Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH

Masterclass "Economic strategies to bounce back – how to trigger local economic development"

The idea behind this masterclass originates from a paper commissioned by the Governance Fund on the Social-Ecological Market Economy in Germany, which I had the privilege to contribute to. As a former minister for economic affairs in the state of Schleswig-Holstein – a strip of land in the north of Germany characterised by small municipalities and firms – my focus was on small and medium-sized enterprises (SME) and on local business development.

The paper provided an overview of the key characteristics of a socially and ecologically balanced market economy and raised specific questions: Which of these characteristics can be translated into emerging economies? What specific conditions apply to SMEs? Which factors drive growth? The answer was that SMEs need strong public bodies at the local level and a regulatory framework at the macroeconomic level.

a.) Favourable framework conditions for SMEs

Of course, it is true that all business is local business, and yet particularly small firms rely on market conditions and a business environment they are unable to change on their own.

<u>Essential conditions for SMEs to be competitive:</u>

✓ Market access

The first prerequisite is fair and indiscriminate access to markets, which may sound trivial, but it is not. Many developing economies are often dominated by state-owned companies and international corporations. Therefore, a fair system of licensing, procurement laws and import and export regulations is needed if SMEs are not to operate on the fringes of a country's commercial activities.

✓ Access to infrastructure

Economic performance fundamentally relies on having a reliable and efficient physical infrastructure for transport, communication, energy and water supply. This means it needs to be available regionally – outside the big cities – and competitively neutral.

Let me give you two examples. One is Myanmar, where forty per cent of the country is not covered by the electricity grid, and it is therefore impossible to foster sustainable economic development in rural areas.

The other example is Germany, where a change in the market design of energy sources involved a shift towards small and decentralised suppliers (the so-called energy transition or 'Energiewende'). Twenty-five years ago, the German electricity market was characterised by municipal suppliers and a handful of energy producers and grid owners. Then, following much controversy, a new regulation proved to be tremendously effective. Any producer was entitled to feed electricity into the grid for a fixed feed-in tariff and local renewable energy production – particularly in rural areas – immediately boomed.

✓ Access to financing

This is another essential market condition for SMEs. Commercial banks on their own often cannot provide financing due to restrictive policies and regulations. There are state instruments that can fill that gap.

One objective of the GIZ Governance Fund is to try and translate best practices into solutions for developing countries. Of course, it is difficult to use elaborate business development structures, which include publicly owned promotional banks and guarantee funds as a role model for other countries. Nevertheless, some kind of publicly guaranteed financing will need to be provided for small firms to prosper. Giving loans to SMEs is not just a matter for the private capital market, modelling a market environment favourable to SMEs is about self-reliance and enabling a business case for the environment and regional development.

✓ Localised and operational administrative structures

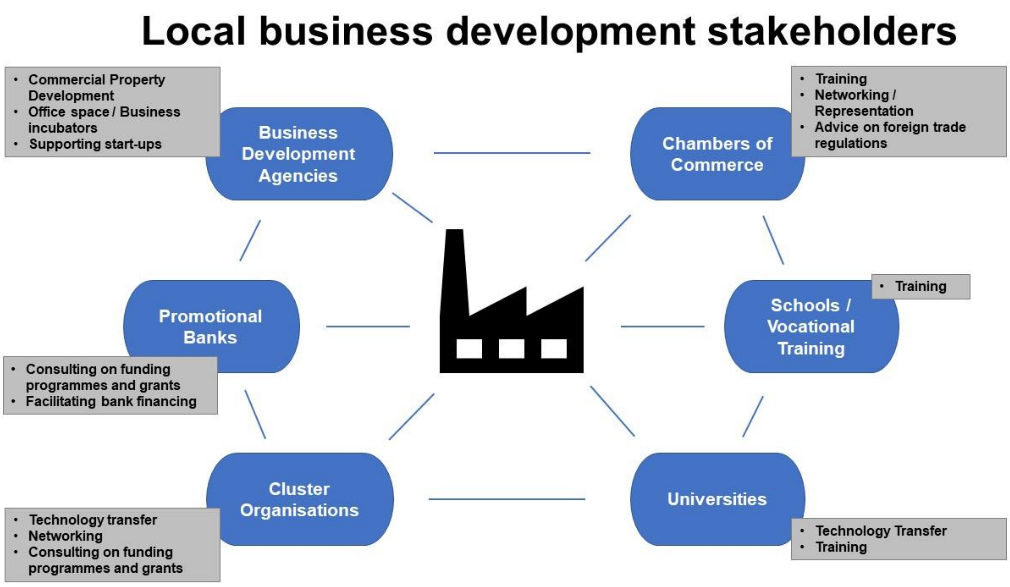
When I travel through Germany with delegations what strikes visitors the most is the country's high levels of performance in the public sector. This includes schools, the judicial system, functioning local governments and federal administrative services. There is also a regional structure of business development institutions to support companies and promote technologies and market changes.

b.) Local governments drive local business development

In the German market economy, local governments have a direct interest and say in business development. For a start, corporate tax is a local tax. Local governments set the tax rate and participate indirectly in local growth by receiving a share of income tax.

Local governments also have direct powers in business development. For example, designating commercial property is an essential part of local planning law. Municipalities sponsor business development agencies, they act as guarantors for public savings banks and set up and partner with local and regional networks.

However, they are not alone. They are one stakeholder among many as the following chart of local business development stakeholders shows:



Local business development is not static. On the contrary, it is all about providing individual solutions for different local situations. Any activity can start by answering a set of simple questions:

- ✓ What is the local situation? What are the business opportunities?
- ✓ What can SMEs expect from local governments?
- ✓ When are SMEs key to meeting political objectives, e.g. fiscal decentralisation, local revenue?
- ✓ Where can local decision-makers take action to support SMEs?
- ✓ Are the local structures functioning? What do they need to improve?
- ✓ What do SMEs need the most: office space, property, advice, political support?
- ✓ Are new agencies/institutions needed?

This masterclass aims to answer these questions by engaging with decision-makers, ministries and local governments.

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