectives in economic, social and environmental terms. In this context, PPP involves a contract between a public authority and a private sector company in which both parties agree on the design of a project with clearly defined roles and responsibilities.<sup>209</sup>

The private party delivers a service or implements a business project, thereby assuming the main technical and managerial responsibilities in agreement with the public party. The sharing of costs and risks may be justified by the nature of *public goods* delivered (e.g. access to water and energy, social services, etc) and/or by the *positive externalities* generated by viable business projects (e.g. achieving development objectives such as strengthening of pro-poor value chains, gender focus in productive activities, improved natural resource management, etc.). Most donors include the public co-funding of CSR and inclusive business projects in the notion of PPP.

The rationale for donor support to PPP initiatives relies on different factors, including:

- **Availability of funds / Liquidity:** leveraging of larger amounts of capital that would otherwise not be made available by a single actor (donor or investor).
- **Affordability / efficiency:** lower cost-per-unit (e.g. in service delivery or infrastructure development) due to engagement of private sector in the operations.
- **Harnessing expertise and know-how** from relevant stakeholders in the private and public sector, ensuring complementarity and synergy – including the provision of expert knowledge by the public partner (e.g. in specific sectors such as health or nutrition in developing countries, or in relation to methods for results measurement, etc.).
- **Facilitating/brokering of development-relevant investment** from private sector through advocacy and highlighting of incentives, facilitation of contacts and partnerships.
- **Risk sharing** on feasibility studies and start-up costs.

Below, we include a few examples of projects in each of the above-mentioned areas of CSR, Fair Trade and inclusive business.

#### 3.1.1 Corporate Social Responsibility

##### Box 2. Asia – Platform for business collaboration

Concerning the activities of financing and creating platforms for business collaboration, the EU-funded Asia Invest Programme has yielded some interesting results. It financed the ETHIC-MATCH project. This project is supporting business co-operation in Europe and Asia between socially responsible SMEs operating throughout the child garment supply chain. At least 400 enterprises, including Italian, Spanish, Indian and Pakistani SMEs, complying with specific working condition codes of conduct, are promoted through the Project Portal.

<sup>209</sup> The draft Communication of the Commission on “Mobilising private and public investment for recovery and long-term structural change: developing Public Private Partnerships” provides additional background on present experiences with and approaches to PPP within the internal EU context

**Box 3. Better work – building a competitive advantage in the apparel industry of Cambodia**

When the MultiFiber Arrangement (MFA) came to an end in 2005, numerous countries were faced with uncertainty regarding the future of their apparel industry. While the quota system under the MFA had prompted the development of garment assembly industries in numerous countries, the sector liberalisation brought with it fear over the loss of related jobs and revenues.

As far as Cambodia was concerned, its US quota allocations were based on demonstrated improvement of labour conditions in the garment industry. An ILO capacity-building and monitoring programme had thus been put in place to help ensure that progress was indeed being made. At the end of 2004, Cambodia, in a strategic move to maintain the competitiveness of its garment industry, decided to pursue a CSR strategy for its whole garment industry. While working on quality and other issues, its competitive advantage would be better labour standards, with a credible reporting scheme. The strategy bore fruits and post liberalisation, Cambodia fared relatively well with sales continuing to increase compared to similar countries that were losing market shares.<sup>210</sup>

**3.1.2 Fair Trade****Box 4. Kenya – Enabling the poor to share the fruits**

Through this project, the EU has contributed to improve working conditions as well as financial return for thousands of Kenyans. The project started in 2008 with a 408.000€ budget, and different actions involving small scale coffee, tea, fruit and horticulture producers. The project strategy focused on compliance with international codes of conduct and Fairtrade certification to improve the value of local products. A first external monitoring reported positive results, such as the employment of 16,469 workers at factories and farms and an improvement of the socio-economic conditions for over 10,000 workers – both in terms of ethical management and of access to critical resources (i.e. water) and social initiatives. Africa Now – the main implementer – has also been successful in lobbying the Fairtrade Labelling Organizations International (FLO) to modify standards for Kenyan small producers. There is reasonable indication that these benefits will continue in the longer term, as all value-improving services are affordable or being paid for by retailers or Fairtrade, and institutionalisation is ensured through joint bodies and committees, creating a solid structure of incentives. The project has received 15% financial support from the private sector and the partnership with the Exporting Processing Zone Authority could facilitate support from the GoK in the longer term. The project's self sustainability is also ensured by the investment of premiums in other social initiatives, which could allow for further donor funding and become a model of extension and dissemination.

210 See [www.ilo.org/wow/Articles/lang--en/WCMS\\_094381/](http://www.ilo.org/wow/Articles/lang--en/WCMS_094381/). This experience has led to the subsequent development of a joint work programme by the IFC and ILO to support similar initiatives in developing countries. See [www.betterwork.org](http://www.betterwork.org)

**Box 5. Mali - Fair trade cotton<sup>211</sup>**

Cotton is one of the world's oldest commercial crops, harvested in Africa for more than 5,000 years. Today, it is the main source of income for 20 million people and accounts for up to 60% of national export earnings in West and Central Africa. Since 1999, however, African producers have suffered from successive price falls—with no guarantee for farmers that the selling price will allow them to earn a return on investment and recoup the production costs. African producers are disproportionately vulnerable, often working with old-fashioned tools on family plots but competing with highly subsidized producers from rich countries. African cotton farmers thus often see no benefits from international trade.

Since 2002, the EU has been supporting organic "Fair Trade cotton in Mali" to improve the livelihoods of small producers. Organic farming brings more revenue to the farmers, allows them to save on the costs of fertilizers and pesticides and protects their health and the environment. Furthermore the EU initiative helps producers organize in cooperatives and common platforms giving them the leverage and the means to influence politics in Mali and initiate social projects. The project supports individual producers of organic Fair Trade cotton and approximately 60 farmer cooperatives in the sector, with a special focus on empowering women (30% of farmers). With a budget of US\$ 894,000 by the year 2007, 4,445 producers had joined the initiative, and could sell their cotton at a price almost 50% higher than that of the international market (238 CFA francs per kilo instead of 160). During 2006-2007, 15 storage rooms and two schools in 17 villages were founded. Through workshops and active handout of compost bags the program secured that more than 80% of the fields were organically fertilized. Other products were also cultivated such as sesame seeds and shea nuts, for the sake of intensification and diversification. Focus was also set on supporting MOBIOM (*Mouvement Biologique Malien*), which gathers co-operatives and is becoming the key actor in the sector. MOBIOM has largely improved producers' capacity to access international as well as national markets and shall in the long run take responsibility for monitoring the production.

**3.1.3 Inclusive Business models and Social Entrepreneurship****Box 6. South-Africa – Financial services for education<sup>212</sup>: adapting products**

For decades during apartheid, South Africa's public authorities neglected the education of the vast majority of the country's people—now referred to as the historically disadvantaged. In the new South African economy, there are big needs for skilled and educated workers to sustain development. But post-secondary education is not free, and most historically disadvantaged people do not have money to pay. Nor do they qualify for traditional modes of financing. Edu-Loan, a for-profit company focused exclusively on loans for post-secondary education, offers simple repayment options—at affordable rates—to historically disadvantaged applicants interested in advancing their skills. Since its inception in 1996, Edu-Loan has financed close to 400,000 students with loans totalling more than \$140 million. Edu-Loan's commercial success mirrors its social impact: the company offers shareholders a return on capital employed of 30%.

211 See EuropeAid's information note on Fair Trade (September 2009) and UNDP (2008). Creating Value for All: Strategies for Doing Business with the Poor.

212 From UNDP (2008). Creating Value for All: Strategies for Doing Business with the Poor.

### Box 7. *Danida – Innovative partnerships for development – Grundfos lifelink*

The Innovative Partnerships for Development (IPD) Programme supports partnerships that advance Strategic Corporate Social Responsibility (CSR), and partnerships that advance Socially Responsible Innovation. It supports Grundfos Lifelink initiative in Kenya. Grundfos is the world's leading pump manufacturer. It has established Grundfos lifelink whose strategy is to sell sustainable water systems to local communities or village entrepreneurs by combining pump, mobile phone and mobile banking technologies. The owner of the water system (often a village or community) resells the water to BOP consumers, who are charged via their mobile phone account. The water systems are financed by commercial loans provided by local banks on market terms. The communities owning the water system can make a profit after the financing period and once maintenance costs are deducted, and use it for further community development. Grundfos lifelink manages an active network of various partners: NGOs (organising community affairs), public institutions (clarifying problems related to polluted water) and private companies (providing after sales service, training, finance and technological inputs).

## 3.2 Expected results and results measurement

The types of projects and the sectors and areas in which the projects may take place may be so diverse that it would be difficult to define a series of key results to be obtained and corresponding results indicators. One can however say that there are two broad areas where results need to be measured – successful development outcomes (in essence poverty reduction) and successful business results (growth, profits, etc). Businesses need to see positive returns for their investment, and communities need to see the development outcomes. Indicators for the latter could include jobs created and increased earnings by poor families, but also other results important in terms of empowerment of the poor, in particular women, and increased capacities to participate to economic activities.

A lot of research has taken place and continues to take place for defining tools to better measure results in these areas. Some tentative methods and tools for results measurement in these areas of interventions are included below. A short paper published by the *Grassroots Business Fund* provides an overview of a number of approaches coming out of the research so far in this constantly evolving field.<sup>213</sup>

While most of this research is undertaken by research organisations and institutes and other actors of civil society, some efforts have also been undertaken on the side of business actors, in collaboration with international NGOs. An interesting example is the *Oxfam/Unilever poverty footprint methodology*, which looks at five dimensions of poverty to assess the effects of the company on people's lives and the way in which these effects relate back to the company. These dimensions are: macro economy (how a company's economic contribution affects the standard of living of poor people); the value chain; social implications and environmental prac-

tices; institutions and policy; and product development and marketing<sup>214</sup>.

*On the donor side, the Donor Committee for Enterprise Development (DCED)* has initiated a process to develop good practices for outcome monitoring within an approach of *Making Markets Work for the Poor* (M4P). The aim is to develop a common minimum standard, a set of key guidelines that aim to provide 'comparable' impact data of a 'predictable' quality.

## 3.3 Cross-cutting issues

Cross-cutting issues are at the heart of the actions in the areas of CSR, fair trade and inclusive business models.

### Governance

Governance as a broad concept (involving public, private and civil society actors) is a particularly relevant cross-cutting issue. In particular, BoP and IB initiatives entail the entry of new players into the governance system. Generally, businesses increasingly need to take responsibility, and be accountable, for the social, environmental and economic impact of their decisions. This finds its expression in various ways:

- Generalized legislation in developed countries obliging companies to disclose more and better information about their management of social, environmental and economic issues;
- Growing interest by the mainstream financial community in the link between shareholder value and non-financial corporate performance;
- Integration of public goods dimension in business activities.

213 Grassroots Business Funds. "An Overview of Approaches to Impact Measurement". May 2009. It can be found here: [www.gbfund.org/sites/default/files/Synthesis\\_Document\\_FINAL.pdf](http://www.gbfund.org/sites/default/files/Synthesis_Document_FINAL.pdf)

214 [www.unilever.com/images/es\\_Exploring\\_the\\_Links\\_Executive\\_Summary\\_tcm13-43083.pdf](http://www.unilever.com/images/es_Exploring_the_Links_Executive_Summary_tcm13-43083.pdf)

**Box 8. Lesotho - supporting textile sector productivity by addressing HIV-AIDS**

The Apparel Lesotho Alliance to Fight AIDS (ALAFA) stands for an industry-wide HIV/AIDS programme to safeguard the human capital base of the industry and thus enhance productivity, as well as to deliver HIV prevention, support people living with HIV/AIDS, and strengthen perceptions of Lesotho as an ethical sourcing destination. The programme both addressed the sector's productivity challenges arising from HIV/AIDS (43% of workers are estimated to be HIV positive) and contributed to the reputation of Lesotho as an ethical sourcing destination. ALAFA represents an alliance of stakeholders, whereby funding is assured through brands (e.g. EDUN, Wal-Mart, Gap Inc., Levi Strauss and Nordstrom) and donors (e.g. DFID, Irish Aid and the EU). The emerging best practice, according to ALAFA reports, is an integrated approach, with primary health clinics in or near the factory and contractual arrangements with private doctors and nurses teaming up with factory-based peer educators, counsellors and expert patients (who are workers themselves). These clinics are co-financed by the factories, and workers pay a small amount for treatment.

**Human and labour rights**

Corporate responsibility to respect human rights, which in essence means to act with due diligence to avoid infringing on the rights of others is a well established principle. Businesses engage nowadays increasingly in active promotion of human rights. An example is the Kimberley Process, which is a joint initiative of governments, industry and civil society to stem the flow of 'conflict' diamonds. The trade in these illicit stones has fuelled decades of devastating conflicts in countries such as Angola, Cote d'Ivoire, the Democratic Republic of the Congo and Sierra Leone. Fair trade and inclusive business models also integrate a strong sense for respect of human rights. Furthermore, mention should be made of the "Protect, Respect and Remedy" Framework for business and human rights proposed by the Special Representative of the Secretary-General of the UN and on the work undertaken to define its accompanying guiding principles for implementation. The subject is also an integral part of the work undertaken by the Commission's Directorates general Employment and Enterprise within the overall CSR agenda.

Labour rights are also a growing issue. They apply to a company's own employment practices as well as to workers along the supply chain. A significant number of workers operate outside the scope of labour laws and are, therefore, in need of protection. This particularly applies to the many children who continue to be involved in forms of labour that are likely to harm their safety, health or morals, conflicting with the terms of the agreement made at the UN Convention on the Rights of a Child in 1999. Besides the expectation that companies are supposed to comply with specific laws and regulations related to labour rights set in international and national frameworks, CSR, Fair Trade and inclusive business initiatives are expected to complement and strengthen the promotion of 'decent work' conditions.

**Gender**

Both fair trade and inclusive business aim at including low income communities in the economic chain. CSR also focuses in many cases on local communities dependent on or surrounding the production sites of the company undertaking CSR based action. It is therefore expected to target women as key economic actors of the local communities. They represent 70% of the world's poor<sup>215</sup>. The gender aspect also includes the manner in which businesses make specific provision for women's needs, such as baby and child-care facilities and flexible working hours.

**HIV/AIDS**

HIV/AIDS continues to cut into the fabric of mainly poor households and societies, above all in Sub-Saharan Africa. Top-down analyses and decisions about prevention have shaped public health responses with generally no CSR linkages. As companies become more aware of their CSR responsibilities, it is likely that they will pay more attention to what they can do within their work force and their local communities to address HIV/AIDS issues (see Box 8).

**Environment**

There is a growing awareness of environmental issues and of the need to develop climate change strategies and to reduce carbon emissions. The growing market opportunities and the possibilities of cost reduction, in particular through energy and material saving, make enterprises reconsider their productive patterns and look towards innovation, which thus could affect climate change and its consequences. Based on this premise, the so-called Sustainable Consumption and Production (SCP) approach has been developed. SCP can be defined as "production and use of goods and services that respond to basic needs and bring a better quality of life, while minimising



the use of natural resources, toxic materials and emissions of waste and pollutants over the life cycle, so as not to jeopardise the needs of future generations (see Box 9).<sup>216</sup>

Moreover, the use of “green technologies”, such as, for example, renewable energy, may help in the provision of services in remote areas where provision of basic services like electricity is lacking (see Box 10).

### **Box 9. SWITCH Programme (2007-2013), €90 million, Asia**

The SWITCH Programme aims to promote sustainable production (i.e. development of less polluting and more resource efficient products, processes and services) and sustainable consumption patterns and behaviour in the Asia region. These objectives are to be achieved through an improved understanding and strengthened cooperation between Europe and Asia, notably by mobilizing the private sector (i.e. SMEs, retailers, producers, financial institutions and consumer organisations), along with relevant public sector authorities. The programme entails three components: (i) Grant Projects, (ii) Network Facility, and (iii) Policy Component. The grant projects component aims at increasing the use of environmentally-friendly technologies and practices by SMEs and switching to consumption of products that are less environmentally damaging. The first Call for Proposals was launched in November 2007 and resulted in 15 funded projects. The interest was even higher in the 2nd Call for Proposals, launched in 2008, with 352 project applications (15 projects were recommended for funding). The mid-term evaluation of SWITCH Phase I has highlighted a number of successes in terms of promotion of appropriate technologies allowing for more environmentally friendly techniques on the supply side, as well as increased awareness on green products and services on the demand side. Relatively new fields, such as the promotion of ‘green procurement’ have been promoted in complex environments (e.g. supply relationships between Chinese local authorities and SMEs).

### **Box 10. Mali – Rural electrification<sup>217</sup>**

In Mali, only 10% of the country’s 12 million inhabitants have access to electricity. Access is even lower—just 2%–3%—in rural areas, where appliances are powered with car batteries and kerosene lamps. Candles are used for daily lighting. Koraye Kurumba and Yeelen Kura are two rural energy services companies operated in rural Mali by Électricité de France—in partnership with the Dutch energy company NUON and the French TOTAL, with support from the French Agency for the Environment and Energy Efficiency. Their low-cost electricity, based on solar home systems or small low-voltage village micro-networks supplied by diesel generators, made big development impacts. They enhanced standards of living. They also developed new income-generating activities. And they improved the quality of health care and education. Backed by a new institutional framework and international donors, the model—designed to ensure profitability, sustainability, scalability and local ownership—is to be expanded beyond the 24 villages and 40,000 people it serves today.

216 For further reference to definitions, issues, methodologies of SCP refer to the document: UNEP, (2008), “Planning for Change: Guidelines for national programmes on sustainable production and consumption”. [www.unep.fr/shared/publications/pdf/DTIx1028xPA-Planning4change.pdf](http://www.unep.fr/shared/publications/pdf/DTIx1028xPA-Planning4change.pdf)

217 From UNDP (2008). Creating Value for All: Strategies for Doing Business with the Poor.

## 4. Where to find out more?

### 4.1 About CSR

EC DG Enterprise and Industry on CSR:

[http://ec.europa.eu/enterprise/csr/official\\_doc.html](http://ec.europa.eu/enterprise/csr/official_doc.html)

EC DG Employment, Social Affairs and Equal Opportunities on CSR : <http://ec.europa.eu/social/main.jsp?catId=331&langId=en> and <http://ec.europa.eu/social/main.jsp?catId=104&langId=en>

World Bank / IFC (FIAS) approach to CSR – CSR and competitiveness in different sectors (apparel, ICT, tourism...) [www.fias.net/ifcext/fias.nsf/Content/Pubs-CorporateSocialResponsibility](http://www.fias.net/ifcext/fias.nsf/Content/Pubs-CorporateSocialResponsibility)

<http://go.worldbank.org/UO8A34U8G0>: World Bank site reporting on the relationship between CSR and labour standards.

[www.globalcsr.eu](http://www.globalcsr.eu): research project financed by EuropeAid and implemented by ICEP and Codespa (an Austrian and a Spanish NGOs focused on economic development) on involvement of European private companies in developing countries in CSR and BOP context; it combines case studies and theoretical approach.

[www.ashoka.org](http://www.ashoka.org): Ashoka is one of the main networks of social entrepreneurs, with branches in all 5 continents.

[www.gbfund.org](http://www.gbfund.org): Grassroots Business Fund (created by IFC) provides financial and technical assistance to intermediary business organisations working with enterprises at the base of the pyramid.

[www.copenhagencentre.org/main](http://www.copenhagencentre.org/main) The Copenhagen Centre (TCC), Denmark is an international autonomous institution set up by the Danish government, focusing on private/public partnerships for social cohesion. Its website contains an interactive knowledge centre with a case database and publications.

[www.eldis.org/go/topics/resource-guides/corporate-responsibility](http://www.eldis.org/go/topics/resource-guides/corporate-responsibility): this Eldis resource guide contains many publications and reports in the field of corporate responsibility.

**CSR in Africa:** Internet Research Study Extending Service Delivery Project/Meridian Group International, Inc. April 3, 2006 [www.esdproj.org/site/DocServer/CSR\\_in\\_Africa\\_06\\_FINAL.pdf?docID=2061](http://www.esdproj.org/site/DocServer/CSR_in_Africa_06_FINAL.pdf?docID=2061) This report

provides an overview of the concept of CSR in Section 1, followed by a summary of the leading international and African actors in CSR in Sections 2 and 3. Section 4 provides country overviews of Angola, Ghana, Kenya, Mali, Tanzania, Uganda, Senegal, and South Africa. Section 5 examines CSR in key African commercial sectors including extractives, agriculture, construction, manufacturing, bottling, and tourism. In Section 6, recommendations for CSR activities in reproductive health and family planning are put forth.

### 4.2 About Inclusive Business

Examples and case studies on Inclusive Business can be found in :

Jenkins, Beth and Eriko Ishikawa (2010). *“Scaling Up Inclusive Business: Advancing the Knowledge and Action Agenda.”* Washington, DC: International Finance Corporation and the CSR Initiative at the Harvard Kennedy School.

UNDP (2008). *“Creating Value for All: Strategies for Doing Business with the Poor.”* United Nations Development Programme. New York. July 2008.

Growing Inclusive Markets initiatives : [www.growinginclusivemarkets.org/index.php?option=com\\_content&view=article&id=495&Itemid=1](http://www.growinginclusivemarkets.org/index.php?option=com_content&view=article&id=495&Itemid=1) This initiative has been developed by UNDP together with bilateral donors, academia, business representatives etc. The objective is to illustrate how the private sector can contribute to poverty reduction and achieving the MDGs.

[www.inclusivebusiness.org](http://www.inclusivebusiness.org): An alliance between the World Business Council for Sustainable Development and SNV to create inclusive business opportunities mainly by linking local communities with big businesses. (mainly in Latin America).

IFC and World resource institute: *The Next 4 Billion: Market Size and Business Strategy at the Base of the Pyramid*: <http://rru.worldbank.org/thenext4billion>, measures the size of markets at the base of the economic pyramid using income and expenditure data from household surveys. The analysis is complemented by an overview of business strategies from successful enterprises operating in these markets.

### 4.3 On Fair Trade

FT charter:

[www.fairtrade.net/fileadmin/user\\_upload/content/2009/about\\_us/documents/Fair\\_Trade\\_Charter.pdf](http://www.fairtrade.net/fileadmin/user_upload/content/2009/about_us/documents/Fair_Trade_Charter.pdf)

**WFTO** *World Fair Trade Organisation* — previously IFAT, [www.wfto.com](http://www.wfto.com)

**FLO** Fairtrade Labelling Organisation — [www.fairtrade.net](http://www.fairtrade.net)

**Africa COFTA** (Cooperation for Fair Trade in Africa) [www.cofta.org/en](http://www.cofta.org/en)

**AFN** (African Fairtrade Network) [www.2can-consult.com/afn](http://www.2can-consult.com/afn)

**Asia AFTF** (Asian Fair Trade Forum)

**NAP** (Network of Asian Producers) [www.fairtrade.net/305.html](http://www.fairtrade.net/305.html)

**Latin America IFAT-LA** (Asociación Internacional de Comercio Justo Latino America) [www.ifat-la.org](http://www.ifat-la.org)

**CLAC** (Coordinadora Latinoamericana y del Caribe de Comercio Justo) [www.claccomerciojusto.org](http://www.claccomerciojusto.org)

**Overseas Development Institute:** A review of ethical standards and labels: Is there a gap in the market for a new “Good for Development” label? By Jodie Keane and Karen Ellis; [www.odi.org.uk](http://www.odi.org.uk)

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- Guidelines (n°4) – “Guidelines on the Integration of Environment and Climate Change in Development Cooperation” 2009

### Reference documents

- Reference document (n°1) - “Institutional Assessment and Capacity Development – Why, what and how?” - 2005
- Reference document (n°2) - “Supporting decentralisation and local governance in third countries” - 2008
- Reference document (n°3) - “Strengthening project internal monitoring: How to enhance the role of EC task managers” - 2009
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- Reference document (n°6) - “Toolkit for Capacity Development” – 2009
- Reference document (n°7) - “Water Sector Development and Governance: Complementarities and synergies between Sector-wide Approach and Integrated Water Resource Management” – 2009
- Reference document (n°8) - “Engaging and Supporting Parliaments Worldwide Strategies and methodologies for EC action in support to parliaments” – 2010
- Reference document (n°9) - “Support for judicial reform in ACP Countries” – 2010

### Concept papers

- Concept paper (n°1) - “Public Sector Reform: An Introduction”

