



2014 Small States Forum Issues Note:

The Private Sector as an Engine of Growth and Service Delivery

Today, many small states have resumed economic growth since the recent global crisis. Their economic growth is however weaker compared to that of larger peers and lower, reflecting not only the more limited policy tools and resources but also the challenge of diversifying economic structures and re-orienting economic activities in new markets and sectors.

Because of their size, economic recovery in small states has been more dependent on the health of traditional markets and influenced by the strength of external demand in specific sectors. Their remoteness and isolation make it difficult and costly to fully exploit new opportunities — a situation that increases the cost of intermediated inputs and imports and prevents efficiency and innovation. When one dominant activity declines, it has an impact throughout the economy, exposing the population to income volatility which can create additional hardships as the poorest are less able to weather shocks to their incomes. Government revenues are also affected as they depend on few sources of income.

Despite these common challenges, a number of **global trends offer new opportunities** for small states—the emergence of global value chains, advancements in hard and soft connectivity, the emergence of new production technologies, and the potential of tapping financial, social, and human capacities of successful diasporas.

To exploit these opportunities, a number of countries are embarking on **competitiveness strategies** that complement country-wide macroeconomic reforms with sector specific efforts, for example, in fisheries, tourism, agribusiness, extractives and other sectors. The focus on competitiveness is new territory for many small states. Success will require a heavy emphasis on



learning-by-doing and tailoring policies to the characteristics and capacities of small states.

Salient features include:

- **Pragmatic, well sequenced and integrated efforts** to address problems. In small resource scarce states, the bundling, sequencing and governance of activities is essential, as is the speed and sustainability of any solutions being proposed. The existing institutions and private sector in a small state will clearly highlight – through transparent public private dialogue – where to remove policy and infrastructure bottlenecks to allow local firms to grow.
- **Growth needs to be differentiated.** Small states compete against other countries for the same FDIs – but not all small states will turn into the next international port hub or the next financial center. Learning how to maximize the dynamism of the private sector base, and integrating effectively into global value chains, is vital in generating differentiated growth.
- **The possibility of new partnerships** – including **regionalization** efforts as a basis for specialization and value addition – between governments, their citizens, the private sector, and development partners, is a key ingredient of competitiveness efforts.

Questions for discussion:

1. How can new and innovative competitiveness policies and strategies be integrated at economy-wide, sector and firm levels?
2. How can the engagement of the private sector (both domestic and international) be promoted? What are the emerging risks, challenges and (most importantly) opportunities faced by businesses and entrepreneurs in small states?
3. What are potential areas of international support? How can the World Bank Group assist?



The private sector plays a critical role in issues of economic growth and jobs creation and also it is a key partner for small states governments that can help meet the increasing demands stemming from growing urbanization, rehabilitating aging infrastructure, and providing services to lacking or underserved populations. **Public-Private Partnerships (PPPs)** are increasingly being created to:

- **Expand and improve the delivery of services and the operation of infrastructure** by tapping the expertise and efficiency of the private sector;
- **Mobilize private capital to facilitate cost-effective delivery** of infrastructure and services; and
- **Enable more efficient use of resources** by improving the identification of long-term risks and their allocation, while maintaining affordable tariffs.

However, the small states context has proven to be difficult for PPPs, given the challenge of achieving economies of scale, increasing costs due to remoteness, lack of domestic resources, investor appetite for small projects, and dealing with sometimes cyclical nature of demand. Higher vulnerability to natural disasters and complex environmental and social issues add further risks to the private sector.

Implementing PPPs and managing long-term contracts with the private sector remain a key challenge for small states, given their limited government capacity. Developing sustainable PPPs requires a comprehensive approach to address the multiple challenges faced by many infrastructure sectors and public services. These include developing an adequate enabling environment (legal, regulatory and institutional capacity that are conducive to private sector involvement in key infrastructure sectors and public services) through long-term contractual relationships with governments/public sector.



Despite these challenges, PPPs can be successful in small states in a broad range of public services such as electricity, water and sanitation, transport, tourism, health and education. PPP projects can realize their full benefits and mitigate risks in a small states context if adequately prepared and structured to balance public policy considerations, investors' interests, lender's bankability requirements and community needs.

Questions for discussion:

1. How can a small state promote South-South Investment? For international investors from larger regional economies, what are the key factors for investment in local infrastructure development?
2. How can we ensure that all risks are properly mitigated and fiscal commitments properly managed? How can we identify direct and contingent cost and ensure that they are properly costed and provided for?
3. What are potential areas of international support? How can the World Bank Group assist?