Africa Overview Paper

Donor support for business environment reform in Africa: A review of key issues.

Paper presented by: Graham Bannock and Chris Darroll

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Donor Committee for Enterprise Development
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AFRICA CONSULTATIVE CONFERENCE

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Key Points

This paper provides an overview of the most important issues that shape the African business environment and identifies the main challenges and emerging lessons for reform initiatives in the region.

The core argument is simple: More effective donor practices for business environment reform require donors to engage much more closely and intensively with businesses operating in Africa. Institutions and instruments should be created to enable governments, the private sector and development agencies to work together in principled, evidence-led ways in order to make real improvements to the day-to-day working environment for businesses.

The main themes are:

1. Take the long view. Sustained growth requires a favourable business environment to be in place over several decades. Patience and long-term commitment are needed. This may appear obvious, but in the past, mostly for internal reasons, donors have often taken too short a view, leading to their exit from projects before the conditions for self-sustainability are established.

2. After several decades of decline, the economic outlook for Africa is improving. This presents an opportunity for donors to help reinforce positive business environment trends. Donors need to encourage countries not to squander their rapidly growing resources, but rather to use them in ways that establish the preconditions for sustained growth and a more equitable distribution of development benefits.

3. Get incentives right, both for governments and for businesses. Opportunities for productive quick fixes are rare and generally have very modest results. Given the opportunity and enough time, people will generally find ways of improving their own circumstances provided that they are not unnecessarily obstructed by rent-seekers or diverted by perverse incentives to channel their own energies into rent-seeking.

4. However, incentives for change are not always purely material, and there is still a lot of work to be done to persuade African governments and publics that business climate reforms are really necessary for Africa's development.

5. To improve the quality of donor practice on business environment reform, donors should support efforts to reduce corruption and raise the quality of governance. Donors should be aware the ODA can in itself create opportunities for corruption, and should work to reduce these. Efforts to improve the efficiency of donor practice should also include better donor coordination and more support for realistic steps towards regional integration. Lowering the barriers to intra-African trade is one of the most important of these steps

6. Reducing regulatory costs and improving regulatory efficiency remain the most practical and effective means of encouraging enterprise development. New

arguments for old approaches – such as active industrial policy and donor-subsidised business development services - should be very carefully assessed in light of past experience and the capacity of African governments to implement them

7. The shortage of high-quality data about the outcomes of business environment interventions make it difficult to design and evaluate programmes effectively and to bring about systematic improvements. Closer engagement with businesspeople working in Africa is necessary to ensure that the indicators donors use are the ones that really matter to business.

Section 1: Understanding the context for business environment reform in Africa

1.0. This section discusses the context in which efforts to improve donor practice on business climate reform should be understood. Africa is highly diverse: only cautious generalisations are possible. There are, however, useful lessons to be learnt from economic history and especially the East Asian experience. Patience and pragmatism must be the watchwords.

1.1 Africa's diversity

1.1.0 Africa is extremely diverse. Its 53 countries are at significantly different stages of development. While Africa is far more democratic now than at any previous time, democracy remains under strain in many places, coup threats and civil wars remain prevalent in some regions, and democratically elected leaders often remain in place for decades, despite popularity ups and downs. The continent contains over 900 million people – about 14 percent of the world's population. Economies vary in size from South Africa (around PPP $520 billion) to tiny Sao Tome and Principe (with GDP of around PPP $300 million in 2005 Levels of economic growth vary from negative growth in Zimbabwe to nearly 20 percent per annum in Angola. South Africa and Nigeria have by far the highest number of formal registered businesses. South Africa's informal sector is relatively small compared to the rest of the continent, at 30 percent, whereas the figure for Tanzania is 60 percent South Africa's population is nearly sixty percent urbanised, while ninety percent of Burundi's population lives in non-urban areas. (World Development Indicators: 2007). In Swaziland, one in three working age adults is infected with HIV, while Madagascar has only a 0.5 percent HIV prevalence. (UNAIDS 2006) It is encouraging to note that donors are increasingly aware of this diversity, and are placing greater emphasis on the need to tailor their support to each country's specific circumstances. (Brenthurst Foundation 2007)

1.1.1 There are, however, certain characteristics which hold true for much of the continent and which therefore make cautious generalisations useful. FDI inflows are highly concentrated in a small number of countries, and are largely limited to the natural resources and extractive industry sectors. Africa contains most of the world's least business-friendly regulatory environments. It takes 148% of per capita income to start a business in sub-Saharan Africa. The equivalent figure for East Asia is 38%. (Doing Business 2008) Africa also contains almost all of the world's poorest countries. The fact that poverty, a narrow range of FDI and bad business environments are found together is almost certainly not a coincidence. Furthermore, while any realistic prospect of African unity is far off, African economic and political events have often been linked together in ‘domino’ patterns. An opportunity for reform or a risk of back-sliding in one African country is very likely to be replicated in others.

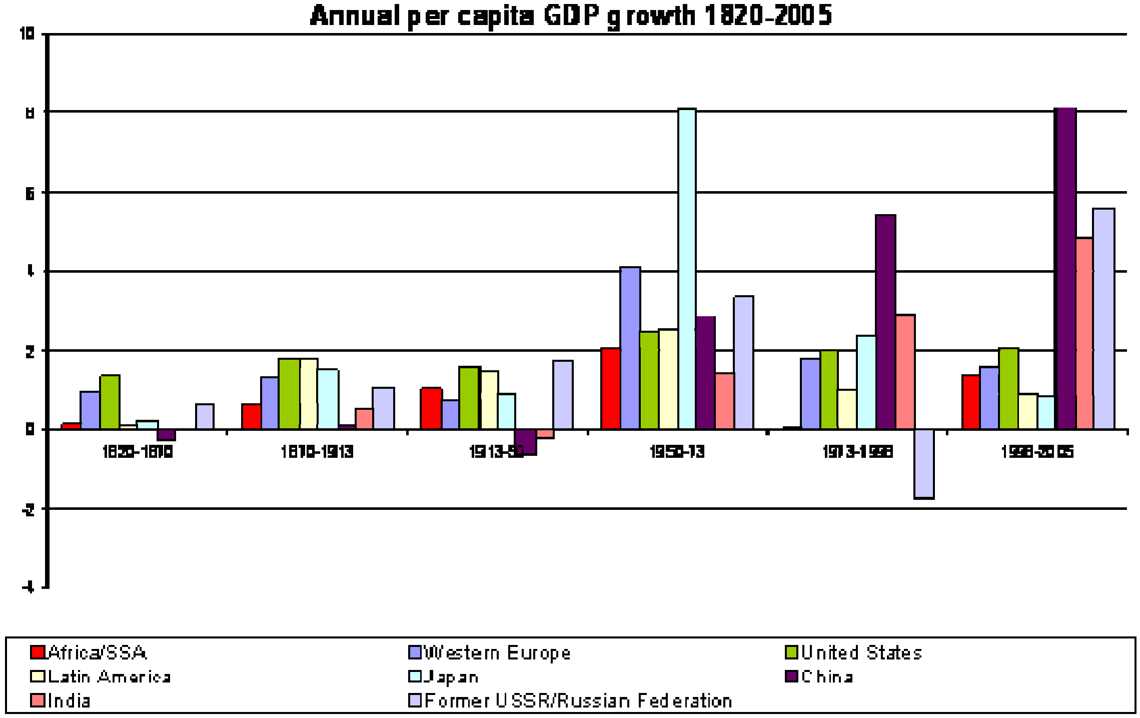
1.2 Taking the long view

1.2.0 Long-term economic history provides some valuable insights for business environment reform in Africa.

1.2.1 Chart 1 shows annual per capita GDP growth for Africa and six other regions or countries over the past two centuries. While the Industrial Revolution is often perceived as an explosion of growth, no major region or country achieved per capita economic growth at above 2% per year before 1950. During the long post-war boom (from 1950 to 1973), Western Europe achieved 4% growth and Japan 8%. After the oil shock, Europe returned to slower rates of growth, while the Japanese economy became relatively stagnant and Russia entered a period of contraction. The last years of the 20th century saw China and India begin to achieve extremely rapid growth.

1.2.2 Africa’s best period was in the post-war boom when it grew at just over 2%, largely thanks to strong demand for African commodities. Between 1973 and 1998 Africa is missing from chart 1 - it recorded just 0.01% annual per capita growth. The situation has been improving since the late 1990s, again largely because of strong demand for Africa’s commodities, this time from China and India. Several African countries have grown extremely fast in the last five years. In 2005/6, Angola achieved 19% GDP growth, driven almost exclusively by oil. Equatorial Guinea, Libya, Sudan and the Republic of Congo – all oil economies – experienced growth of 8% or more. Other strong performers in 2006 included Ethiopia, Burkina Faso, Mozambique and Sierra Leone, with growth of 7% or more driven mainly by the agricultural and service sectors. (UNECA 2006a)

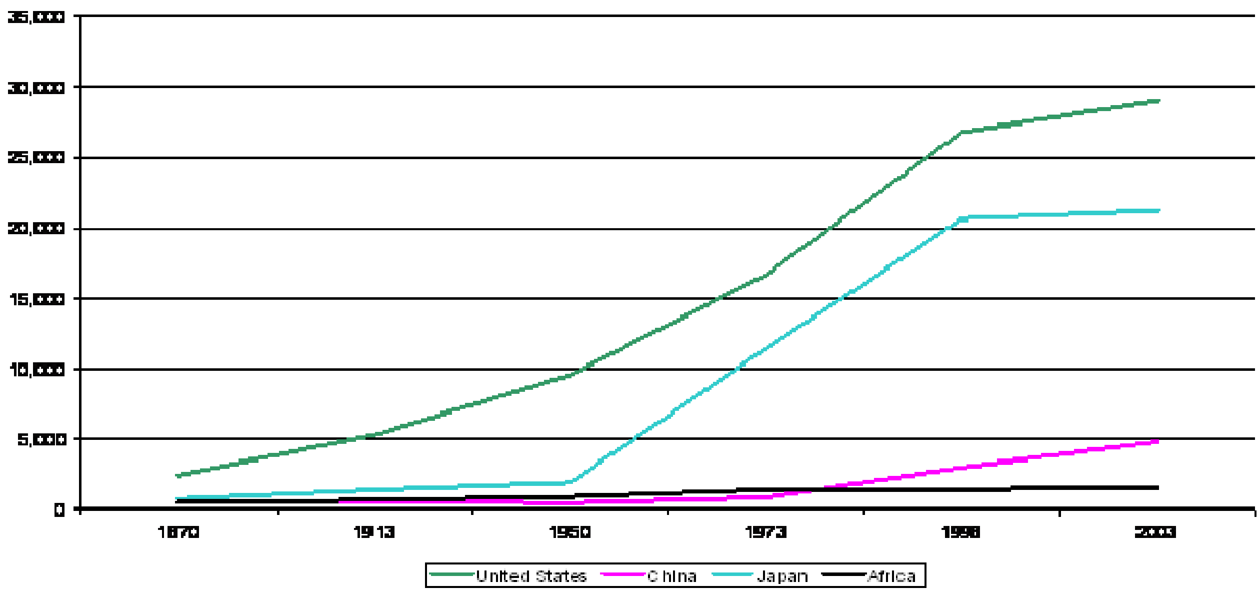
Chart 1
Annual per capita GDP growth 1820-2005



(Source: Maddison 2001 and Maddison Historical Statistics 2007)

1.2.3 Chart 2 shows estimates of changes in the level of GDP per head in Africa, China, Japan and the United States over roughly the same period as Chart 1. Without a single period of hyper-growth, the United States extended its substantial lead into a vast advantage. Even after its dramatic slow-down, the Japanese economy continues to make Japanese people steadily better off. China's world-beating growth is clearly beginning to have a major impact, but would still need to continue for decades at the current pace – which is unlikely to be maintained - before China reaches developed world levels of per capita income.

Chart 2
GDP per capita, 1870-2003
1990 Geary-Khamis international dollars



(Sources: Maddison Historical Statistics 2007; World Development Indicators 2007)

1.2.4 Three useful points emerge from Charts 1 and 2. First, they remind us that the journey to prosperity has been a long one. There is some evidence that time scales for development have been shortening with technological change and globalisation, but business climate improvement and economic growth are slow processes. Second, while episodes of unusually fast growth have occurred in the past, and are happening in China and parts of Africa now, this pace has never been sustained over a long period. When periods of rapid growth end, they may leave behind a newly-prosperous country growing at a sedate pace, like Japan. However, they may also yield a major economic collapse, as the experience of Russia and some Latin America countries demonstrate. Third, and with only a few exceptions, Africa's economies have performed poorly for at least 200 years. Africa has had commodity booms before, but has always missed out on the benefits of sustained growth. Africa will need much improved resource management policies to use the present boom to create the conditions that will allow the continent's economy to grow at a steady - and unspectacular - pace for several decades

1.2.5 The long view suggests that business environment reformers should be patient and committed to consistent work over decades, and should exercise caution in boom times. Donors ought to be thinking less in terms of annual project cycles and more in terms of achievements to be reached over a decade or more. Business environment reform practitioners need to measure their performance in terms of the outcomes for Africa's private sector over the length of their career rather than by looking at what they have spent over a budget cycle.

1.2.6 An immediate consequence of this is a need to rethink what should be meant by sustainability. Donors sometimes take too narrow a view of sustainability. (Morduch 1999) In the narrow view, a project is sustainable only if it is able to become self-financing over a period of a few years. But if donor agencies themselves were judged by the standards of financial sustainability they seek to apply to the business climate reform programmes they support, they would have long since shut down. The relevant measure of sustainability is often not financial viability, but whether the net socio-economic benefits of a programme are greater than its costs. If the benefits of a subsidised programme continue to outweigh its costs for decades, it should continue for decades. And some business environment reform programmes may well have to last that long.

1.2.7 This is particularly true in the case of building up local skills and capacity. Donor agencies tend to argue that they are constrained by the limited range of well-capacitated local counterparts with which to engage in business environment reform initiatives. The result is that the most capable counterparts for reform are swamped by donor attention. (White and Chacaltana 2002) This problem becomes even more acute when programmes move from policy-formation to implementation phases and international consultants withdraw. When donors are committed to the long view, this problem becomes much more manageable. Donors can and should be thinking in terms of the years and decades required to build up the necessary skills and capacity in African governments and businesses to enable reforms to be implemented successfully.

1.3 Growth theory and lessons from East Asia

1.3.0 Behind the goal of creating better business environments in Africa is the ultimate ambition of promoting long-run economic growth. However, as enthusiasts for the Washington Consensus, Monterrey Consensus and other lists of 'magic bullets' are inevitably reminded, there is no combination of endowments, investments, institutions or policies that is guaranteed to create growth. Economists have a good idea about what the ingredients of growth are. But if there is a foolproof recipe, it hasn't been found yet. In fact, it is extremely unlikely that a single recipe for growth that works in all circumstances could exist.

1.3.1 Bearing this important qualification in mind, it is nevertheless useful to assemble the ingredients of growth into a summary list

1. The operation of markets, the division of labour and specialisation, the pursuit of comparative advantage, and the accumulation of capital drive rising incomes per head.

2. Economies achieve sustained long run growth by technological, managerial, and institutional advances that increase efficiency.

3. Sustained growth almost always depends on political, legal and market institutions that guarantee the rule of law, protect private property rights and ensure that contracts are enforceable.

4. As the East Asian experience shows, strong and stable government, disciplined macroeconomic management, high national savings rates, and the pursuit of universal literacy and numeracy have preceded and accompanied rapid growth.

5. Growth has tended to be associated with increasingly healthy populations and increasingly productive agriculture. It is likely that African economies are held back by the continent's heavy disease burden and low agricultural productivity.

6. Growth in poor countries cannot be 'bought' with large-scale public investment in physical or human capital; sustained growth depends on entrepreneurs having the right incentives to take risks and expand their businesses.

1.3.2 The wide variety of policies towards encouraging development taken by Asian countries in recent decades demonstrates the difficulty of defining a single 'model of development.' Hong Kong, Taiwan and Singapore pursued predominantly free-market policies while South Korea, like Japan earlier, made much use of 'corporate guidance' - though there was only limited direct intervention and in Japan at least the guidance was often ignored. The recent Chinese experience points to the importance of deregulation (at a controlled pace) and also suggests the value of loose local as distinct from tight central control over events. The differences in policies adopted have allowed plenty of scope for disagreement about the explanation for what became known as the 'Asian Miracle'. Taken as a whole, however, experience in Asian countries does provide both a source of good practice and a cause for encouragement. What Asian growth clearly demonstrates is that territories which have lain economically dormant for long periods can, in the right circumstances, start growing and in a few decades make a major impact on poverty. In three decades, the percentage of the population of East Asia living on less than $1 a day fell successively from 58 per cent in 1981 to 30 per cent in 1990 to 15 per cent in 2001.

1.3.3 There is no universal formula for growth, but there is pragmatic wisdom. As the list above shows, if a country wants to grow, it needs to work to make itself more attractive to private business. This work may range from improving infrastructure, to assisting governments to develop more sophisticated industrial and trade policies, to cutting red tape and raising regulatory quality. But it should always be guided by the question 'Is this project going to make it easier for a business to start and flourish?' The easiest way to get an accurate answer is to ask businesspeople themselves.

Section 2: Key issues affecting the business environment

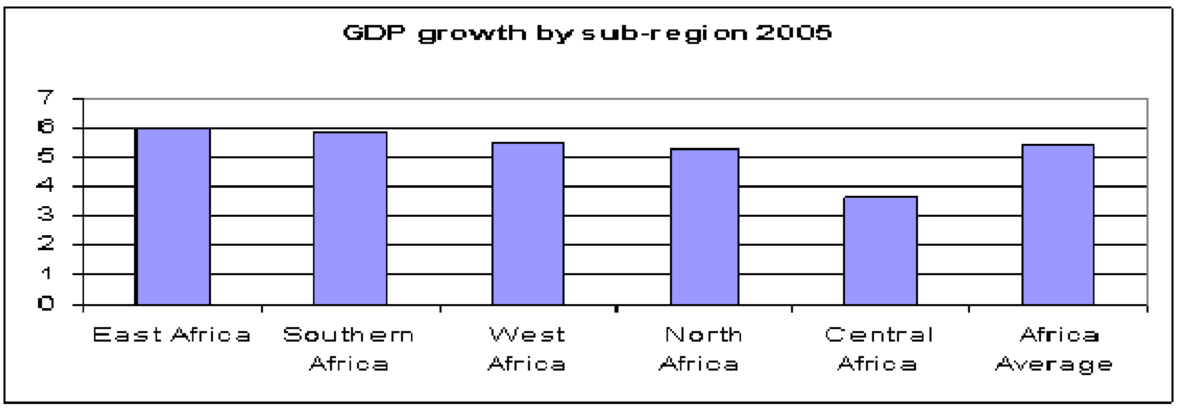
2.0 This section discusses key issues impacting on efforts to improve the business environment in Africa. It discusses risks and constraints facing business climate reform practitioners, including the limited demand for reform, and makes suggestions about how donors can improve their practice. In particular, it recommends closer attention to incentives, closer engagement with business, improved coordination among donors, support for realistic regional integration initiatives, and ways to gather better data about project outcomes to inform better practice.

2.1 Africa's boom: opportunities and risks

2.1.0 Much time was lost following independence from the 1960s in unproductive socialist and one-party experiments in many African countries. The continent-wide transition to democratic and multi party rule, together with the improved economic climate should encourage a new readiness for change. In the past, donors have often worked in countries with stagnant economies, repressed business sectors and civil societies, and governments that were often inclined to pay only lip service to donors' suggestions. In the context of increased political and social openness, the present boom creates a new pattern of risks and opportunities for donors working to improve the business climate.

2.1.1 Average gross growth rates in Africa have exceeded 5 percent over each of the past three years, outstripping global averages, and matching that of the post-communist transition economies. As Chart 3 shows, East Africa led sub-regional growth. North Africa benefited from the strong performance of the oil sector in Algeria, Egypt and Sudan. Central Africa has performed relatively poorly, with growth declining from 6.3 percent in 2004 to 3.6 percent in 2005.

Chart 3



(Source: UNECA 2006a)

2.1.3 Africa's current growth is largely the result of a commodity boom driven by East Asian and Indian growth. Such commodity booms have happened before, leaving unsustainable domestic policies and international debt in their wake, and there is a risk that this will happen again. So far, however, macro-economic management has been much better than in previous booms. Current account deficits are for the most part being contained or reduced. On average, inflation has been below 5% since 2000, and the continent's debt burden has been falling since 1995. (APF/NEPAD 2007)

2.1.4 Boom times are likely to make some of Africa's governments and established business communities more open to suggestions about improving the business climate. Economic success can breed confidence and openness to reform. But it is also possible that the wealth currently being generated by the commodity boom will increase the risk of African countries succumbing to the 'Resource Curse' – allowing rapidly growing incomes from natural resources to put pressure on real exchange rates, trigger inflation, and reduce export competitiveness. The exploitation of natural resources is capital-intensive and creates relatively few jobs. Governments are presented with opportunities to extract rent from resource wealth, increasing political complacency, discouraging transparency, corrupting the state and weakening the private sector.

2.1.6 Another important new trend is that in many African countries, governments can now trade off Chinese and Western support. At worst, this can lead to situations like that in Sudan - China's largest overseas oil project – where China delivers billions of dollars in investment, oil revenue and weapons to a government that stands accused of genocide in Darfur. However, at best it creates opportunities for a new and healthier relationship between donors and governments, enabling host governments to be more selective in accepting development assistance. In cases where governments are genuinely free to choose, and have willingly adopted a donor or business-backed reform, chances of success are much higher than in cases where governments would make whatever promise was required to get budget support.

2.1.7 Western donors have for some time argued the importance of African ownership of donor-funded initiatives by which is meant that host governments should be actively involved in implementing these initiatives and fully committed to the planned outcomes. In a slightly ironic way, the rise of Asian influence on the continent increases the impetus for African ownership of donor-funded reforms. Donor agencies now have a real interest in pursuing a participative and collaborative approach to economic development projects. African governments that choose a donor-supported programme will increasingly have done so because they are genuinely committed to it.

2.1.8 The boom therefore makes donors' work more difficult in one way, and more promising in another. Governments can and will openly ignore donors more often. But well-designed development interventions that are genuinely owned by governments and business stand an excellent chance of permanently improving the business climate.

2.1.9 Oil-rich post-conflict countries represent a special and extreme case of the general point made in the previous paragraphs of this section. It is not coincidental that several of Africa's fastest-growing economies are also post-conflict countries. Hyper-growth is particularly likely when an oil boom is combined with post-war reconstruction. Post conflict countries tend to be characterised by especially weak institutions, an almost complete lack of services and resources to support private sector development, limited access to finance, highly insecure property rights, very weak commercial justice, contracting laws and commercial dispute resolution, lack of skilled labour and inadequate infrastructure. The early post-conflict period potentially provides opportunities for rapid policy and institutional reform. Equally, however, post-conflict oil-fuelled hyper-growth presents much-heightened risks of 'Resource Curse' and rejection of advice from western donors.

Hyper-growth and the Resource Curse in Angola

The efforts of international financial institutions to apply stabilisation and structural adjustment policies to revive Angola's collapsed economy in the 1990s created unintended adverse effects. The tiny Angolan elite captured the newly privatized public sector trade and production monopolies, and raised prices. International financial institutions' efforts toward economic restructuring and better fiscal transparency were ignored, in favour of no strings attached investment from China. The benefits of this investment were channelled to the elite and middle class, leaving the agricultural sector gravely uncompetitive as a result of large increases in Angola's real exchange rate. (Auty 2007)

2.2 Increasing effective demand for business climate reform

2.2.0 It is important to recognize that Africa is making some progress in regulatory reform. The World Bank's 2007 *Doing Business* report notes that in 2006 Africa ranked third in terms of positive reforms to the business environment, behind Eastern Europe and Central Asia and the OECD high-income countries. Two-thirds of African countries made at least one reform in 2006, and Tanzania and Ghana ranked among the top 10 reformers in the world in 2006. In 2007, 52% of African countries made at least one reform, and Egypt, Ghana and Kenya were in the top 10. The reforms were generally small but the progress is encouraging and seems set to continue. (Doing Business 2007/8)

2.2.1 It is just as important to note that business environment reform is often contentious, involving significant transfers of wealth and opportunity. The short-term losers are often powerful elites, in government and the private sector, who benefit from long-established rent-seeking arrangements and preferential treatment. These arrangements are perpetuated by strong presidential systems of governance, weak administrative and technical capacity in the public service, and the fact that African non-agricultural private sectors are often dominated by a few large and highly profitable firms that tend to be foreign or minority-owned. Such firms usually enjoy significantly higher productivity, more market power and more export competitiveness than domestic firms. They may also benefit from anticompetitive rents generated by the poor business environment. In situations like these, regulatory reform can have limited appeal for some in the business community, given the potential for large increases in entry and competition. To preserve the dominance of a minority of large firms and protect rent-seeking arrangements, some big businesses and government officials have an interest in presenting donors with enough partial reform to keep the money flowing in, while avoiding reforms that would assist the rest of the private sector and therefore increase competition. (Eifert et al 2005)

2.2.2 Obtaining support from civil society for business climate reform can also present challenges. Public attitude surveys show limited support for market-based approaches to growth and development. Afrobarometer surveys undertaken in 15 African countries found a preference for a market economy in only six countries – and the percentage of respondents indicating this preference was only slightly over half. In most countries, the majority of respondents supported government control over planning, production and distribution of all goods and services. 58 percent of all respondents indicated that the government should be primarily responsible for job creation. 72 percent of respondents said that all civil servants should keep their jobs, even if paying their salaries was costly to the country (Eifert et al 2005). Attitudes like these mean that public pressure to improve the business climate may sometimes be relatively weak.

2.2.3 Donor initiatives to improve the business environment should grapple with the challenges of limited demand for reform from the public and from some vested interests in business and government. The following paragraphs make recommendations for better donor practice to increase demand for business environment reform from governments, from businesses and from the public.

2.2.4 Two decades of experience have shown that strict conditionalities on ODA tend to increase political tension without increasing the chances that the reforms 'purchased' in return for aid actually take place. In recent years development theorists and practitioners have placed a significantly increased emphasis on the importance of ensuring that client governments really intend to make reforms.

2.2.5 This paper endorses Paul Collier's argument for 'selectivity' rather than 'conditionality' - instead of trying to use aid to induce policy change, donors should look for environments where aid will enhance growth and alleviate poverty, based on governments' demonstrated commitment to, and capacity for, reform. African governments should be expected to work with the private sector to identify reform priorities that will make a real difference in their particular context and should be 'rewarded' with donor support after they have actually begun to undertake reforms. (Collier 1997)

The African Peer Review Mechanism

African governments have sought to demonstrate their commitment to reform through the African Peer Review Mechanism. This was established by NEPAD as a tool to promote improved governance. By signing up to the APRM, governments commit themselves to undertaking an honest assessment of their strengths and weaknesses in political governance, peace and security and socio-economic policy and practice, and to working with a broad range of stakeholders to identify concrete action for reform. The APRM aims to encourage and build responsible leadership through self-assessment, constructive peer dialogue and sharing of information and experience. Twenty-six countries have acceded to the mechanism. Since its inception in 2003 the APRM Panel has launched reviews in 13 countries and country review missions in five countries. Peer review at the level of heads of state has been conducted in Ghana, Rwanda, Kenya and South Africa. Despite some teething problems, and tardiness among many of the signatories to move to the review stage, the APRM is a very real effort by some African governments to demonstrate a commitment to self-critique and policy and process reform. Donors pursuing a 'selectivity' based approach may well consider post-review programmes of action to be promising candidates for support.

<u>2.2.7</u> However, a purely incentive-centred analysis of African politicians and states is incomplete. Like everyone else, African officials, politicians and publics have non-material values and aspirations as well as rationally self-interested responses to material incentives. Donors should not be over-sceptical. When governments and business associations appear to be acting in good faith when calling for assistance in making business climate reforms, donors should still respond – cautiously – to signs of progress. To do otherwise would be to hold African officials to higher standards than those applied in the donors' home countries.

<u>2.2.8</u> Established businesses may well have powerful incentives not to reform the business climate. To address this, reforms should take into account the need to do the least amount of damage to already-established businesses that is consistent with creating new opportunities and reducing costs for the private sector as a whole. Established businesses need to be confident that the expanded profits to be made in a more open and better regulated economy will compensate for lost rents. (Eifert et al 2005) Donors therefore should work closely with businesses of all types in order to implement reform programmes that are compatible with businesses' interests.

<u>2.2.9</u> Businesses are intimately familiar with the realities of the African business environment. Efforts to improve the business environment should tap into that knowledge. This requires effective dialogue between donors, African governments and business, to identify mutual priorities and develop interventions that are capable of making a real impact. Cooperative engagement mechanisms such as the South African

Presidential Working Groups with various business sectors are a useful model for future donor support in countries where such dialogue would benefit from external facilitation. Informal businesses should be included in the dialogue - they rarely have in the past.

The ICF: donors, governments and the private sector working together

The Investment Climate Facility (ICF) has been designed as an innovative, flexible instrument to facilitate changes in policy and practice, toward making Africa a more attractive place to do business. It is underpinned by the recognition that real change in Africa cannot take place without the commitment of African leaders, and that practical, outcomes-focused solutions are best developed in partnership with the people actually doing business on the continent.

Central to the concept of the ICF was the need to bring the skills, insights, practices and principles of businesses themselves to bear upon the challenges of business climate reform. Corporate investors bring to the table their experience of doing business on a day to day basis in different countries and regions in Africa– and their detailed knowledge of the opportunities and frustrations involved. This expertise, together with the collective experience of donor partners regarding what has worked, and not worked, in different areas of business environment reform, can be mobilised to identify and develop projects that address real priorities.

The ICF conceptualised the 'task force model' to take this stakeholder engagement one step further. This model would see the ICF working proactively with private sector interests and key government officials at country and regional level to identify key challenges under agreed priority sectors (e.g. customs), and developing and implementing solutions through coalitions of appropriate players. Task forces would include those actors responsible for implementation of reforms – thus ensuring that key decision makers are part of the process of change.

To date, the task force model has worked very well in the context of the BAFICAA customs reform project, which is supported by the ICF, and has strong momentum of its own. It remains to be seen whether the ideal of multi-stakeholder, issue-based task forces will take off in other sectors of business environment reform – but the model is certainly a promising one.

<u>2.2.10</u> The first step towards increasing civil society support for business climate reform is to show that ordinary citizens will benefit from it directly. Business environment reform practitioners should not forget that the majority of business transactions undertaken by most African people happen in the informal economy. To gain popular support, therefore, business environment reform initiatives should lower the barriers to formalisation and make the operating and regulatory environment easier for the smallest firms.

<u>2.2.11</u> Publicity and information campaigns making the case for a more market-oriented economy are also likely to be helpful here - though it has to be accepted that deep-seated cultural attitudes change only slowly. Until more Africans are intellectually persuaded of its advantages, even the most appropriately incentivised officials will face serious resistance in their efforts to improve the business environment.

The Africa Enterprise Challenge Fund

The Africa Enterprise Challenge Fund (AECF) is an initiative that could help to increase civil society support for business climate reform by showing how entrepreneurial activity can work for growth and development

In line with the recommendations of The Commission for Africa, the AECF was launched in mid-2007. It aims to stimulate private sector entrepreneurs in Africa to start businesses that both make a profit and improve the lives of the poor, particularly in rural areas. Funds will be made available as grants, matched by private sector contributions, to support innovative business ideas. AECF will primarily offer grants for business ideas that help the rural poor by providing goods or services that have a direct and positive impact on their wellbeing by offering new livelihood opportunities or employment as workers or entrepreneurs. Donors include the African Development Bank, CGAP, the International Fund for Agricultural Development (IFAD) and DFID.

2.3 Improving the supply of business climate reform

Improving donor coordination

2.3.0 Poor donor coordination undermines the effectiveness of development aid and increases the administrative costs for beneficiary governments. Donor fragmentation means building relationships with a multiplicity of donor agencies, coordinating multiple mission visits and coping with incompatible project reporting requirements – all of which squeeze the time and energy of recipient line ministries. (Roodman 2004; Djankov, Montalvo et al 2006) Donor fragmentation has been found to be predictive of lower recipient bureaucratic quality, suggesting that donors out-compete recipient governments for the scarce resource of skilled local workers. (Roodman 2004)

2.3.1 The benefits of collaboration are equally well-known: reduced transaction costs for governments and donors, provision of balanced and consistent advice to governments by donors, and improved design and implementation of policies, strategies and programmes. Recent recommendations to address donor fragmentation include:

1. special purpose global funds focussing on a specific problem, and which bring together official institutions, international organizations, foundations and private firms. (A challenge that needs to be faced is to ensure that individual donor bureaucracies do not reproduce themselves inside or alongside new funds.)

2. establishment of an International Financing Facility to increase and front-load aid resources by combining actions by donor governments, private capital markets, and multilateral institutions. (Sagasti et al 2004)

3. active promotion of regional and local partnerships to take forward development initiatives.

2.3.2 All three of these suggestions are to be welcomed because they recognise the importance of close engagement with African governments and private sectors. We would add that the chances for better coordination are increased when:

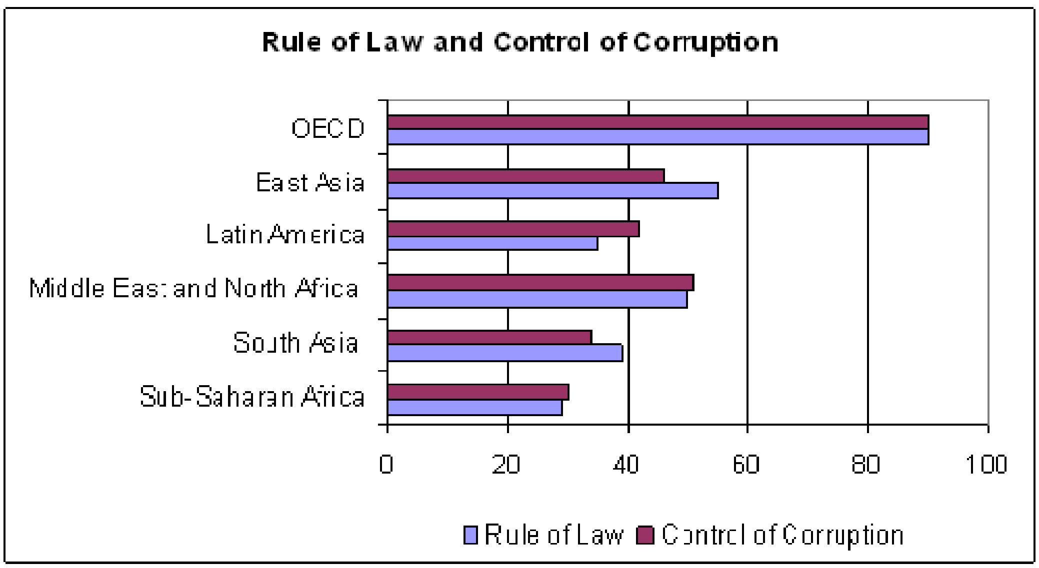
1. donor staff are themselves appropriately incentivised to communicate across institutional boundaries (staff KPIs could usefully include measures of knowledge of the range of donor programmes happening in a country or region)

2. efforts at coordination go beyond head office. Country offices should be mandated and incentivised to communicate horizontally with the local offices of other donors.

Reducing corruption and improving governance

2.3.4 While Africa has made some progress on improving transparency and tackling corruption, it continues to score poorly in terms of rule of law and control of corruption when compared to other regions, as Chart 4 indicates. There are at least two reasons why this matters. First, corrupt and arbitrary governments are unreliable suppliers of business environment improvements. Second, corruption and erratic governance themselves seriously worsen the quality of the business environment.

Chart 4



(Source: Kaufmann et al 2007)

2.3.5 Business environment reform donors can do much more to improve their practice in this area. Donor agencies are sometimes guilty of allocating funds on the basis of their country's strategic priorities without reference to countries' governance practices or the likelihood of successful reform. Countries of greater economic importance but poor governance standards are likely to have governance preconditions waived. (Roodman 2004)

2.3.6 Donors are making a wide variety of efforts to reduce corruption. These include developing investment codes, modernising financial systems, strengthening the oversight function of parliaments and supporting the new international Public Expenditure Financial Accountability Framework (PEFA). (DFID 2006) Other initiatives include the OECD Anti-Bribery Convention and the UN Convention against Corruption, which has been ratified by thirty African countries to date.

2.3.7 More can be done. Donors ought to be more aware that development aid can be a significant source of rent for African governments and businesses. (Auty 2007) In order to reduce the proportion of business climate reform ODA that is taken in rent, we would encourage donors to increase their support for business-linked initiatives such as the Extractive Industries Transparency Initiative (EITI)

2.3.8 The EITI appears to be bearing fruit, with fifteen African countries and eighteen companies signed up. Nigeria was the first African country to publish detailed results in January 2006. Efforts are being made to establish the initiative as an international standard of good practice, and similar initiatives are underway in the forestry and fishery sectors.

2.3.9 EITI-type mechanisms are likely to be more successful in reducing corruption than approaches which focus only on government. The EITI and similar systems work because they link donors, business and government into a single system of accountability.

2.4 Supporting regional integration

2.4.0 Africa's economies are for the most part very small. Efforts to promote regional integration have the potential to realize benefits such as regulatory harmonization, cooperative approaches to infrastructure development, and reduced barriers to intra-African trade, as well as providing a foundation for stronger political cooperation and conflict resolution.

2.4.1 Regional integration is not proceeding smoothly. Despite longstanding rhetorical commitment to integration from almost all African leaders, a lack of real political will and the overlapping mandates, objectives and memberships of RECs have slowed the integration process and reduced the effectiveness of regional integration efforts.

2.4.2 Nevertheless, some RECs are making good progress toward regulatory harmonisation. (See box below on promising models of regional integration.) Progress in customs integration is most promising - around half of Africa's countries have harmonized customs documentation. But there is still a long way to go in achieving common labour laws or policies allowing free movement of people and goods. Progress in tax harmonisation, implementation of tariff reductions or elimination of non-tariff barriers has been limited. A small number of RECs are making headway in increasing intra-regional trade, but progress on the whole remains slow. Intra-regional trade is only 5% of regional GDP, compared to 27% in East Asia. (DFID 2006) Only 28 percent of African countries report reducing tariffs to levels agreed to by the RECs, and 32 percent are behind in implementing agreed tariff reductions. Barely a third of member countries have eliminated non-tariff barriers that impede trade within RECs. (UNECA 2006b)

Promising models of regional Integration

The EAC

The East African Community, which incorporates Kenya, Uganda and Tanzania, is one of the success stories of regional integration in Africa. The EAC was originally founded in 1967. After being disbanded in 1977 it was re-established in 2000, with the objective of establishing a

European Union-style common market and monetary union. In June 2007 the trading bloc was expanded to include Rwanda and Burundi, bringing its total coverage to 115 million people. The EAC prioritises cooperation in areas of transport and communication, trade and industry, security, immigration and the promotion of investment in the region. Efforts are being made to ease travel restrictions within the EAC, harmonise tariffs, increase cooperation among security forces, improve communications and share electrical power. Trade within the region is robust. A double taxation accord has been agreed, tax reform measures have been put in place to reduce reliance on external budget support, currencies are treated as exchangeable, and members of the community can apply for an East African passport. The EAC's future plans include a common currency and a formal federation with a president, cabinet, parliament and supreme court. Political federation appears to have fairly strong support.

OHADA

The Organization for Harmonization of Corporate Law in Africa (OHADA) is reported to have made impressive progress in unifying regional business laws. OHADA currently has 16 members, concentrated in West Africa and predominantly Francophone. Created in 1993, it aims to restore the confidence of foreign investors and facilitate economic exchanges among the member States, by providing them with a set of common and simple business laws, promoting arbitration as a dispute settlement system in trade-related disputes, improving the training of the judges and court clerks, and preparing for future regional economic integration. The OHADA treaty provides a mechanism for adopting new uniform business laws and modifying existing ones and for a single judicial interpretation of these laws across the treaty territory. OHADA seems to have succeeded in designing, applying and enforcing a substantial body of uniform commercial and corporate laws, which has contributed to an increasing intra-African trade among members. A Common Court of Justice and Arbitration has been established in Cote d'Ivoire and a regional training centre for legal offices operates from Benin. Research in the region suggests that the sophistication of the new uniform business laws, together with the supranational legislature and judicial system, can facilitate commerce by increasing predictability and transparency.(Dickerson 2004)

A regional approach to infrastructure development

2.4.3 The African business environment is characterised by high indirect operating costs associated with weak infrastructure in areas such as energy, land transport and telecoms. In most African countries the combination of energy and indirect costs accounts for 20 to 30 percent of total costs, compared to 13 to 15 percent in countries such as China and India. (Eifert et al 2005)

2.4.4 Inadequate infrastructure pushes up transaction costs, inhibits investment outside capital cities, limits productivity, constrains access to markets and retards economic growth. While private sector investment in infrastructure has increased significantly in recent years, particularly in telecommunications and energy, investment is still constrained by a lack of capacity among governments to conduct the necessary feasibility studies, to create appropriate regulatory frameworks, and to provide credible assurances of political and economic stability. Regional approaches could be a useful way to address these constraints by increasing market size and building government and regional capacity to manage infrastructure development at an efficient scale.

2.4.5 A number of donor programmes have been established to work with RECs to improve the policy environment and strengthen the capacity of RECs to prepare and facilitate regional approaches to managing private-sector-led infrastructure investment projects. Efforts have focused on harmonising regulations and creating common platforms for infrastructure investment promotion. The World Bank for example has established a Regional Integration Department to work with Bank staff and clients to incorporate regional approaches into country programmes and to support regional bodies. The Bank is developing a Regional Integration Assistance Strategy which will focus on areas where approaches can deliver additional impact at country level. (World Bank 2007) DFID's Regional Trade Facilitation Programme in Southern Africa is providing significant support to help countries to analyse their trading interests. (HM Government 2006) Another initiative is NEPAD's multi-donor Project Preparation Facility (PPF), hosted by the African Development Bank, which aims to support RECs and countries in preparation of physical or capital investment projects for implementation. The fund's projects have included the Kenya-Uganda Oil Pipeline Project, the Benin-Togo-Ghana Power Interconnection, the Zambia-Tanzania-Kenya Electricity Interconnection Project and COMTEL. (NEPAD 2005)

More effective donor practice

2.4.6 Closer regional integration is likely to improve the African business environment. We have three suggestions for improving donor practice in support of integration efforts. First, a lesson from economic history: successful regional integration efforts have started with – and focussed on – trade integration. At least for several decades, the entities that now form the European Union were almost exclusively concerned with practical issues around tariffs and trade infrastructure. Little attention was paid to political integration until this phase was complete. We would therefore urge donors to spend relatively less effort on supporting politically-oriented regional secretariats and relatively more on the practicalities of trade integration.

2.4.7 Second, it is useful to remember that sovereignty is highly valued. Rhetoric aside, governments will need to be confident that the political gains from regional integration will more than compensate for the pooling of sovereign power required. It would be unrealistic to expect real political enthusiasm for regional integration unless it could be shown, for instance, that tax revenues would grow faster than tariff revenues would fall.

2.4.8 Last, to return to the main theme of this paper, businesses should be at the heart of regional integration. It is firms, after all, that actually have to grapple with the complexity of operating across borders. Donors and governments would do well to listen closely to the concerns and suggestions for improvements put forward by the business community. The BAFICAA initiative (see box) is an excellent example of this sort of approach.

Private sector action for customs reform

BAFICAA is an international coalition of businesses committed to identifying, promoting and supporting effective measures to improve customs administration and enhance trade facilitation in Africa. Following the launch of the Commission for Africa in early 2004, businesses with interests in Africa came together to form Business Action for Africa (BAA). BAFICAA emerged from this consultation process as a sub-group focused on customs. The group has no formal organisational structure. It works on a "light-touch" basis, and aims to complement existing work on customs reform in Africa. Interested companies come together to pinpoint key issues and find ways for the private sector to make a positive and proactive contribution to improvements in customs administrations. Corporations working under the BAFICAA banner recognize the private sector as the driver of change, with an active role to play in customs improvements and ready to make practical contributions to improvements that will benefit the economy as a whole. To achieve real improvements, BAFICAA is committed to developing a cooperative dialogue between business and governments based on a relationship of trust, as well as to devising and implementing joint, practical and real-world proposals for reform.

BAFICAA has compiled a report providing an accurate up-to-date picture of business perceptions of customs administrations in Africa. Three countries in the East African Community (Kenya, Tanzania, and Uganda) have been chosen as the initial pilot region (Rwanda and Burundi will also be invited to join the initiative). A series of workshops have tested the feasibility of the recommendations and national private sector taskforces have been established. These taskforces have set up dialogues with their national customs administrations and a regional dialogue has been initiated through the East African Community Secretariat and the East African Business Council (EABC). Working together, the taskforces and customs administrations have identified six key project areas. All stakeholders have agreed that establishment of national Authorised Trader Schemes is a top priority. The Commissioners of Customs are due to meet in late 2007 to develop an action plan to implement such Schemes, with common standards across the region allowing for mutual recognition in the East African region.

2.5 Regulatory reform and active enterprise development: the debate

2.5.0 In a stimulating recent paper, Altenburg and Drachenfels argue that the regulatory reforms which they characterise as the New Minimalist Approach (NMA) are important and desirable - but insufficient in the absence of active measures to support enterprise development, including Business Development Services (BDS), export promotion and government support for 'self-discovery' of new areas of comparative advantage. (Altenburg and Drachenfels 2006, Rodrik and Hausmann, 2007) The first part of this analysis and in particular the statement that the proponents of investment climate reform have not been able to present rigorous evaluations of the impacts of reform processes cannot be denied. Their prescription for specific market interventions in the form of selective and targeted policies is a different matter. This amount to a call for a return to active industrial policy: picking winners and sheltering 'infant industries' – an approach that has not often worked in the past.

2.5.1 Economic history does not support the view that planning policies have played a major part in economic development in mixed and market economies. (There is, however, historical support for the strategic trade policy which Altenburg and Drachenfels recommend. The United States, Japan and South Korea made considerable use of import substitution in the early stages of their development.)

2.5.2 Although targeted industrial policies have been used in many countries, particular measures have rarely been subject to rigorous evaluation. It is certainly possible to identify some cases where government purchasing, planning and support have played a quite important role in building up a particular industry – such as computers in the US, aviation in Europe, ship building in South Korea, steel in South Africa and fruit and fisheries in Chile. It is doubtful, however, that active industrial policy has played a major part in speeding aggregate growth in these – or any other - cases. This is for three reasons.

2.5.3 First, successful interventions have been far less common than failed ones even in the industrialised countries for example in Europe, Second, successful industrial policy requires a great deal of capacity in a country's Department of Trade and Industry (or equivalent.) Large volumes of information have to be processed quickly. Tempting opportunities to extract rent have to be avoided. Political pressure to continue to shield industries long after their 'infancy' must be resisted – a problem that has arisen historically in several Latin American countries and in South Africa. Donors would have to be sure that these political and administrative capacities were firmly in place before supporting active industrial policy in Africa. Third, it remains very doubtful that selective intervention has played a significant role in altering trends in overall economic development, even in Asia. (Wade 1992) Much more important have been changes in the business environment (as in China and India) and responses to these changes via market forces. Outsourcing by western manufacturers and wholesalers with the active participation of local networks to take advantage of lower labour costs, for example, have been powerful instruments for growth and change.

2.5.4 Research assessing government-run Business Development Services (BDS) has found that there is no evidence that such services have played a significant role in the improvement of competitiveness (Bannock, 2005). State-run BDS reaches only a very small proportion of the business population in developed and emerging economies and it has proved very difficult to maintain quality of service. By contrast, profit-making business services have proved to be one of the fastest growing elements of the private sectors in the OECD and in India. In India the private sector supplies effective BDS without state support, strengthening the argument that there is little need for state-run BDS. A 2005 ILO report found evidence of 'extensive provision' of BDS services by the private sector to the poor worldwide. The report noted that, 'contrary to what has often been assumed in the past, the poor sometimes prefer these services over the free of charge public provision, as they have more control when they are customers.' (ILO 2005)

2.5.5 Recent estimates of the size of the informal sector suggest that it accounts for 43 per cent of GDP in Africa and that this proportion is growing. (Schneider 2006) Given that fact that most African businesses are very small and informal, the chances of publicly-supported BDS (or other active enterprise development tools) reaching a useful scale are small. The odds of government and donor-run schemes stumbling upon the most promising entrepreneurs among so many candidates are even slimmer. If African countries are fully to utilise the vast reserves of labour and entrepreneurship that exist outside the formal economy, they will need to look first at the regulatory barriers to business growth and formality rather than attempting active enterprise development. Regulatory reform has much greater potential to improve the business environment for the broad spectrum of African enterprises. This point by is reinforced both by cross-section econometric studies and by economic history.

2.5.6 There is now overwhelming evidence that the quality of the regulatory environment is crucial for development in general and for business growth and formalisation in particular. Several cross-section studies (summarised in WDR 2005) comparing various institutional factors such as the rule of law, property rights and aspects of business regulation show a strong relationship with economic development. (See for instance Djankov, McLeish and Ramalho 2006; Dabla-Norris and Inchauste 2007) Economic history supports this. For instance, the dramatic improvement in India and China's growth performance dates from the early 1980s when the investment climate began to be liberalised. These reforms included the granting of property rights to farmers and others in China, the beginnings of the liberalisation of foreign trade and reductions in licensing requirements in India.

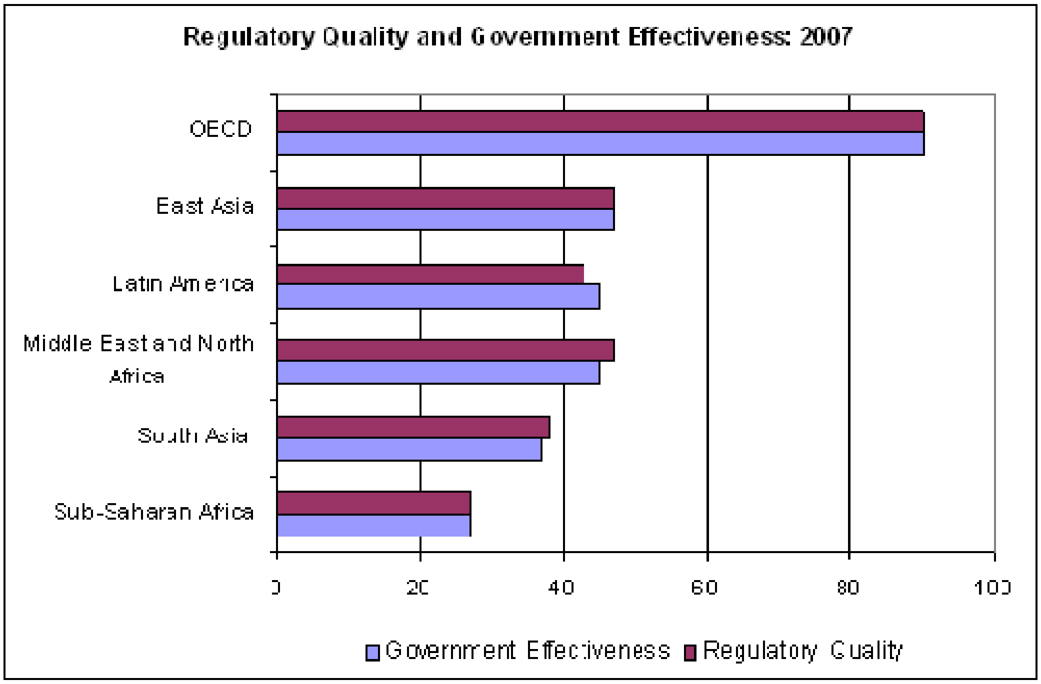
2.5.7 High regulatory costs keep emerging enterprises out of the formal sector. (SBP 2005) The size of the informal sector reflects the fact that the poor cannot do business under the rules that apply in the formal or 'modern' sector. Where regulatory costs are high and the benefits of regulation are small or doubtful, informal enterprises have little incentive to formalise, as they perceive the benefits of formalisation, such as secure property rights, access to legal protection and access to finance, to be outweighed by the time and costs associated with regulatory compliance and by uncertainty that the promised benefits will in fact materialise.

2.5.8 Although cutting expensive red tape is very important, making the path from the informal to the formal sector easier to travel is not only a matter of reducing regulatory costs. It is also necessary to raise regulatory quality. If rules and taxes are enforced consistently and systematically, and better public services are provided, then more growth and development can be achieved and the size of the informal economy will shrink in the process. This, in essence, is what has happened in the advanced countries. Other types of policy such as tax reform, better infrastructure for informals and imaginative ways to increase purchasing from informals by formal enterprises can contribute, but the best way to reduce the size of the informal sector is to improve the business environment and lower the costs of doing business in the formal sector. It is often not appreciated that even though regulation is not enforced in the informal sector that sector is still greatly influenced by it because it reduces the opportunities for transition.

2.5.9 In summary, it is known that regulatory improvements and other aspects of the business environment stimulate growth, and can have positive impacts on the very small firms that dominate the African economic landscape. We are much less sure that the same can be said for active enterprise development policies.

2.5.10 As Chart 4 shows, there is a great deal of work to be done in reforming the business environment. Africa continues to score very poorly on ratings of 'Regulatory Quality' and 'Government Effectiveness.' Those detailed indicators that are available indicate that regulatory costs in Africa are very much higher in both absolute terms and in relation to incomes than other parts of the world and especially compared with South Asia. Since a major challenge for business is to compete with these countries and inter-regionally in exports and as a location for inward investment this is obviously a problem that urgently needs dealing with.

Chart 4



(Source: Governance Matters VI 2007)

2.5.11 Donors are of course already very active in the area of regulatory reform. Current initiatives include awareness-raising and lobbying, working with national governments to achieve policy change in areas such as tax and labour regulation, and establishment of one stop shops for business registration and customs. (UNECA 2006)

2.5.12 In order to improve their practice, donors need to develop a much more precise sense of which parts of the regulatory regime create the most serious constraints to enterprise development - and therefore offer the best opportunities for successful business environment reform. Two ways to develop this more accurate picture are to develop better indicators of what is happening on the ground in terms of the environment and to take the views of business more into account.

2.6 Understanding the relative importance of different types of regulatory reform

2.6.0 Since history and several cross section studies bear out the relationship between an improved business climate and growth, it is at first sight disconcerting to read that Altenburg and Drachenfels 2006 find it difficult to see positive relationships between the rankings of the Doing Business indicators and other measures of the investment climate and actual economic performance.

2.6.1 Before drawing the conclusion that the regulatory environment is not as important to growth as suggested by cross-section data and economic history, several other possible explanations for this finding should be considered. First, it is likely that the time lags between regulatory reform and the more rapid growth caused by those improvements is much longer than the periods they examine (1985-2005 or forecasts).

A second may be that the indicators measure costs and burdens as perceived by large firms or outside observers looking at the letter of the law. The wide gap between legal formalities and the real world of business in many countries may weaken relationships between the existing indicators and growth performance. A third possible reason is that the Doing Business and other indicators may contain components which have been selected more because they are easy to measure than because they are important. A fourth may be that these indicators employ inappropriate weighting among their various components, or do not weight them at all. Fifth, there may be technical statistical issues which make it difficult to find relationships between this kind of relatively slow-moving time-series data and the much more volatile growth performance of almost all developing countries. (Pritchett 2000)

2.6.2 This paper's recommendation is therefore not to downgrade the importance of regulatory quality in stimulating growth, but to upgrade the existing business climate indicators. Existing business climate indicators have been very useful in building demand for regulatory reform and stimulating competition among countries to achieve it. But they are much less useful in guiding donors to identify the precise types of reform programme most likely to have the biggest positive impact on the business climate and growth.

2.6.3 Research is now required to create indicators of regulatory quality that weight components of the business climate by their importance in business activity. We suspect, for example, that labour, tax and property regulation may be far more significant in many African countries than licensing or business registration procedures, and the issues that are most important to large firms will be quite different to those prioritised by small businesses.

2.6.4 It may also be useful to make more use of interview-based techniques and regulatory cost-benefit analysis to find out precisely what features of regulatory regimes create barriers to business growth and to discover what reforms are possible, country by country.

Cooperative engagement with business

2.6.5 As we have argued throughout this paper, the aggregated wisdom of business people about regulatory constraints should be a crucial source of information for donors and governments.

2.6.6 This does not mean, however, that donors and governments should expect or allow themselves to be captured by narrow business interests. Nonetheless, the institutions and mechanisms for structured interaction between donors, governments and African business interests could be much further developed.

2.6.7 On the institutional side, more support for structures that permit regular high-level tripartite discussion between business, government and donors is needed. To reduce risks of capture, business should be represented in these forums by broad sectoral or multi-sectoral associations rather than by individual firms.

2.6.8 A useful mechanism for obtaining constructive input from business to processes of regulatory reform is Regulatory Impact Analysis (RIA). RIA is a tool that is used to analyse the objectives of a regulatory proposal, the risks to be addressed by the regulation and the options for delivering the objectives. In doing so it makes transparent the expected costs and benefits of options for different stakeholders (such as other parts of government and small businesses) – the implications for compliance as well as the cost of enforcement for government. A properly conducted RIA systematically examines the impacts arising or likely to arise from government regulations and communicates this information to decision makers. RIA requires broad consultation to identify and measure benefits and costs. It therefore structures business engagement with regulatory reform along highly constructive lines: business people have to speak on the basis of evidence and for the business community as a whole. Bureaucracies are required to place a high value on empirical evidence and to make a serious effort to understand likely impacts on relatively 'silent' groups, such as informal sector traders. Donors should be aware, however, that RIAs have so far proved most useful in improving the quality of legislation affecting business in OECD countries. RIA techniques will need to be modified considerably if they are to work effectively in African countries where capacity is much more limited. (See box below on RIA implementation in South Africa)

2.6.9 Donors should remain willing to provide support to broad-based business associations, to NGOs representing consumer interests, and to think-tanks and academic institutions with interests in regulatory quality and RIA techniques.

Regulatory Impact Analysis in South Africa

The South African government has begun the process of implementing RIA at national level. The South African government and organised business are in agreement that RIA has the potential to build a partnership between the private sector and key government departments in pursuit of a more cost-effective regulatory system

South Africans adapted developed-world RIA procedures to South African conditions through a process involving intensive engagement with local stakeholders and RIA practitioners in developed countries. The government has been careful to ensure that South Africa's RIA requirements are realistic given South Africa's level of bureaucratic capacity. It has designed South Africa's RIA criteria to ensure that issues of local importance (e.g. Black Economic Empowerment and inequality) are given sufficient weight among the criteria to be considered when weighing about the costs and benefits of proposed new regulations.

2.7 Better information for better donor practice

2.7.0 Donors are unanimous in recognizing the importance of high-quality monitoring and evaluation and in calling for project design to be informed by the results of rigorous outcomes monitoring. A recent report by the World Bank, for example, emphasised that monitoring should be an integral part of the reform process, with clear performance targets and monitoring arrangements built in at the start of projects, enabling citizens to hold reformers accountable for results and build support for sustaining reform. (Kikeri et al 2006) The Bank reports that it has established baseline data for social and economic development outcomes based on regional averages, and that country progress will be assessed against country-specific baselines and targets. ((World Bank 2007). The International Finance Corporation's Business Environment snapshots are another valuable step in this direction.

2.7.1 While the indications are that the need for rigorous and publicly available evaluation data is being taken more seriously by the donor community, previous initiatives in this direction have tended to peter out. It is vitally important question why it remains so difficult to find high-quality evaluation or hard evidence that evaluation data is being systematically used to improve donor performance. (See, for example, Lancaster 2006; Patrick and Brown 2007)

2.7.2 One argument is that it is practically difficult to measure changes in the business environment. White and Chacaltana discussed these difficulties in their 2002 report. Problems include the fact that reforms take a long time; that measuring impact rigorously should try to take into account what would have happened in the absence of the intervention; that there is limited technical evaluation capacity in developing countries; and that mechanisms for collaboration between donors and governments are fragile or indeed absent. (White and Chacaltana 2002) These problems need to be addressed.

2.7.3 Technical difficulties certainly exist. But they are far from insurmountable.For example where specific reforms are intended to reduce regulatory costs, it is not difficult to measure these costs before and after reforms. Designing projects to include collection of useful and valid data is certainly feasible. (Duflo et al 2006) Problems with establishing the counterfactuals of an aid programme can be significantly reduced by, for instance, staggering implementation of a country programme province-by-province over a period of years. In our view, technical problems like these are not the real reason why so little rigorous evaluation of donor-supported programmes takes place.

2.7.4 The real problem is likely to be one of political and reputational risk. The results of a rigorous evaluation using randomised control and treatment groups are more-or-less guaranteed to present political challenges. (Kremer 2003) Policy makers in both donor and recipient countries are used to positive evaluations of development programmes. Inputs have taken place; outputs have occurred; a satisfactory report to Parliament can be prepared. 'Something' is demonstrably being done for the poor. In cases where quantitative results of outputs are required, it is frequently the case that decision makers are presented with the most optimistic estimates.

2.7.5 Rigorous evaluation results are likely to look very different. Some programmes have no positive effects and the positive effects of many others are far smaller than the estimates that the donor and political communities are accustomed to. Rigorous evaluation creates a real risk that budgets will shrink and that votes will be lost.

2.7.6 It cannot be known whether programmes work or how to improve them unless their outcomes are measured accurately, using appropriate controls. An important part of the way forward could be to create mechanisms though which donors can mitigate or pool the political and reputational risks of rigorous outcome measurement. For instance, rigorous evaluation may be easier if evaluation reports are anonymised before publication. In this way, learning could be shared while embarrassment is avoided. In the longer run, it should be possible to work towards conducting evaluations on the basis of programme type and by country rather than donor-by-donor.

2.7.7 The recently announced International Initiative for Impact Evaluation (see box) is a promising first step in surmounting both the technical and political difficulties of rigorous impact evaluation.

The International Initiative for Impact Evaluation (3IE)

In May 2006 an expert working group organised by the Centre for Global Development published a report highlighting the shortage of good impact evaluations in development work. Recommendations arising from the report included establishment of a new entity to channel funds to high quality, independent impact evaluation around key policy issues. Country governments, donors and others came together to form the Leading Edge group, convened in October 2006. Leading Edge spent the next six months negotiating the architecture of an independent international initiative to promote more and better impact evaluation of social and economic development programmes in low and middle income countries. The result is 3EI, a collaborative effort bringing together countries, bilateral and multilateral donor agencies, non-profit organisations and others.

3EI will work toward improving the production and use of systematic and rigorous impact evaluation to inform policy making and improve social and economic development programmes. Its founding document was confirmed in March 2007 and it is expected that the initiative will be formally launched by the end of 2007. 3EI's activities will include the identification of 'enduring questions' about how to improve social and economic development programmes; and encouragement, facilitation and/or funding of impact evaluations for programmes where such assessments are feasible, findings can affect policy and results will advance practical knowledge. 3EI will adopt quality standards to guide its reviews of impact evaluations, and will also prepare or commission synthesis of impact evaluations to link the findings of individual studies with broader policy questions. A key part of its work will be to assist in developing the capacity to conduct rigorous impact evaluations and use to use such evidence in policy making. The initiative is committed to transparency and will ensure that its own efforts are also open to independent review. All studies financed by 3EI will be prospectively registered in a publicly accessible database, and data will be available for re-analysis and replication, with clear information about context to inform the extent to which findings might be generalised.

3. Conclusion

3.0 The ultimate source of economic growth and sustainable development is a steadily-growing, diversifying and innovating private sector. In order to support this kind of private sector development in Africa, donor agencies need to be committed to a long-term approach. Intellectual courage and the political will are needed to accept that business environment reform should be assessed in terms of decades of development and careers of achievement, rather than in relation to three-to-five year budget and output cycles. Periods of very rapid growth and 'big push' development initiatives are unlikely to last more than a few years, and may end up causing more problems than they solve.

3.1 It is possible that well-designed active enterprise development programmes and business development services may have useful roles to play in supporting private sector growth in Africa. But the bulk of the historical evidence weighs against attempts to pick winners. Many – if not most - African bureaucracies lack the flexibility, incorruptibility and technical skills required to run sophisticated industrial policies. Most African businesses are informal, and are therefore even more unlikely than other firms to be reached by 'self-discovery' or state-provided BDS.

3.2 The case for business environment reform is much stronger. Therefore, donors should continue to apply most of their skill, funds and energy to improving the regulatory environment for all firms; to lowering barriers to entry; and to making it as easy as possible for Africa's small entrepreneurs to travel the path to formalisation.

3.3 This is not a call for business as usual. This paper has analysed current donor practice, and found considerable room for improvement. Donors need to confront the barriers to regulatory reform with more realism. Many members of African business and government elites will resist substantive regulatory reform until it is clear that the benefits of reform to these powerful insiders will outweigh the costs. Regulatory reform programmes should be designed to ensure that they do. African publics continue to be sceptical about private-sector-led development, and more work is needed both to change minds and to deliver tangible benefits of private sector growth to more of Africa's citizens.

3.4 Donors should increase inter-agency coordination both at head office and at country level. This advice is frequently given. It is more likely to be heeded if performance assessments of donor staff give greater emphasis to finding ways to minimise overlap and maximise the efficiency of all donor work, regardless of agency.

3.5 Donors also need to be more sensitive to the risk that ODA can be a source of rent and corruption. In an ideal world, donors, African governments and businesses operating in Africa would be linked in a single chain of enforceable legal accountability. It is not likely this ideal will be fully realised but it is to be hoped that donors will increasingly aim to get as close as possible to it.

3.6 Another frequently-given piece of advice is to do more rigorous monitoring and evaluation. This will not become common practice until the donor community becomes much more frank about just how politically risky it is. Donors need to try to find ways to pool and to mitigate this risk. This will clear the way to actually doing rigorous evaluation. Without rigorous evaluation, it is much more difficult to improve practice.

3.7 Finally, it is worth repeating the main point of this paper. Donors should be engaging much more closely and intensively with businesses operating in Africa. This does not mean that donors should allow themselves to be captured by business. Expectations should be high on both sides for broad, principled, evidence-led dialogue that includes firms of all sizes and types, as well as informal entrepreneurs. But the best test of a proposed project is to ask the question 'Is this project going to make it easier for a business to start and flourish?' The way to get a reliable answer to this question is quite literally to ask businesspeople using surveys, focus groups, in-depth interviews and other standard techniques.

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